EFFECTIVENESS OF DEBT COLLECTION STRATEGIES AT STANDARD CHARTERED BANK KENYA LIMITED

BY

JOSEPH MBATHA

A RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION, SCHOOL OF BUSINESS, UNIVERSITY OF NAIROBI

OCTOBER, 2013

DECLARATION

I declare that, this is my original work and has not been presented for a graduate degree in any other university.

Signature____________________________________Date_________________________

JOSEPH MBATHA

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

Signature___________________________________Date___________________________

Supervisor

MR. J. KAGWE

DEPARTMENT OF BUSINESS ADMINISTRATION

SCHOOL OF BUSINESS, UNIVERSITY OF NAIROBI

ACKNOWLEDGEMENT

I would like to extend my appreciation to my supervisor, family, friends and all the interviewees who contributed tremendous inputs towards the successful completion of this research project. Special gratitude and appreciation go to my Supervisor, Mr. Kagwe, for his patience, guidance, support and dedication throughout the study. He was such an inspiration! I truly feel indebted to him. Secondly, I am grateful to my parents for foreseeing the future and sacrificing so much to prepare and support me, the same extends to my entire family, for cheering me up after every tough day of fieldwork. Thirdly, I am grateful to all the respondents who provided invaluable data and information. I couldn't have done it without them! Finally, I am deeply grateful to the Almighty God who makes all things possible and for giving me strength, good health and sound mind throughout the study period.

DEDICATION

I dedicate this research project to the Almighty God for His grace, mercy and blessings that have seen me through.

LIST OF ABBREVIATIONS AND ACRONYMS

CBK:	Central Bank of Kenya
CRB:	Credit Reference Bureau
KBA:	Kenya Bankers Association
KRA:	Kenya Revenue Authority
NSSF:	National Social Security Fund
NHIF:	National Hospital Insurance Fund
NSE:	Nairobi Stock Exchange
SCB:	Standard Chartered Bank Kenya Limited

ABSTRACT

The main objective of this study was to evaluate the effectiveness of debt collection strategies at Standard Chartered Bank Kenya Limited. The study was justified by the need to address the dismal performance of debt collection strategies at SCB. In addition, there was need to address the soaring loan default at SCB and by extension inform the way forward for other commercial banks and other lending institutions. The study adopted a case study design and collected primary data by use of interview guides and secondary data from audited financial reports, news bulletins and the official website of SCB. A total of 5 interviewees were targeted. The interviewees included the Collections Strategy Manager, Credit Documentation Manager, Manager Collections (Small and Medium Enterprises), Manager Collections (Personal Loans and Mortgages), and Manager Recoveries. The collected data was cleaned and coded before being analyzed by use of the Statistical Package for Social Sciences (SPSS). Data analysis was done through content analysis of the responses of the interviewees in line with the three main themes: Types of debt collection strategies, effectiveness of the debt collection strategies and the measures to improve the debt collection strategies. The findings were presented in form of a report on the thematic areas. Major research findings indicated that the main debt collection strategies at SCB included litigation, debt collection agencies, change of payment terms and constant reminders. The findings also indicated that the most effective debt collection strategies were change of payment terms and constant reminders while litigation and debt collection agencies were found to be ineffective and costly. The main conclusion was that the poor debt collection was a result of poor prioritization of debt collection strategies, inadequate financing of debt collection strategies and lack of motivation among the debt collection staff. The researcher recommends introduction of laws and regulations to allow for a provision to attach international assets of loan defaulters. There is also need to introduce arbitration clauses in loan agreements so that the process of litigation and associated costs can be minimized. In practice, there is need to make it a matter of policy that the litigation and debt collection strategies should be used as last resorts after the failure of constant reminders and change of payment terms. In addition, there is also need to increase budgetary allocations towards improving capacity and motivation level of the debt collection staff and also invest in research and development towards more effective debt collection strategies. Lastly, the researcher suggests that a similar study that targets managers and junior staff, be carried out to come up with a model to guide the establishment of appropriate debt collection strategies.

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CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

Collection of loans is an important activity that helps to both maintain clients and free up money for lending again. It is a strategic process that is key to generating good habits and a payment culture among clients. It can also be seen as a business activity whose primary objective is to generate returns for the institution, converting losses into income. Commercial banks should view collections as an essential piece of the credit cycle, not just the final step. During the collections process, institutions receive feedback on policies and activities within each sub process of the lending cycle: Promotion, evaluation, approval, and disbursement. Delinquency starts when a client misses a payment date, resulting in a collections problem. However, many delinquency problems would be avoided if commercial banks ensured that the earlier lending processes were conducted correctly (Pandey, 2011).

The issue of lending institutions managing their debt collection in a responsible manner is no longer disputable due to the common understanding of the inherent benefits. In order to achieve healthy, sustainable growth, lending institutions must plan collections strategies prior to launching a new program or product. Commercial banks should strive to create proactive strategies to diminish the occurrence of overdue loans. Preventive action is less costly, and the best collections activities are those that manage clients who are not yet past due carefully. The proactive strategies that a commercial bank may employ in the management of those clients before their loans are due include educating borrowers about product features and collections fees and charges, establishing mutually agreeable payment dates, addressing customer-service complaints quickly and using positive reinforcement like rewarding clients who pay on time by offering them immediate access to renewals, larger loan amounts, preferential rates, certificates of good payment, training and prizes. There is also need to address the productivity of the collections area by introducing incentives to the staff to boost their morale in executing the collections and recovery strategy (Nzomo, 2009).

1.1.1 Concept of Strategy

Strategy can be defined as a set of plans, decisions and objectives that the company adopts to achieve its goals. It also refers to a plan of action for allocating resources effectively among the different stakeholders of an organization. Macmillan & Tampoe (2001) hold the view that strategic intent is where an organization wants to get to and how it intends to get there. They also argue that the strategic intent is strongly determined by the directors in view of the response of powerful stakeholders. The shareholder exercises ownership of the firm but does not enjoy absolute control of the resources of the firm. For instance, business-level strategies may range from the planned to the opportunistic, depending on how the company executives interpret the business environment.

Arieu (2007) contends that there is strategic consistency when the actions of an organization are consistent with the expectations of management, and these in turn are with the market and the context. Indeed, Hamel & Prahalad (2010) observe that too much planning can lead to inflexibility while too much opportunism may suggest a lack of direction. Therefore, strategy is about being able and ready to adapt to an ever changing external business environment and it denotes being prepared for flexibility when various situations occur and having an obsession of attaining excellence and excelling within an organization, market, and economy. They conclude that strategic is a tendency that remains stable over time and its main goal is to fold the future into the present through personal effort and commitment.

1.1.2 Debt Collection Strategies

Debt collection refers to both activities to recover past-due debts (debts with one or more days of default) and activities to prevent delinquency within the institutions. It is an important service that helps to both maintain clients and free up money for lending again. It is a strategic process that generates good habits and a payment culture among clients. It can also be seen as a business activity whose primary objective is to generate returns for the institution by converting losses into revenue (Pandey, 2011). Commercial banks and other lending institutions should view collections as an essential piece of the credit cycle, not just the final step. During the collections process, institutions receive feedback on policies and activities within each sub-process of the lending cycle: promotion, evaluation, approval, and disbursement (Nzomo, 2009).

There are four main strategies that are used by lending institutions to collect their due debts. First strategy is change in payment terms to allow the client more time to settle the outstanding debt. This also includes reducing the amount of monthly instalments to make it easier for the client to settle the outstanding debts. The second strategy is constant reminders from creditors where the agents of the lender visit the office, residence or business premises of the debtor to remind him of the due debt and secure tangible committment on the payment plan. It involves telephone calls or field visits and other electronic communications like use of electronic mail. The third debt collection strategy is outsourcing debt collection to a third party, mostly a collection agency. This is done when the original creditor exhausts all the above means to collect the debt from the debtor. The final strategy is litigation of bad debtors to recover unpaid debts. This strategy is appropriate for debtors who are able but unwilling to clear their debts. Litigation helps to compel the bad debtors to settle their debts (Nzomo, 2009).

1.1.3 Effectiveness of Debt Collection Strategies

An effective collections process requires significant interaction with the client, beginning with a careful analysis of the client’s situation and continuing through timely and frequent contact over the duration of the loan. Clients should be offered payment alternatives that are timely and appropriate to each situation, and all collections activities should be recorded to facilitate continuous monitoring and follow-up as well as control of client compliance with negotiated agreements. Some typical collections activities include analysis of the particular case, contacting the client to understand the information that the client can provide, where the client is located and the history of the client, assessment of the client to know the problem at the root of the current delinquency and suggesting alternatives and possible solutions to sell the benefits of paying on time in order to foster a positive payment culture with the client (Pandey, 2011).

The other practice is to secure payment commitments by negotiating effectively. The lending institution must clearly identify when, where, how, and how much the client will pay and must remember, for example, how a client in a situation of over-indebtedness or decreased income will prioritize the payment of his bills. The client should also be assessed to ascertain his compliance with payment commitments and also be able to record the collections activities. There is also need to follow-up on each case and intensify collections activities even if it means losing the client (Pandey, 2011).

1.1.4 The Banking Industry in Kenya

Banking business is the accepting from members of the public of money on deposit repayable on demand or at the expiry of a fixed period or after notice, the accepting from members of the public of money on current account and payment on and acceptance of cheques; and the employing of money held on deposit or on current account, or any part of the money, by lending, investment or in any other manner for the account and at the risk of the person so employing the money. (Banking Act of Kenya Cap 488). Apart from accepting deposits and making loans, the banking industry has a wide variety of other business line. In addition to lending business, commercial banks today provide a broad range of products and services, such as underwriting and dealing in securities, selling and managing shares in mutual funds and even insurance.

The banking industry in Kenya is governed by the Companies Act, the Banking Act, the Central Bank of Kenya (CBK) Act and the various prudential guidelines issued by the CBK. The CBK which falls under the Ministry of Finance's docket is responsible for formulating and implementing monetary policy directed to achieving and maintaining stability in the general price levels and fostering liquidity, solvency and proper functioning of a stable market-based financial system. As at the end of 31st December 2012, the number of financial institutions comprised 43 commercial banks, 1 mortgage finance company, 6 deposit taking microfinance institutions, 4 representative offices of foreign banks, 112 foreign exchange bureaus and 2 credit reference bureaus. The 43 commercial banks have come together under the Kenya Bankers Association (KBA), which serves as a lobby for the banking sector's interests and a forum to address issues affecting members (CBK, 2013).

It is a challenge for banks in Kenya to effectively set their growth strategies in the recent economic market as the effect of the changes on consumers and businesses is not predictable and the challenge remains for banks to grow and effectively manage the spread to generate a return to their shareholders. Globalization has changed the way banks use technology, information and communication to better serve their customers. More banks are rolling out diverse products with the help of technology in order to meet the client's needs. As the banks become more integrated into the global economy, they are facing opportunities and challenges thus the need for establishing effective strategies to ensure collection of debts and minimization of losses through bad debts (Nzomo, 2009).

1.1.5 Standard Chartered Bank Kenya Limited

Standard Chartered Bank Kenya Limited opened its operations in Kenya in 1911. The bank has operated in Kenya for the past one hundred years and currently has 32 branches.

The parent company of Standard Chartered Bank Kenya Limited is Standard Chartered Bank Limited domiciled in London, United Kingdom. The Organizational Structure of the Bank is decentralised in operations management but policy and product standards are centralised and managed by the Group Managers who operate from the bank's head office in Singapore. The vision of Standard Chartered Bank is to be the World's best international bank leading the way in Asia, Africa and the Middle East. The core values of the bank include: Responsive, Trustworthy, Creative, International and Courageous (SCB, 2013).

In 2010, Standard Chartered Bank Kenya Limited launched its new brand promise dubbed "Here for Good." The promise is anchored under three pillars that summarise the commitment of the Bank to its People through building of long term sustainable relationships, commitment to setting the highest standards in investments and commitment to exist perpetually in its markets. To its communities the bank commits to be trusted and caring, dedicated to making a difference. To its customers the bank commits to be passionate about customers' success delighting them with quality service. To its employees the bank commits to helping them to grow, enabling individuals to make a difference and teams to win. To its shareholders the bank commits to provide a distinctive investment delivering outstanding performance and superior returns and lastly to regulators the bank commits to practice exemplary governance and ethics in its businesses. Standard Chartered Bank has centralised its loan collections activities in their headquarters located in Chiromo, Nairobi Kenya. The loan collections officers are entrusted with collections of diferent portfolios including personal loans, Small and Medium Enterprises (SMEs) and Large Corporate Loans (SCB, 2013).

1.2 Research Problem

Over the last few years, the commercial banks in Kenya have continued to grow in assets, deposits, profitability and products offering. The growth has been mainly underpinned by expansion in the loan portfolios, an industry wide branch network expansion strategy both in Kenya and in the East African community region, automation of a large number of services and a move towards emphasis on the complex customer needs rather than traditional 'off-the-shelf' banking products (Nzomo, 2009). Nonetheless, the amounts of debt charges have also been on the increase thus bringing to focus the effectiveness of the debt collection strategies of the commercial banks. For instance SCB (2012) indicates that loans and advances grew from KShs7.3 Billion in 2011 to KShs 8.4 Billion in 2012. Similarly, the net bad debt charge increased from KShs 413 Million in 2011 to KShs 717 Million in 2012.

So far, some scholars have studied some aspects of the debt collection strategies in lending institutions. Kariuki (2011) studied the effect of debt collection management on financial performance of listed companies at Nairobi Securities Exchange (NSE). He establsihed that debt collection was a critical factor in the success of listed companies. He recommended a robust collections strategy to ensure that debt collection was optimised. Akehege (2011) also studied the determinants of non performing loans among commercial banks in Kenya. He found out that one of the key determinants of the the non performing loans is the weak collections strategy among the commercial banks in Kenya. He recommended an evaluation of existing collections strategy with a view to strengthening them in order to ensure adequate collections and minimization of bad debts among the commercial banks. Roche (2003) studied the reasons why bank customers fail to service their loans in Kenya through a data survey of Standard Chartered Bank and established that the main reasons for default included loss of revenue in form of salaries and business returns, natural calamities like political turmoil and floods and deliberate default in rare instances.

However, according to my research, I have not found a study that has been done to determine the effectiveness of debt collections strategy among the commercial banks in Kenya. Therefore, there is urgent need for more research to be done on this subject and establish the actual challenges, strengths and weaknesses of the debt collection strategies with a view to suggesting the areas for improvement to ensure that the collection strategies of commercial banks are strengthened . This study therefore seeks to fill the identified research gap by answering the questions: What are the debt collection strategies and what is the level of effectiveness of the debt collection strategies at Standard Chareterd Bank Kenya Limited?

1.3 Research Objectives

The research objectives of the study were as follows:

i. To identify the debt collection strategies at SCB
ii. To determine the effectiveness of the debt collection strategies at SCB

1.4 Value of the Study

The management of SCB would use the findings of this study as a source of information on the effectiveness of the loans collections strategy at the bank. In addition, the findings of this study will help the managers in formulating relevant loans collections procedures and policies that woud increase the loans collections in the shortrun and reduce the size of the bad debt in the longrun.

The policy makers in the commercial banking sector like the Kenya Bankers Association (KBA) and Central Bank of Kenya (CBK) would use the findings of this study in formulation of policies regarding the types of loans, amounts of loans, requirements of borrowers and the processes of conducting loans collections in the commercial banks in Kenya.

The current and future scholars would also benefit from the findings of this research on the factors that determine the effectiveness of the debt collection strategies of lending institutions. The information will be part and parcel of the established knowledge in the field of strategic management and would enable future researchers to come up with areas for further research.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter presents the theoretical foundation of debts in commercial banks and also discusses the descriptions, views and contentions on the concept of strategy and specifically the debt collection strategies. Lastly, the chapter presents established theory on effectiveness and effective debt collection strategies.

2.2 Theoretical Foundation

The process of debt collection is about the relationship that exists between the lending institution and the borrower of funds. There is a mutual benefit that accrues to both the lender and borrower when the debt is fully collected. The lender gains profits from the margin between lending rate and interest on deposits rate. On the other hand, the borrower is assured of a favourable credit worthiness score from the lender upon full repayment of debts. There are three main theories that explain the types of relationships that exist between the lender and the borrower, they include the Customer-Supplier Relationship Theory, The Expected Utility Theory and the Value Based Portfolio Theory.

The customer-supplier relationship theory holds that there are costs and benefits that accrue to both the lender and the borrower in their relationship created by the debt collection process. The four types of costs in the debtor-creditor relationship range from presale, production, distribution and post-sale service costs. The main benefits include customer economics, power, the nature of the decision-making unit and the institutional relationship between the debtor and the creditor. Therefore, depending on the amount of interet charged on the loan there is always a wide range of profit margins that would accrue to the creditor if the debt is fully repaid and also accrue to the debtor if they default on the debt repayment. The proponents of this theory use a portfolio approach to analyze customer-supplier relationships and propose a relationship classification matrix based on the concepts of relationship value and interest commonality. This implies that debt repayment is a matter of relationship between the debtor and creditor and the existence of mutual interests in terms of gains for both parties (Brealey and Myers, 2005).

The expected utility theory is based on logical explanations rooted in human and social psychology. It contends that individuals have limited information processing capabilities, exhibit systematic bias in processing information, are prone to making mistakes, and often tend to rely on the opinion of others. They therefore hold that behaviors like default on debt repayment are motivated by risk aversion with an expected utility of unwarranted gains through earnings from the unpaid debts. However, this theory is not plausible since it fails to provide a reason behind the default decisions made under uncertainty like business failures, loss of employment and accidents (Brealey and Myers, 2005).

The value based portfolio theory explains that different components of portfolios play different roles in enhancing the overall value of the total portfolio. The specific value gained from each component of the portfolio includes the ratio of contribution to the portfolio outputs like the resale value, reliability, safety and comfort. It also includes the value that customers obtain from a product relative to inputs like the price and running costs that customers have to deliver in exchange. The derived efficiency value can be understood as the return on the customer's investment. Therefore, the debts that have created products offering a maximum customer value relative to all other alternatives in the market are characterized as efficient and could most likely experience little possibilities of default and vice-versa. This theory suggests that debt repayment, from the perspective of the debtor, is determined by the value that the debt has added to the existing portfolio of investments (Brealey and Myers, 2005).

2.3 The Concept of Strategy

Strategy can be defined as a set of plans, decisions and objectives that the company adopts to achieve its goals. Consequently, strategic management involves deciding which customer to serve, with which products and services, and meeting those customers' legitimate needs and wants by allocating resources in the most advantageous way (Cole, 2004). It is an organizational process designed to sustain, invigorate and direct the organization's human and other resources in the profitable fulfillment of the needs of customers and other principal stakeholders. The process is guided by the organization's value system, or culture, which is manifested not only in the organization's mission statement, policies, and strategic goals, but also in the behaviour of top management and other key managers in the organization. If an organization wishes to address issues of service delivery and performance management based on strategy focus, then service delivery must become one of the values of that organization and the managers must be seen to live that value in their everyday lives and for this to happen, there is need for a well thought strategic management system working throughout the organization (Neale, 2004).

Strategy researchers, writers and practitioners largely agree that every strategy context is unique (Wit and Meyer, 2001). Moreover, they are almost unanimous that it is usually wise for strategists to adopt the strategy process and strategy content to the specific circumstances prevalent in the strategy context. However, disagreement arises as soon as the discussion turns to the actual level of influence that the strategy context has. Frequently it is argued that strategists can, and should, create their own circumstances, instead of being enslaved by the circumstances they find. In short, the strategy context can be determined, instead of letting it determine.

The overall aim of any research on strategy is "to examine various forms of advantages that a dominant firm may be able to develop and hold over its competitors for the same period of time" Shamsie (2003). However, despite a common operating environment, some firms perform better than others. The reason for greater performance is attributed to the various stages of the strategy process from formulation to implementation. While it is not what part of the generic strategic process triggers the increase in performance potential, a key component in the response of public institutions to the operating environment is based on their strategic orientation.

Strategy implementation is a component of strategic management. Strategic management by itself is a process and it refers to a set of decisions and actions that result in the formulation and implementation of long term designed plans to achieve organizational objectives (Pearce and Robinson, 2003). According to Pearce and Robinson (2004) strategic management is the process that encompasses strategic planning, implementation and evaluation. In their view, strategic management process is a way of considering, dealing, and realizing already formulated strategies. On the other hand strategy implementation involves allocation and management of sufficient resources, establishing a chain of command or some alternative structure, assigning responsibility of specific tasks or processes to specific individuals or groups.

Implementing strategies successfully is vital for any organization public or private. Without implementation, even the most superior strategy is useless. The notion of strategy implementation might at first seem quite straightforward: the strategy is formulated and then it is implemented. Implementing would thus be perceived as being about allocating resources and changing organizational structure. However, transforming strategies into action is a far more complex and difficult task (Wheelan and Hunger, 2008).

In the face of a high level of uncertainty and change within competitive environments, strategy implementation should represent a continuous and simultaneous process (Cole, 2001). This requires strategy implementation to be treated as part of individual responsibilities throughout the organization as opposed to a central function. By transferring the ownership of strategy in this way the quality of knowledge used for strategy formulation will be substantially improved while potential conflicts and the timeframe for strategy implementation will be dramatically reduced. The former approach represents a series of steps, which follow one another, while the latter represents a concurrent approach of identifying opportunities in competitive environments and evaluating them in the light of the organization′s existing and potential future competences together with the level of resource commitment necessary to exploit such opportunities (Johnson and Scholes, 2005).

The simultaneous approach brings about three major benefits to organizations when compared with the sequential approach. First, it reduces the time window between opportunity identification and exploitation which is one of the most important considerations when operating in a highly dynamic environment. Second, it reduces risk. This is because the sequential approach requires committing at a very early stage investments in terms of capital, people and time, whereas the simultaneous approach continually evaluates and dynamically adjusts resource commitments. Third, the simultaneous process continually adjusts strategies according to the changes in the competitive environment (Johnson and Scholes, 2005).

2.4 Debt Collection Strategies

Debt collection strategies refer to the plans of action and activities that lenders use to recover past-due debts from the debtors. Lending institutions use different approaches to debt collection but there are four distinct strategies that are applied by all lending institutions in their debt collection activities: Change of payment terms, sending reminders to debtors, contracting the services of a debt collector (agent) and litigation (use of legal means to compel the debtor to honour their debts).

2.4.1 Change of Payment Terms

The first collection strategy that debt collectors use is change in payment terms. This is a tactic that helps the debtors to pay their debts and in turn helps the creditor to collect debt. For instance, if the creditor moves the due date ahead by 15 days, the debt may not be paid on time. Oppositely, if the due date is moved 15 days after the original date, the debt may be paid on time. Therefore, if a debtor is already having a bad time in paying their debts it will be hard to pay a bill earlier than scheduled but it might be easier to pay the debt much later. Therefore, lending institutions usually enter into agreements with the debtors to ensure that the new payment terms are convenient to the debtor. This usually happens during depressions, natural calamities, loss or change of employment or loss of livelihoods through accidents or normal business cycles (Nzomo, 2009).

2.4.2 Constant Reminders

This strategy entails constant reminders from creditors. The debtor will receive written or phone calls from creditors as a reminder to pay their debts on time. This technique is only effective if the debtor has simply forgotten to pay their debts. However, it will not be useful if there are any other reasons why the bill cannot be paid on time since there are legal guidelines that prohibit the creditor from making constant follow ups on the debtor. For example, creditors can only call the debtor within working hours mostly between 8 a.m. and 9 p.m. except if they have previously agreed to let them call beyond these timings. Other regulations involve prohibition of use of foul language, excessive pressure and threats to publish lists of debtors who do not pay debts (Munyiri, 2010).

2.4.3 Contracting a Debt Collection Agency

This strategy involves contracting a third party to collect debts from the defaulting debtors. The original creditor may choose to outsource debt collection attempts to a collection agency if they have exhausted all the means to collect the debt from the debtors. They can also sell the whole debt to a collection agency. The agency will then pursue the payment with the debtor. Again, there are legal guidelines that apply to third party debt collection and other costs that accrue to the original creditor when they elect to contract a third party to collect the debt on their behalf or decide to sell the whole debt to the third party (Kariuki, 2011).

2.4.4 Litigation

The fourth strategy is litigation of bad debtors to recover unpaid debts. This process starts by issue of a letter of demand which provides the details of the debt like the date the debt was incurred, the date the payment was to be made and the specific legal proceedings that will result from the debt default. The letter of demand might result in the payment being made, fresh negotiations, mediation or arbitration or commencement of legal proceedings. The legal proceedings start with the issue of court summons with particulars like name of defendant and plaintiff and their addresses. The court summons is then given to the defendant and an affidavit of service received as proof of service of summons. On receiving the summons the defendant might agree to pay in lump sum, pay in installments or proceed to court where the judgment would be passed in favor of the defendant by disputing the debt or upheld in favor of the plaintiff and the defendant compelled to honor the debt (Nzomo, 2009).

2.5 The Concept of Effectiveness

Effectiveness is the capability of producing a desired result. When something is deemed effective, it means it has an intended or expected outcome, or produces a deep, vivid impression. In management, effectiveness relates to getting the right things done. Drucker (2006) holds that effectiveness can and must be learned. Efficacy, efficiency, and effectivity are terms that can, in some cases, be interchangeable with the term effectiveness. However, neither effectiveness, nor effectively, inform about the direction (positive or negative) and the comparison to a standard of the given effect. Efficacy, on the other hand, is the extent to which a desired effect is achieved; the ability to produce a desired amount of the desired effect, or the success in achieving a given goal. Contrary to the term efficiency, the focus of efficacy is the achievement as such, not the resources spent in achieving the desired effect. Therefore, what is effective is not necessarily efficacious, and what is efficacious is not necessarily efficient (Drucker, 2006).

2.6 Effectiveness of Debt Collection Strategies

Effectiveness of debt collection refers to the ability of the debt collection strategies to deliver the expected results of enabling the debt collector to collect the outstanding debts in full. It entails a checklist that provides a collection equation that serves the need for collectors and enables them to remain professional and maintain or improve their success rates. The equation gives collectors the flexibility to address the needs of any situation while executing the debt collection strategies (Nzomo, 2009).

The main indicators of effectiveness of debt collection strategies include preparedness, credibility, setting of expectations, understanding the customer, establishing a sense of urgency and creating genuine commitment to the debt collection process. To start with, in preparedness, the debt collector should be prepared mentally before executing any of the debt collection strategies. This would involve being aware of the client and their business model, being able to confidently demonstrate an understanding of the software and hardware they use to complete their job as well as know what can be negotiated, arbitrated or compromised during the debt collection process. Secondly, the creditor or the debt collector should be able to speak in a professional manner that engages the debtor. In this case, professionalism extends to both how and what a collector says during the debt collection process. By establishing credibility and raising curiosity of the consumer a debt collector will have an easier time of discussing the issue at hand which will allow for collectors to differentiate themselves from other collectors and competing demands for the deafaulter’s money (Nzomo, 2009).

Thirdly, debt collectors should be able to establish reasonable expectations that are understood by the consumer throughout the debt collection process. The debtor’s expectations are much more than asking for payment in full. The role of the debt collector is to manage the expectations of the consumer and establishing how the relationship will operate starting with the time frame they will operate in to the method they will use to reclaim the debt. Fourthly, the debt collector should analyze the debtor by identifying how the consumer wants to communicate and possessing the ability to match that style and cater the approach in a manner that ensures that the debt is fully collected at the convenience of both the debt collector and the debtor. Fifthly, the debt collector should establish a sense of urgency. Here the debt collector should understand how to take what is important to the debtor and ethically turn that into an immediate desire to pay. Sixthly, the debt collector should establish a plan and should understand that negotiating is a skill and there is a specific time and place for it. Lastly, the debt collector should have reasonable committment to the debt collection process and be able to understand when to close the process more especially when the outstanding debt is not forthcoming (Nzomo, 2009)

CHAPTER THREE: METHODOLOGY

3.1 Introduction

This chapter contains the research design to be used and explains the reason of choosing the design. It also explains the types of data to be collected, sources of data to be relied on and the data collection instruments. Finally, the chapter discusses the data analaysis and presentation methods.

3.2 Research Design

The research was conducted through a case study. The case study design was chosen due to its appropriateness in carrying out a holistic, in depth and comprehensive investigation of phenomenon. Therefore, it was the most appropriate research design to determine the effectiveness of debt collection strategies at Standard Chartered Bank Kenya Limited.

3.3 Data Collection

Data was obtained from semi-structured interview talks based on an interview guide (Appendix I). There were five interviewees who were all senior managers at SCB namely; The Collections Strategy Manager, Credit Documentation Manager, Manager Collections (Small and Medium Enterprises), Manager Collections (Personal Loans and Mortgages), and Manager Recoveries. The interviewees were selected because they are in positions of authority and possess key strategic and operational experience on matters related to debt collection strategies at Standard Chartered Bank Kenya Limited. The interview guides were administered by the researcher on each of the interviewees at their respective work stations. The researcher called the interviewees and secured an appointment before the interview. The data collection tool enabled a trade-off between cost, speed, accuracy, detail, comprehensiveness, response rate, clarity and anonymity which were useful for validity and reliability. Permission to conduct interviews was sought through an letter of introduction (Appendix II).

3.4 Data Analysis

The collected data was qualitative in nature. The raw data from the interview was cleaned and checked for completeness by eliminating unusable data, interpreting ambiguous answers and eliminating contradictory data from related questions. Content analysis technique was used to analyse the cleaned data through a systematic analysis which involved grouping and interpretating key issues being investigated to come up with findings. The content analysis technique enabled an objective, systematic and qualitative description of the content of the collected data in line with the research objectives of identifying the debt collection strategies and determining the effectiveness of the debt collection strategies at SCB.

CHAPTER FOUR: DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This chapter presents the findings related to general information, characteristics of debt collection strategies at SCB, effectiveness of debt collection strategies at SCB, measures to improve debt collection strategies at SCB and closes with a discussion of the findings in relation to empirical and theoretical literature.

4.2 Respondents' Information

This focused on the response rate, designation of the respondents and work experience of the respondents. Five out of the five targeted respondents provided feedback hence making a 100% response rate. The respondents were senior managers namely Collections Strategy Manager, Credit Documentation Manager, Manager Collections (Small and Medium Enterprises), Manager Collections (Personal Loans and Mortgages), and Manager Recoveries. The respondents were able to provide reliable and credible information on the effecetiveness of debt collection strategies at SCB due to their positions within the bank and their regular participation in strategic meetings with the management committee of SCB and their extensive interaction with top ranking managers within the banking industry. The average working experince of the respondents was 6-10 years in the banking industry and 3-5 years in their current positions. This showed that they were conversant with their line of trade and hence they were in a position to provide the required insights.

4.3 Debt Collection Strategies at SCB Kenya Limited

The researcher collected the views of the interviewees on the debt collection strategies at SCB and their effectiveness in delivering the debt collection objectives of the bank. The debt collection strategies that were investigated included change of payment terms strategy, constant reminders strategy, collection agents strategy and litigation strategy. In addition, the researcher sought the views of the respondents on the other debt collection strategies that should be introduced at SCB.

4.3.1 The Current Debt Collection Strategies at SCB

The interviewees confirmed the existence of the following debt collection strategies at SCB: Change of payment terms, constant reminders, collections agents and litigation strategies. They held the view that each of these strategies was effectively used in the debt collection endeavors of SCB and that each of them was adequately budgeted for. However, they were also of the opinion that there was need to increase the funding of debt collection strategies more especially in litigation processes, research and development and capacity building among the debt collection staff.

The interviewees also held the view that the debt collection strategies at SCB were sustainable in the long run. In addition, they observed that the sustainability of debt collection strategies could not be assured unless the aspects of adequate funding towards research and development and training of debt collection staff were addressed.

The interiewees were also asked to state the actual annual amounts of debt collections made at SCB. They indicated that the average annual debt collection at SCB did not exceed Kes 200 million. This was way below the annual target of debt collection approximated at Kes 400 million (SCB, 2013). Therefore, the findings indicated that the annual collection amount was halfway the target amount.

The interviewees were also of the view that the debt collection strategies were applicable to the client segments of SCB. The collection strategies for personal loans, SME loans, Mortgages and other secured long term loans were described as relevant, effective and appropriate. However, the interviewees also held the view that the debt collection strategies needed to be differentiated based on the amount of debt outstanding instead of the type of loan involved. They were of the opinion that by creating debt collection strategies based on the amount of loan outstanding, SCB and other commercial banks would be able to increase the actual output through increased effectiveness and robustness in debt collection.

The interviewees held the view that all the employees involved in debt collection were adequately skilled and possesed relevant skills that enabled them to execute their debt collection responsibilities. However, the interviewees also expressed the need for continous training and capacity development to enhance and maintain the employee skills.They also intimated that there is need for exchange programmes among employees to enable migration of best practice and enhance the attainment of expected standards in line with the ever changing complexities of loan defaulters.

4.3.2 Other Debt Collection Strategies Applicable to SCB

The researcher sought to gather the views of the interviewees on other possible debt collection strategies that could be introduced at SCB in addition to the existing ones. The interviewees held the view that there is need to introduce investigations strategy, field collection strategy, international debt collection and litigation strategy and employer engagement strategy. In investigations strategy, the interviewees held the view that there is need to institute investigations on each potential loan defaulter and assist the loan defaulters to mitigate possible financial woes that lead to bad debts. They observed that most loan defaulters need to be investigated because their financial backgrounds keep changing and such information may not be availed to the bank without the intervention of the bank.

Secondly, the interviewees also observed that there is need for SCB to introduce international debt collection and litigation strategy where the bank can be able to attach the international assets of loan defaulters. However, this strategy would only be realized if the necessary laws and regulations were enacted. Thirdly, the interviewees suggested the need for employer engagement strategy where the employers of loanees would be engaged in ensuring that any of their employees who would be leaving employment are compelled to allow their final dues to be channeled towards settlement of their debt obligations. However, this strategy would also require introduction of new laws and regulations.

4.4 Effectiveness of Debt Collection Strategies at SCB

The researcher sought to gather the views of the interviewees on the effectiveness of debt collection strategies at SCB. The strategies that were evaluated included change of payment terms strategy, constatnt reminders strategy, debt collection agencies strategy and litigation strategy.

4.4.1 Effectiveness of Change of Payment Terms Strategy

The interviewees held the view that the change of payment terms strategy was largely effective. However, the interviewees observed that the change of payment terms strategy should be more consultative to ensure that the loan defaulter is the one who recommends the new loan repayment instalment. In addition, they observed that if the bank was to prescribe the new payment terms then there would be a higher probability of default on the loans. They also observed that the change of payment terms strategy should not be the first priority in collecting debt but should be the last resort that should only be used when it is evident that the loanee has low credit ratings.

4.4.2 Effectiveness of Constatnt Reminders Strategy

The interviewees held the view that the constant reminders strategy was not highly effective in debt collection. They observed that the emphasis on telephone calls and written corespondences instead of actual visits to the loan defaulters was a wrong approach. They were of the view that actual field vsists would be more effective than telephone and written reminders. However, they also observed that intensification of field visits would mean lack of business for the debt collection agencies and increased cost in enhancing the capacity of the current crop of staff engaged in debt collection.

4.4.3 Effectiveness of Debt Collection Agencies Strategy

The views of interviewees on the effectiveness of debt collection agencies strategy were almost similar. They held the view that the strategy was poor in effectiveness. The interviewees observed that the strategy was not costs effective since the amounts of loans collected by debt collection agencies were not commensurate to the high retainer fees and other associated costs that the banks incurred to maintain the debt collection agencies. They therefore held the view that the debt collection strategies should be disengaged and their place taken up by the debt colection staff of the bank. It was also observed that the other services offered by debt collection strategies could easily be procured from the Credit Referencing Bureau. However, there would be urgent need to increase the capacity and enhance the skills of the debt collection staff which would lead to higher costs in the short term. Nonetheless, the interviewees held the view that in the longrun the in house debt collection would be more cost effective.

4.4.4 Effectiveness of Litigation Strategy

The interviewees held the view that the litigation strategy was average in efectiveness. They observed that the litigation strategy was an expensive affair in terms of costs and lengthy periods taken in the law courts. They suggested that the loan application forms should introduce a clause to promote arbitration and out of court settlement in circumstances of loan default. They also observed that the litigation strategy was prone to abuse in some cases where the litigation lawyers colluded with the defendants (loan defaulters). Therefore, the interviewees were of the view that the effectiveness of the litigation strategy would only be enhanced if the process of procuring litigation lawyers was above board and the arbitration clauses were introduced to make the process more consultative and inclusive.

4.5 Discussion of Results

The findings of this study were compared with the established theories and related empirical findings in the field of Strategic Management.

4.5.1 Relationship to Empirical Studies

The interviewees held the view that the effectiveness of debt collection strategies determined the amount of debt collected by SCB and therefore impacted the amount of bad debts written off and by extension the ultimate profitability of the bank. This contention supports the findings by Kariuki (2011) who studied the effect of debt collection management on financial performance of listed companies at Nairobi Securities Exchange (NSE) and established that debt collection was a critical factor in the success of listed companies.

The interviewees also indicated that that there were some weak debt collection strategies at SCB. These included the litigation strategy and the debt collection agencies strategy. In addition, the debt collection agencies was identified as a costly ineffective strategy that needed immediate overhaul. They also observed that the current litigation strategy at

SCB needed to be urgently improved by ensuring proper recruitment of litigation lawyers, inclusion of arbitration as a mechanism to reduce litigation costs and the expansion of litigation to include international assets of the loan defaulters. In a related study by Akehege (2011) focusing on the determinants of non performing loans among commercial banks in Kenya; it was also established that one of the key determinants of the non performing loans is the weak collections strategy among the commercial banks in Kenya.

The interviewees observed that the litigation and debt collection agencies were ineffective in case of extraneous factors like loss of revenue in form of salaries and business returns and natural calamities like political turmoil and floods. Therefore, they were of the view that any attempt to improve the same strategies would most probably be an effort in futility because the factors contributing to loan default are beyond the control of the clients. Therefore, they suggested that SCB should focus its resources on the improvement of other debt collection strategies like constant reminders and investigations. Indeed, Roche (2003) had studied the reasons why bank customers fail to service their loans in Kenya through a data survey of Standard Chartered Bank and had established that the main reasons for default included loss of revenue in form of salaries and business returns and natural calamities like political turmoil and floods.

4.5.2 Linkage of the Findings to Theory

The customer-supplier relationship theory holds that there are costs and benefits that accrue to both the lender and the borrower in their relationship created by the debt collection process. The interviewees confirmed the tenets of this theory by identifying various costs that emerge from the debtor-creditor relationship at SCB. The identified costs were presale costs in form of advertsiment of loans and personal selling expenses. The other costs were production costs mainly involving the employee costs, costs related to legal procedures and paper work. Other costs that were identified included post-sale service costs including insurance costs and seminars and consultany services on investment options.

Munyiri (2010) contends that the constant reminders strategy is only effective if the debtor has simply forgotten to pay their debts. This theory was upheld by the interviewees who observed that constatnt reminders strategy was not useful if there were any other extraneous reasons why the bill could not be paid on time. Kariuki (2011) also holds the view that the original creditor should only choose to outsource debt collection attempts to a collection agency if they have exhausted all the means to collect the debt from the debtors. This theoretical foundation of the debt collection agency strategy was also upheld by the interviewees who indicated that debt collection agencies at SCB were expensive and their level of delivery was not commensurate to the operation costs. They suggested that debt collection agencies should be a last resort and not a mainstream strategy in debt collection. The interviewees also supported the theory by Nzomo (2009) who observes that the litigation strategy is as effective as the lawyers involved and the strength of the evidence provided by the plaintiff (bank). The interviewees therefore suggested that the litigation strategy should be backed by more robust laws and regulations to boost the chances of recovering debt.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter provides the summary of the findings, the conclusions, the recommnedations, the limitations of study and closes with suggestions on areas for further research.

5.2 Summary of the Findings

The interviewees confirmed that SCB has employed four main debt collection strategies namely change of payment terms, constant reminders, debt collection agencies and litigation. It was also established that the most effective debt collection strategies were change of payment terms and constant reminders. However, debt collection agencies and litigation strategies were described as weak and ineffective.

Secondly, the interviewees indicated that the debt collection strategies were adequately funded and were sustainable in the short and medium term but unsustainable in the longrun. The interviewees also observed that the debt collection staff had adequate skills and capacity to engage in their roles. However, they also held the view that the debt collection strategies did not meet the prescribed target of Kes 400 million per annum and only managed half of the target.

Thirdly, the interviewees were of the view that the constant reminders strategy and the litigation strategies were ineffective. They also held the opinion that change of payment terms strategy was the most effective while the debt collection agencies needed to be discarded to cut on costs.

5.3 Conclusions

The researcher concluded that the inability to meet debt collection targets at SCB was as a result of inadequate funding of the main debt collection strategies like constant reminders and litigation. The fact that the debt collection strategies were created to suit types of loans instead of aligning with the types of clients was also identifed as the reason behind the below average performance of debt collection strategies at SCB.

Secondly, the interviewwes indicated that the constant reminders were constrained to telephone calls and written communications. This explained the rampant procession of doubtful debts to bad debts and the eventual use of litigation strategy at SCB. Nonetheless, the inadequate budgetary allocations to the litigation strategy and the constrained legal provisions that excluded international assets of the defendants inhibited debt collection at SCB.

Lastly, the interviewees indicated that the existing debt collection strategies were hinged on assigning responsibilities to lawyers and debt collection agencies at the expense of building internal capacity through training and research. Therefore, the researcher concluded that the most appropriate measure to improve debt collection at SCB was to reorganise the priority of debt collection strategies by emphasizing arbitration and capacity creation among the debt collection staff then supporting the two strategies with filed visits and investigations.

5.4 Recommendations for Policy and Practice

In the area of policy, the researcher recommends the introduction of arbitration mechanisms to compliment the litigation strategy in debt collection. The arbitration mechanisms should be anchored in law to avoid any doubts and confusion. In addition, the litigation strategy should also be enhanced by passing appropriate laws that would expand the scope of assets attachable. It is recommended that all the assets of the loan defaulters, including international assets, should be attachable in case of default.

In practice, there is need for the commercial banks and other lending institutions to invest in research and development of new and more effective debt collection strategies. There is also need to enhance the welfare and motivation levels of the debt collection staff in a bid to increase the amount of debt collected. There is also need to reprioritise the debt collection strategies by giving first priority to constant reminders and filed visits followed by change of payment terms. Therefore, litigation and debt collection agencies, should be used as a last resort or be overhauled and the finances redirected to filed visits, training, research and development and motivation of the debt collection staff.

5.5 Limitations of the Study

The study adopted a case study design and therefore, it was difficult to generalise the findings to the entire banking industry in Kenya. However, the design allowed for an in-depth study of SCB and its findings can be conveniently inferred to other commercial banks with similar loan portfolios.

This study was also limited by time. The researcher had to work within a limited time span which meant that intense exposure to the subject variables may have been constrained. The study was further limited by the fact that the researcher only interviewed top management and therefore did not include the views of middle level management, line management and the subordinate staff.

5.6 Suggestions for Further Study

The researcher suggests that a study whose respondents include junior staff be carried out to provide great insight in their perception of the effectiveness of debt collection strategy at SCB. Another area that would require a study is the establishment of a debt collection model that ensures that any debt collection strategy delivers value to the lending institution and does not infringe on the legal rights of the loan defaulters. This would enable the lending institutions to attain the debt collection targets and prioritise its financial investments towards the most effective debt collection strategies.

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APPENDIX I: INTERVIEW GUIDE

TITLE: EFFECTIVENESS OF DEBT COLLECTION STRATEGIES AT STANDARD CHARTERED BANK KENYA LIMITED

Dear Sir/Madam,

You are kindly requested to answer all questions in this interview guide.

Section A: Respondents Profile

1. How long have you worked with SCB Kenya Limited?
2. How long have you worked in the current position?

Section B: Debt Collection Strategies

3. Are the debt collection strategies adequately funded at SCB?
4. Are the debt collection strategies sustainable at SCB?
5. What is the average annual amount of debt collected at SCB?
6. Are the debt collection strategies applicable to the types of clients at SCB?
7. Do the employees possess relevant skills to implement the debt collection strategies at SCB?
8. What other debt collection strategies should be introduced at SCB?

Section C: Effectiveness of Debt Collection Strategies

9. Comment on the level of effectiveness of the Change of Payment Terms debt collection strategy at SCB.
10. Comment on the level of effectiveness of the Constant Reminders debt collection strategy at SCB.
11. Comment on the level of effectiveness of the engagement of Debt Collection Agencies in debt collection at SCB?

12. Comment on the level of effectiveness of the Litigation debt collection strategy at SCB?
13. What measures can be taken to improve the effectiveness of the debt collection strategies at SCB?

THANKS FOR THE RESPONSE

APPENDIX II: LETTER OF INTRODUCTION

Joseph Mbatha

P.O. Box 30003-00100

Nairobi

Tel: 0720-330710

Dear Sir/Madam,

RE: LETTER OF INTRODUCTION

I am a student undertaking a degree of Master of Business Administration at the University of Nairobi. As a requirement to complete the program; I will need to submit a project report on a management problem. I have elected to conduct a research project on the effectiveness of debt collection strategies at Standard Chartered Bank Kenya Limited.

I kindly request for your participation in providing answers to the attached interview guide.

The results will be used solely for academic purposes and a copy of the same will be availed to you on request.

Thank you.

Yours faithfully,

MBA Student.