

**IMPLEMENTATION OF CREDIT RATING SCORING STRATEGIES AT  
NATIONAL INDUSTRIAL CREDIT BANK**

**BY**

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**DECLARATION**

I declare that this project is my original work and has not been submitted for a degree in any other university or Institution of Higher Learning for examination/academic purposes.

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**SUPERVISOR'S DECLARATION**

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

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## **DEDICATION**

First, this study is dedicated to my parents Mr. and Mrs. Asande and secondly to my beautiful wife Shiphrah and beloved son Emmanuel who were a great source of inspiration to my education and without their foresight, sacrifice and support I would not have gone this far.

## ABSTRACT

Credit reference reports help banks stem out misconduct in the banking sector since customers whose credit reports indicate as having been involved in malpractices are subjected to stringent terms and conditions. Credit information sharing to bank customers, is expected to minimize the problem of information asymmetry in the financial sector. Information asymmetry between banks and borrowers is one of the main contributors to high cost of credit as banks tend to load a risk premium to borrowers because of lack of customer information. This in turn, increases cost of borrowing, meaning high repayment instalments of loans which translate to a high level of default. The Credit Information Sharing (CIS) apparatus is therefore expected to facilitate the development of information capital to reduce information asymmetry or increase information symmetry and allow cost of credit to decline substantially. It is therefore expected that savings arising from the sharing of credit information will translate to lower cost of credit. The executive management at National Industrial Credit Bank which comprises of 7 executives was interviewed directly using an already set interview guide as so to access their opinion on what they perceived to be the successes in implementation of credit rating scoring strategies and the measures they have taken to mitigate the challenges. The study used primary data that was collected using interview guide containing both structured and unstructured questions. Given this fact, content analysis was used to analyze the data. Findings from the study indicated that there were various challenges affecting NIC bank in its implementation of credit score rating process. These included structure, culture, technology, leadership, lack of focus, choice of external service strategy consultants, competition in the industry, very high cost of operation, and substitute products/services. The study concludes that the organization had in a way been able to amend its implementation of credit score rating process as per the challenges. This was through application of all management functions namely planning, controlling, organizing, motivating, leading, directing, integrating, communicating, and innovation to the implementation process. From the findings, the study also concluded that over 90% of the challenges faced by NIC bank while implementing their strategy are largely attributable to the internal environment. These challenges revolve around the organizational resources and organizational processes. This clearly shows that managers place little or no emphasis on implementation phase while they are drafting their strategies. Most of these challenges are avoidable if they have been accounted for during the analysis and formulation stages. It is obvious that many strategies fail to realize the anticipated benefits due to challenges encountered during implementation. The study recommends that for a successful strategy implementation, firms in Kenya should adopt such measures as; spending more time on analysis so as to identify problems that could surface in implementation phase.

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# CHAPTER ONE

## INTRODUCTION

### 1.1 Background of the Study

Organizations strive to serve the needs of society in which they operate. They therefore need to be managed in a certain way so as to achieve their goals. For management of an organization to succeed, they must manage their strategy in an organized manner through planning. Planning is done by strategizing in different fields such as strategic management of organizations make strategic plans for a span of years. These are plans mainly for financial and human resources. It is in this regard that strategic management is referred to as an environmental scanning for both internal and external environment strategy formulation, strategy implementation and control. It emphasizes the monitoring and evaluating of external opportunities and threats in light of an organization's strengths and weaknesses. According to Aaltonen (2001), strategic management is that set of managerial decisions and actions that determines the long performance of organizations.

A company's strategy is management's action plan for running the business and conducting its operations. Crafting of a company's strategy represents a managerial commitment to pursue a particular set of actions in growing the business, attracting and pleasing customers, competing successfully, conducting operations and improving the company's financial and market performance, Bourgeois (2004). Strategy on service delivery is thus an important element of this management process. For global business market acceleration, business must respond to customers faster than ever with value added products and services, while they struggle to maintain competitive advantage.

According to Hambrick (2003), strategic management has evolved over the years to the point that its primary values are helping organizations operate successfully in a dynamic and complex environment. According to Aosa (1992), the key to gaining competitive advantage is the willingness and ability of employees to share their knowledge, skills and attitudes in the work process. The internal and external environment of an organization is important for its success. This means that the organization monitoring, evaluation and dissemination of information from both external and internal environment is undertaken to stakeholders. This helps the organization to identify strategic factors that can be used to develop the future plan (Kariuki, 2004).

This study is based on the arguments of Environmental Dependency Theory and Open System Theory that state that organizations and communities are open systems; changing and influencing each other over time and that the fit between a business's strategy and its environment has significant implications on its performance (Bartlett&Ghoshal,2012) .Numerous Environmental Dependency and Open system theory based studies have been conducted (Bartlett & Ghoshal, 2012) argued that convergences in economic systems and technological change, especially in information technology, were the most important external environmental factors that influenced organizational performance and informed strategy. Political, legal and cultural systems significantly impact organization strategic positioning and eventually dictate the success of strategy implementation (Bartlett & Ghoshal, 2012).

NIC Bank is a multinational organization that has pursued several strategies over the years. The pursued strategies have encountered frustrations in their application most recent being the implementation of credit score rating within its lending fraternity. Reflecting in its complex and

diverse contexts of enactment, strategy implementation is synonymous with big challenges. Cultural and institutional complexities remain as potent challenge and have been joined by newer concerns such as climate change, terrorism, international fraud, unfavorable political environment; economic-financial challenges and Natural catastrophe (Bartlett & Ghoshal, 2012). The problems encountered by multinationals organizations in international business have brought forth high levels of uncertainties. Hence the need to identify strategy implementation challenges to aid in making informed strategic plans for international business.

### **1.1.1 The Concept of Strategy**

Strategy consists of competitive moves and business approaches to produce successful performance. Strategy implementation is the action aspect of the strategic management process through which strategy is translated into action and involves change. Strategic management can be broadly described as a concept about how to compete in an industry. It is the direction and scope of an organization over long-term, which achieves advantage for the organization through configuration of resources within a changing environment, to meet the needs of markets and to fulfill stakeholder's expectations (Johnson & Scholes, 2004).

Strategic change is defined as the use of systematic methods to ensure that a planned organization change is guided in the planned direction, conducted in a cost effective and efficient manner and completed within targeted time frame with desired results. Strategy implementation boils down to managing change and the resistance thereof, and is where the real test to the success of a strategy lies.

### **1.1.2 Strategy Implementation**

While strategy formulation is entrepreneurial and involves visionary as well as theoretical perspective, implementation is basically, administrative and involves bringing change by working through other people, organizing, motivating culture change, building and finding the optimal fit between strategy and the organization structure. The implementation process may involve significant changes in the organization structure, culture and systems (Pearce and Robinson, 2002). Since change has become an enduring feature of organizational life, today's managers have to face the challenges posed by the environment hence embrace the ensuing strategic responses.

Strategic management is a process by which an organization establishes objectives, formulates actions designed to achieve these objectives in the desired timescale, implements the actions and assesses progress and results for continuous improvement. Strategy implementation is the action aspect of the strategic management process through which strategy is translated into action. Strategy implementation boils down to managing change and the resistance thereof. The implementation process may involve significant changes in the organization structure, culture and systems (Pearce and Robinson, 2002). Implementations challenges arise in organizations as a result of failure to match these elements to the strategies.

Strategy execution involves, motivating, controlling and balancing the power politics. The unpredictable nature of today's environment makes strategy implementation more

difficult and complex. Research carried out indicates an implementation failure rate of over 65% in organizations. Strategy implementation is part of strategic management that is described as a concept about how to compete in an industry. It achieves advantage for the organization through configuration of resources within a changing environment, to meet the needs of markets and to fulfill stakeholders' expectations (Johnson & Scholes 2002).

Emphasizing on the behavioral aspect, (Todd, 1999) defines change management as a structured and systematic approach to achieving a sustainable change in human behavior within an organization. Since change has become an enduring feature of organizational life, today's managers have to face the challenges posed by the environment hence embracing strategy.

### **1.1.3 Credit Rating Scores**

A credit score is a numerical expression based on a level analysis of a person's credit files, to represent the creditworthiness of that person. A credit score is primarily based on credit report information typically sourced from credit bureaus. Credit scores are determined by formulas that assess an individual creditworthiness. Lenders evaluate the risk of extending credit to individual by using credit scores, which measures an individual credit risk namely, how likely it is that you will pay them back and pay on time. Credit scores constantly adjust as the information in an individual credit report changes. A consumer benefits from knowing their credit score and keeping track of changes and setbacks.

Credit scores introduced in 1950's is now widely used in developed economies for consumer lending, especially to credit card users and is becoming more widely used by commercial banks (Mester, 1997).The information about the borrower is obtained from their loan applications and from credit bureaus. This include applicants' monthly income, outstanding debt, financial assets, how long the applicant has been on same job, whether the applicant rents or owns a home, among others. Regression analysis relating loan performance to these variables is used to pick which combination of factors best predicts delinquency or default and how much weight should be given to each of these factors.

The process of credit scoring is very important for banks as they need to segregate 'good borrowers' from 'bad borrowers' in terms of their creditworthiness. The methods generally used for credit scoring are based on statistical pattern recognition techniques. Credit scoring in its automated form is often the only way to assess creditworthiness, as banks do not have enough resources to treat each small exposure individually. To build a good scoring model, developers need sufficient historical data which reflects loan performance in periods of both bad and good economic times. During the model building process, the statistical application would use information about the existing customers to build and validate the model. In the end, the result is a model that would take details about the customer as inputs and generate an output (Hand and Henley, 1997).

#### **1.1.4 Credit Reference Bureaus**

These are organizations that provide information to merchants or other businesses concerning the creditworthiness of their customers. Credit bureaus may be private enterprises or may be operated on a cooperative basis by the merchants in one locality.

Users of the service pay a fee and receive information from various sources, including businesses that have granted the customer credit in the past, public records, newspapers, the customer's employment record, and direct investigation (O'Sullivan, & Sheffrin, 2007). At present (National Council for Law Reporting - Kenya, 2008), the Kenya banking act (Cap. 488) only allows information from banks to be combined and only participating institutions can have access to it. Furthermore, banks can only request a report on a borrower who has actually applied for a loan from them. Such reports help the bank decide whether you as a potential borrower is able to repay a new loan. If the report shows that you have a negative credit score one is likely to be denied new credit or issued a facility that is expensively priced. The opposite is also true where a positive credit score will enable one to be issued a loan that is priced lower.

According to Central Bank of Kenya (2012), the law requires credit reference bureaus to meet international data security standards in the transmission and storage of information in their custody. Regular data security audits are conducted by the Central Bank of Kenya and bureaus that do not keep data safe risk losing their licenses. Customers have the right to view any information about them held in a credit reference bureau, if that information has been used to deny them credit. The law and regulations also set out procedures for settling disputes. If a dispute is not settled within a specified time period, the disputed information will have to be removed from the databases of all credit reference bureaus (FSD, 2011).



### **1.1.5 Commercial Banks in Kenya**

The main objective of a commercial bank is the receiving of deposits from customers and lending the same at a profit. It raises funds by collecting deposits via checkable deposits, savings deposits, and time deposits. It offers loans to clients at agreed interest and also buys corporate bonds and government bonds. Its primary liabilities are customer deposits while primary assets are loans and bonds.

This is true of the 43 banks currently operating in the Kenyan economy where 30 are locally owned and 13 are foreign owned. The locally owned financial institutions comprise 3 banks with significant shareholding by the Government and State Corporations. All these banks are governed by the Companies Act, the Banking Act, the Central Bank of Kenya Act and various prudential guidelines issued by Central Bank of Kenya (CBK). CBK is responsible for formulating and implementing monetary policy and fostering the liquidity, solvency and proper functioning of the financial system. The banking sector in Kenya was liberalized in 1995 and exchange controls lifted. The banks have come together under the Kenya Bankers Association (KBA), which serves as a lobby for the banks interests and addresses issues affecting member institutions. Six of the major banks are listed in the Nairobi Stock Exchange.

Over the last few years the banking sector in Kenya has grown tremendously in assets, deposits, profitability and product offering. The growth has been mainly underpinned by industry wide expansion strategy, automation of large number of services and leveraging on technology to meet complex customer needs. The players in the banking sector have

experienced increased competition resulting to many of the players coming up with innovations to thrive in the market. This has led to positive results for the customers, shareholders and the Kenyan economy at large.

### **1.1.6 NIC Bank profile**

NIC Bank Ltd was incorporated in Kenya on 29th September 1959, when Standard Bank Limited (“Standard”) and Mercantile Credit Company Limited (Mercantile) -both based in the United Kingdom - jointly formed the company. The company was amongst the first non-bank financial institutions to provide hire purchase and installment credit finance facilities in Kenya. NIC Bank Ltd became a public company in 1971 and is currently quoted on the Nairobi

Stock Exchange with approximately 21,000 shareholders. Barclays Bank of Kenya Limited acquired 51% of NICs total shares through the acquisition of Mercantile in the 1970s and Standard’s shareholding in NIC in the 1980s. Between 1993 and 1996, BBK divested its shares, selling 38% of its shares to the public in 1994, and the remaining 20% in 1996 to the First Chartered Securities Group (FCS).

Due to changing trends, regulatory requirements in the Kenyan banking industry and the need to meet growing customer requirements, NIC obtained a commercial banking license in 1995. In order to effectively diversify into mainstream commercial banking NIC Bank merged in November 1997 with African Mercantile Bank Limited (AM Bank), which was then owned by FCS, by way of a share swap. The purpose of this merger was to allow NIC Bank to enhance its market position, provide a broader and more efficient

range of services to its customers and increase the returns to shareholders. The Financial reporting excellence award (FIRE award) was awarded to NIC Bank Ltd in 2005, which recognized it as the best institution in corporate governance. This goes a long way in confirming NIC Bank's non-wavering commitment and strict compliance to corporate governance. The bank has a presence in Kenya, Uganda and Tanzania.

## **1.2 Research Problem**

Commercial banks have faced difficulties in credit lending over the years. For many reasons the major cause of serious banking problems continues to be directly related to lax credit standards for borrowers, poor portfolio risk management or lack of attention to changes in the economic circumstances and competitive climate (CBK, Annual Supervision Report, 2000). According to Peter (2002), awarding credit is a journey, the success of which depends on the methodology applied to evaluate and award the credit. This journey starts from the application of credit and ends at the time the loan is finally fully paid. The credit management process has got its smooth and rough stages and therefore needs to be effectively controlled for it to be successful.

Lending has been a thorny issue in the Kenyan banks for a better part of its existence. The Kenyan banking sector was in the 80's and 90's saddled with a momentous Non-Performing Loans (NPLs) portfolio. This invariably led to the collapse of some banks. One of the catalysts in this scenario was "Serial defaulters", who borrowed from various banks with no intention of repaying the loans. Undoubtedly these defaulters thrived in the "information asymmetry" environment that prevailed due to lack of a credit information

sharing mechanism. (Central Bank of Kenya, 2008). To tame this undesirable trend there was a need to come up with a credit reference bureau by the banks regulator.

Credit Reference Bureaus (CRB) complements the central role played by banks and other financial institutions in extending financial services within an economy. CRBs help lenders make faster and more accurate credit decisions. They collect, manage and disseminate customer information to lenders within a provided regulatory framework – in Kenya, the Banking (Credit Reference Bureau) Regulations, 2008 which was operationalized effective 2nd February 2009. Credit histories not only provide necessary input for credit underwriting, but also allow borrowers to take their credit history from one financial institution to another, thereby making lending markets more competitive and, in the end, more affordable. Credit bureaus assist in making credit accessible to more people, and enabling lenders reduce risk and fraud. Sharing of information between financial institutions in respect of customer credit behavior, therefore, has a positive economic impact.

The recent introduction of KBRR by the CBK as a common base rate for lending rate by commercial banks in Kenya has changed the dynamics of traditional interest rate determination. This introduces many challenges as well as opportunities in the way of interest rates determination and risk management. Key among them being the apparent loss of the default risk premium banks have been charging before KBRR introduction and mitigation of issuing bad loans.

Given the critical role that provision of credit plays in the Kenyan economy and the recent introduction of credit reference bureaus in the Kenyan banking industry, it is important to study the implementation strategies of credit rating scoring by commercial banks in Kenya. None of the previous researchers have studied the implementation of credit rating scoring at NIC Bank. This gap in knowledge necessitated the proposed study, thus this research sought to answer the question; what influence does implementation of credit rating scoring strategies have in National Industrial Credit Bank?

### **1.3 Objective of the Study**

The objective of this study is to establish influence of Implementation of Credit Rating Scoring Strategies at National Industrial Credit Bank.

### **1.4 Value of the Study**

The findings of the study are valuable to credit risk managers in commercial banks in Kenya. The managers will use the information to formulate strategies that will enhance application of credit scoring in determination of interest rates. The managers will use the findings of the study as a benchmark for review of the present implementation strategies. In so doing there will be more quality loans and healthy competition between banks in loan pricing.

The Kenyan government serves a main regulator of the credit reference bureaus and commercial banks in the country. The information resulting from this study will therefore form a basis for policy formulation with a view to enhance interest rates in the economy.

The study will contribute to the existing body of knowledge on credit reference information sharing and loan pricing. The study findings will therefore serve as a source of reference for researchers and academicians.

## **CHAPTER TWO: LITERATURE REVIEW**

### **2.1 Introduction**

This chapter will cover theoretical foundations of theories that support the study and the literature review.

### **2.2 Theoretical Foundation**

A theoretical definition gives the meaning of a word in terms of the theories of a specific discipline. This type of definition assumes both knowledge and acceptance of the theories that it depends on. To theoretically define is to create a hypothetical construct.

#### **2.2.1 Credit Rationing Theory**

This theory was introduced by Freimer and Gordon (1965) and comprehensively by Stiglitz and Weiss (1981). According to the seminal Stiglitz and Weiss (1981) paper, unsatisfied agents are borrowers. Asymmetric information leads to credit rationing, as lenders cannot distinguish between high quality and low quality borrowers. However, this dominate view is not without criticism. In particular, De Meza and Webb (1987) vigorously contest this result. They show that asymmetric information in credit markets can lead to the inverse result, which is an excess of credit (over lending).

Banks exist because they screen and monitor borrowers more efficiently than other investors can. They are specialized in gathering private information and analyzing it. Managing money and deposit accounts, banks own highly strategic information on firms and individuals receipts and expenditures. Despite this plethora of information,

relationships between bankers and consumers is not perfect. Banks suffer from informational asymmetries such that evolution of prices (interest rates) cannot clear the credit market.

Finally, non-walrassian equilibrium arises with a fringe of unsatisfied agents. The more interesting form of credit rationing is equilibrium rationing, where the market had fully adjusted to all publicly, i.e. why banks ration credit free, available information and where demand for loans for a certain market interest rate is greater than supply. Stiglitz and Weiss (1981) proved that credit rationing occurs if banks charge the same interest rate to all borrowers, because they cannot distinguish between borrowers and screening borrowers perfectly is too expensive. Both assumptions are very simplifying and do not occur in this manner in the real world. Banks are usually able to distinguish their borrowers up to a certain degree. Moreover, banks face more than only two types of borrowers. Banks usually charge more than just one interest rate to all customers. High-risk borrowers pay a higher interest rate and credit rationing is less likely. However, banks cannot distinguish borrowers perfectly and screening them perfectly is impossible. Thus, credit rationing may occur.

According to Stiglitz and Weiss (1981) adverse selection and thus credit rationing still occurs if banks require collateral. They argue that low-risk borrowers expect a lower rate of return on average. Thus, they are less wealthy than high-risk borrowers on average after some period. Low-risk borrowers are therefore not able to provide more collateral.



Increasing collateral requirements may have the same adverse selection effect as a higher interest rate.

### **2.2.2 Information Sharing Theory**

Research on information sharing is relatively recent and growing. Earlier papers analyze the effect of information sharing in a market with asymmetric information, either moral hazard or adverse selection (Gehrig and Stenbacka, 2005). In moral hazard setups, information sharing may provide borrowers with higher incentives to perform: because information becomes available to competitor banks, borrowers are happy to perform better because they no longer fear being held- up by the lender-monopolist. Second, borrowers do not want to default, because this will be publicly known: when default information is shared, borrowers will face an increase interest rates and a decrease in access to finance not only by the current bank, but by the rest of banks in the market - the so called disciplinary effect (Padilla and Pagano, 2000).

More-over, information sharing resolves adverse selection problems when banks have ex-ante informational advantage. By sharing information, banks may learn about those good and bad borrowers of the competitor banks who switched from the previous banks. Gehrig and Stenbacka (2001), however, identify a dark side of information sharing. Rather than starting with ex-ante informational advantage, their adverse selection model considers a two-period competition with symmetric knowledge in period one. In their location model, when banks have fewer incentives to acquire information for too many customers in period one, they know they will have to compete away rents on them by

sharing information in period two. They show that if information about borrowers' true becomes known to other banks, second-period competition was higher and first-period interest rates will have to go up. As a result, information sharing can lead to welfare losses. However, they assume that all characteristics about true types can be revealed to the outside bank. In contrast, we distinguish between information that can be shared (hard) and information that cannot (soft), relationship specific information. Hauswald and Marquez (2003) show that information processing, providing the screening bank with more informational advantage, will safeguard it from competition allowing earning rents. Advances in the screening technology, therefore, will increase returns from screening. Access to that same information, on the other hand, levels the playing field for banks and erodes their rents due to increased competition. Thus, technological progress that allows for easier access to the incumbent's information will decrease the returns to investing in such information.

### **2.2.3 Moral Hazard Theory**

Moral hazard refers to the risk that a party to a transaction has not entered into the contract in good faith, has provided misleading information about its assets, liabilities or credit capacity, or has an incentive to take unusual risks in a desperate attempt to earn a profit before the contract settles. Problems of moral hazard in banks and other financial institutions were evident at many stages of the recent financial crisis (Myerson, 2011).

As Freixas and Rochet (1997) have noted, modern microeconomic models of banking depend on advances in information economics which was not available when the

traditional Keynesian and monetarist theories were first developed. So now, as economists confront the need for deeper insights into the forces that can drive macroeconomic instability, we should consider new models that can apply the microeconomic theory of banking to the macroeconomic theory of business cycles. In modern macroeconomic theory economic growth rate depends, crucially, on the efficiency of financial institutions. The financial systems themselves depend on accurate information about borrowers and the project the funds are used for (Chakraborty and Play, 2001)

#### **2.2.4 Adverse Selection Theory**

Stiglitz and Weiss (1981) originate the paper of adverse selection theory of credit markets. The theory rests on two main assumptions: that lenders cannot distinguish between borrowers of different degrees of risk, and that loan contracts are subjects to limited liability (i.e. if projected returns are less than debt obligations, the borrower bears no responsibility to pay out of pocket). This analysis is restricted to involuntary default, i.e., it assumes that borrowers repay loans when they have the means to do so. In a world with simple debt contracts between risk-neutral borrowers and lenders, the presence of limited liability of borrowers imparts a preference for risk among borrowers, and a corresponding aversion to risk among lenders. This is because limited liability of borrowers implies that lenders bear all the downside risk.

On the other hand, all returns above the loan repayment obligation accrue to borrowers. Raising interest rates then affects the profitability of low risk borrowers

disproportionately, causing them to drop out of the application pool. This leads to an adverse compositional effect—higher interest rates increase the average riskiness of the applicant pool at a very high interest rates, the only applicants are borrowers who could potentially generate very high return. Since lenders' preference over project risk runs counter to those of borrowers, they may hold interest rates at levels below market-clearing and ration borrowers in order to achieve a better composition and lower risk in their portfolio. Excess demand in the credit market may persist even in the face of competition and flexible interest rates.

In the adverse selection theory, the interest rate may not raise enough to guarantee that all loan applicants secure credit, in times when loanable funds are limited. In general, the volume of credit and level of effort is less than the first-best. Borrowers who have greater wealth to put as collateral obtain cheaper credit, have incentives to work harder, and earn more income as a result. Existing asset inequalities within the borrowing class are projected and possibly magnified into the future by operation of the credit market, a phenomenon that may cause the persistence of poverty. By exchanging information about their customers, banks can improve their knowledge of applicants' characteristics and behavior. In principle, this reduction of informational asymmetries can reduce adverse selection problems in lending, as well as change borrowers' incentives to repay, both directly and by changing the competitiveness of the credit market.

Pagano and Jappelli (1993) show that information sharing reduces adverse selection by improving bank's information on credit applicants. In their model, each bank has

private information about local credit applicants, but has no information about non-local applicants. If banks exchange information about their client's credit worthiness, they can assess also the quality of non-local credit seekers, and lend to them as safely as they do with own clients. Information sharing can also create incentives for borrowers to perform in line with banks' interest. Klein (1982) shows that information sharing can motivate borrowers to repay loans, when the legal environment makes it difficult for banks to enforce credit contracts. In his model borrowers repay their loans because they know that defaulters will be blacklisted, reducing external finance in future.

### **2.3 Strategy Management and Implementation**

Operationalization of strategy constitutes of best practice and benchmarking especially the concept of lean production and its principles and methods have received considerable attention. Here, a strong link between operational excellence of strategy and performance in a market becomes obvious. A major success factor for the dissemination of lean approaches may lie in a considerably higher specificity of its descriptions of operational best practice. There are four possible strategy implementation outcomes. The outcomes include success, trouble, failure, and roulette. Success occurs if a good strategy is appropriately implemented, trouble occurs if a good strategy is poorly implemented, failure occurs if a poor strategy is poorly implemented, whereas roulette occurs if a poor strategy is appropriately implemented. Successful implementation of strategy involves operationalization and institutionalization of strategy. Thompson and Strickland (1989) argue that indeed, good strategy and good implementation are the most trustworthy proof of good management.

Pearce and Robinson, (2002) define Strategic Management as a set of decisions and actions that result in the formulation and implementation of plans designed to achieve a company's objectives. It involves the planning, directing, organizing and controlling of a company's strategy-related decisions and actions that reflect a company's awareness of how, when, and where it should compete, against whom it should compete and for what purpose it should compete. (Irwin, 1995) views strategy as consisting of competitive moves and business approaches to produce successful performance. Strategy is a management game plan for running the business, strengthening firm's competitive position, satisfying customers and achieving performance targets.

Strategy implementation is the process through which strategy is translated into action and results are achieved. It is acting on what has to be done internally to put the chosen strategy into place and actually achieve the targeted results (Thompson & Strickland, 1989). Strategy implementation is a process by which management translate strategies and policies into action through the development of programs, budgets and procedures. It is administrative, looking for workable approaches to executing strategy and getting people to accomplish their jobs in a strategy supportive manner. (Thompson and Strickland, 1989) lends voice to the fact that strategy implementation includes the full range of managerial activities associated with putting a chosen strategy into place, supervising its pursuit and achieving the targeted results. Strategic management is about continual success, competition, long term growth and competitive advantage brought about by making right choices and implementing them effectively and efficiently (Johnson & Scholes, 2004).

Theoretically, strategic management process involves understanding the strategic position of an organization, making strategic choices for the future and turning strategy into action (Johnson & Scholes, 2004). This can also be looked at as strategic analysis, choice and implementation. (Johnson & Scholes, 2004) noted that strategic analysis is an element in the strategic management process that assesses the impact of the external environment, organization capability and stakeholder's expectations. It is concerned with understanding the different forces affecting the organization, and the choice of strategy. Notable tools for this analysis include SWOT, PESTEL and Porter's five forces Model. Corporate level strategy deals mainly with the conceptual and overall purpose and scope of the organizations. At this level top level management and directors have to define what business they are in, the grand strategies that need to be adopted in the long term.

The decision making process at this level is therefore broad based taking into account the overall mission and vision of the organization, how it needs to be structured, the procurement and allocation of resources to the different units and satisfying expectations of the different stakeholders. Decisions at this level are characterized by greater risk cost and profit potential, greater need for flexibility and need for entrepreneurial and visionary approach.

Implementation usually interferes with the status quo, these interferences need to be managed in order to re-establish the organization. According to (Ansoff & McDonnell, 1990) Implementation exhibits its own resistance which can invalidate the planning efforts. Good strategies are of no value unless they are effectively implemented and

translated into action, some of the challenges that organizations face are lack of tight fits between strategy and organizations structure, capabilities, culture and reward systems.

There is growing interest in an attempt to understand why many well formulated strategies fail and the subsequent challenges facing organizations. (Stoner et al,2001) note that the field is so new that there is no consensus about its dimension while (Hrebiniak,2005) recognizes that there is too much talk about planning and formulation and little on implementation. Strategy implementation will therefore continue to attract attention because it plays a central role in the overall success of organizations today be they small or big, profit or nonprofit making and even government institutions worldwide. Conventionally, researchers in this field have been interested in how organizations respond to institutional forces. Several studies have explored how firms adopt external institutions, including quality management practice (Kostova & Roth, 2002), governance structure (Lee & Pennings, 2002) and organizational routine (Massini, Lewin, & Greve, 2005).

Furthermore, Milstein, Hart, and York (2002) recognized that a coercive pressure can lead to heterogeneous results due to environmental variation. As can be seen in the existing literature, firms have been considered as the objects of environmental impacts. After DiMaggio and Powell (1983) recognized that firms can be the sources of isomorphic pressures, several researchers have explored this issue thoroughly. The growing significance of corporate organizations in modern society implies that firms can be the origins of institutional influences. Firms may unintentionally mislead stockholders



by providing wrong information (Largevoort, 1997). Wade, O'Reilly, and Chandratat (1990) suggested that CEOs can exert social influences to achieve favorable conditions. The literature opens possibilities that firms can be the sources of important social influences, including institutional isomorphism (DiMaggio & Powell, 1983). Following this notion, Lawrence (1999) proposed institutional strategies based on the isomorphic pressures from the firms. In order to create favorable competitive environment, firms affect the rules of members (membership strategy) or enforce formal or informal standards (standardization strategy).

Although Lawrence (1999) explained that both types of institutional strategies may result in favorable competitive environment, the focus of his propositions relied on how firms exert institutional pressures rather than how these pressures lead to sustainable competitive advantage. Furthermore, the author mainly paid attention to the establishment of new rules rather than the influence on firm resources in the existing markets. Given the continued importance of enduring success in business for the organization and strategy literature (Barney, 1991), there is need to explore this overlooked aspect of institutionalization strategies.

## **2.4 Implementation of Credit Rating Scoring Strategies**

According to (Byars, 2006) the challenge to implementation arises from lack of understanding of the strategy. Poor planning, ineffective communication, flawed vision and unclear goals can be a hindrance to strategy implementation. Since organizations need people to bring about the necessary changes, strategy implementation therefore

requires the assembling of a capable team with the right skills. (Pearce & Robinson, 2002) note that the chief executive together with key managers must have skills, personalities, education and experience to execute the strategy. More often organizations realize that due to internal power structure and organization politics, selection of competent staff is compromised. Bringing in outsiders has its own challenges that may even lead to resistance and exit of critical staff required for the implementation process.

### **2.4.1 Structure and Strategy Implementation**

Structure is the design of organizations through which the enterprises are administered, including lines of authority and data flow through the lines. Organizational structures are devised to administer enlarged activities and resources. Organizational structure is the firm's formal configuration. It specifies roles, procedures, governance mechanism and decision making processes. Organizational structure is influenced by the organizations age and size and it acts as a framework, which reflects what a firm does and how tasks are completed, given the chosen strategy. Organization structure must be congruent with the strategy that is there must be a 'fit' between them (Ghoshal and Bartlett, 2005)

According to Kroon (2005), the choice of an organization structure is determined by the business strategy. Structure follows strategy and the two must be coordinated to ensure the best results. The organization structure that will result in most effective strategy implementation must be developed, taking into consideration the size of the business, diversification of the product range, rate of change in the environment and the need for information. Kroon further contends that organization goals are derived from the strategy

and goals of the business. The extent of activities and content of hierarchy of goals determine the manner in which the business is structured.

Kroon (2005) suggested that the organization structure that is developed must be practical and acceptable, and must follow the business strategy in order to make it possible to achieve the goals. The business organization structure consists of formal and an informal part. The formal organization structure is established by careful planning and indicates the jobs of the employees in the business. However, the informal organization refers to the formation of informal groups by the employees of a business. These groups develop spontaneously as a result of interaction and communication between employees. Kroon added that the informal group exists because of a man's social needs. The informal organization can have a positive or a negative effect on the business activities.

According to David (2001), changes in strategy often require changes in the way organization is structured for two major reasons. First, structure largely dictates how objectives and policies were established. For example, the format for objectives and policies established under a geographic organizational structure is couched in geographic terms. Objectives and policies are stated largely in terms of products in an organization whose structure is used on products groups. The structural format for developing objectives and policies can significantly impact all other strategy implementation activities.

Baker (2007) asserted that organizational structure can help or hinder, support or block strategic change. A good fit-for- purpose structure will enable changes, continuous or discontinuous, small or large, to be made effectively and efficiently.

### **2.4.2 Culture and Strategy Implementation**

Culture dictates what groups of people pay attention to. It guides how the world is perceived, how the self is experienced and how life itself is organized. Kroon (2005) indicated that management philosophy determines the business culture. Each business has its own culture, just as each individual has his or her own personality. Business culture is the shared values, expectations and norms that are established in a business over time. It determines how things are done in the business, for example how problems are approached and priorities determined in the execution of the work. Successful implementation of a strategy demands a compatible business culture.

Burnes (2003) suggested that the strategic management of change is ‘essentially a culture and cognitive phenomenon’ rather than an analytical, rational exercise. Clarke (2004) stated that the essence of sustainable change is to understand the culture of the organization that is to be changed. If proposed changes contradict cultural biases and traditions, it is inevitable that they will be difficult to embed in the organization.

Sharma (2007) indicated that the culture of an organization may reflect in various forms and norms adopted by the organization such as the physical infrastructure, routine behavior, language, ceremonies, gender equality, and equity payment. Creation of an appropriate work culture is a time consuming process. Culture communicates to people

through symbols, values, physical settings, language and thereby supplements the rational management tool such as technology and structure. In his study, Okumus (2003) viewed organizational culture as the shared understanding of employees about how they do things within an organization. Okumus identified key issues in organizational culture as company's culture and subcultures and their possible impact on the implementation process, impact of organizational culture on communication, coordination and cooperation between different management and functional levels, implications of the new strategy on the company's culture and subcultures, and efforts and activities to change the company's overall culture and subcultures and potential challenges.

### **2.4.3 Leadership and Strategy Implementation**

Duck (2003) indicated that there is a general consensus that leadership is at the core of strategy implementation, while the strategic plan may have good ideas and guidelines, the challenge is in translating the ideas and following the guidelines that lead to concerted well guided effort to lead the change. According to Kroon (2005), leadership is the human factor that leads an institution towards realizing goals through voluntary co-operation of all the people in the business. A business often succeeds or fails because of the presence or absence of good leadership.

Kroon (2005) pointed out that leadership consists of the interaction between personalities and circumstances, as interpreted by the group. A particular relationship develops between a leader and his followers. The relationship implies that subordinate willingly strive to achieve the leaders aims and that leaders influence their subordinates. The leader

also determines how subordinate should carry out assignments. In such a case subordinate are urged to a level of activity that they themselves never thought possible.

The manager's responsibility lies in the use of power in such a way that subordinates are influenced to work harder and strive to achieve mutual objectives. Leadership depends on an ability to acquire and use power from both positional and personal sources. The importance of leadership to the strategic management process is underscored by the fact the process entails formulation and institutionalizing of the new approach (Elsenbach, Pillai and Watson, 2009). According to Goleman (2000), there are six styles of leadership which include coercive, authoritative, afflictive, democratic, pace setting, and coaching. However, Goleman emphasizes that an effective leader is skilled at several of the basic style and has flexibility to switch between the styles as circumstances dictates. Leadership is the entire process of translating strategy into results and is essential in engaging the hearts and minds of the people. Goleman (2000) further contends that visionary leadership creates efficiency by moving decision making responsibility to the frontline. Saka (2003) point out that the success of implementing strategy is generally associated with those who facilitate the change process.

Okumus (2003) viewed leadership as the actual support and involvement of the Chief Executive Officer (CEO) in the strategic initiative. Leadership is crucial in using process factors and also in manipulating the internal context to create a context receptive to change. Okumus identified the following key issues in leadership actual involvement of the CEO in the strategy development and implementation process, level of support and

backing from the CEO to the new strategy until it is completed, and open and covert messages coming from the CEO about the project and its importance.

#### **2.4.4 Resource Allocation and Strategy Implementation**

In the service strategy implementation process, resources are allocated and an organization is designed and built to make it possible to carry out the strategic plan (Kumar et al, 2006). Alexander (2001) points out that “strategy implementation addresses the issue of how to put a formulated strategy into effect – with defined time constraint, within budget, and human resources, and its capabilities”. In the service strategy execution process, the organization utilizes the resources to deliver the services, and to carry out the strategic plan on a continuous basis throughout the predetermined life cycle. “Without an executable plan – and the resources needed to implement that plan – even the most innovative strategy is merely words on paper” (Wery and Waco, 2004).

Okumus (2003) viewed resource allocation as the process of ensuring that all necessary time, financial resources, skills and knowledge are made available. It is closely linked with operational planning and has a great deal of impact on communicating and on providing training and incentives. Key issues to be considered are procedures of securing and allocating financial resources for the new strategy, information and knowledge requirements for the process of implementing a new strategy, time available to complete the implementation process, and political and cultural issues within the company and their impact on resource allocation.

Sterling (2003) stated that chronic lack of resources – capital or otherwise hinders implementation of strategy. Budgeting should be a fundamental part of any action planning, especially where capital-intensive strategies are concerned. Therefore, it makes sense to incorporate financial considerations within a draft strategic plan. Increased awareness should enable CEOs to allocate sufficient capital to a strategy but without draining finances to the degree that investors' returns are jeopardized. Equally important is the expending of other key resources, such as people or time. Service companies in particular can suffer when these resources are insufficiently allocated.

#### **2.4.5 Communication and Strategy Implementation**

According to Speculand (2009), poor communication has been blamed for failure in implementation of strategy in many organizations. Strategy is designed at the top, but implemented from the bottom. Communication is the link to make this happen. A new strategy is launched with fanfare, presenting a multimedia exhibit. After the initial fanfare, the problem is that very little tends to be communicated, and as a result staff members do not adopt it. For successful implementation, the leaders are the voice of strategy, the communication is consistent and coherent, and a balance is found between old and new media. Kumar et al (2006) pointed out that excellent communications and transparency between involved parties, as well as clearly defined performance factors, play a vital role to create trust in the implementation and execution phase. Well-aligned communication and relationships are the foundation for trust- building between involved parties throughout the implementation and execution process.



To become a successful strategy implementer and executor, the top management personnel should clearly communicate, “What the new strategic decision is all about” with involved parties and with operative personnel (Alexander, 1985). Any delay caused through poor communication or coordination could create conflict between parties and have an impact on business and relationships. Responsibilities and duties need to be clearly explained to reduce uncertainty, speculation and unfounded fears. The goal is to minimize the gap between required and delivered services, and to assure continuous excellent production assurance.

In their study, Aaltonen and Ikävalko (2002) suggested that much is still to be done in the field of communicating strategies. A considerable number of interviewees linked the problems of strategy implementation with communication. A common concern was the creation of shared understanding of strategy among the organizational members. The amount of strategic communication in most of the organizations was large: both written and oral communications were used, mostly in the form of top-down communication. However, a great amount of information does not guarantee understanding.

The middle managers’ role in communicating strategies was emphasized in the findings (Aaltonen and Ikävalko, 2002). The middle managers were often responsible for the continuation of the flow of strategic information and also for ensuring the understanding of the strategy. In this process of communication, the informal communication between superiors and subordinates was considered more important than the formal communication of strategy.

However, sufficient communication does not guarantee successful implementation. Interpretation, acceptance and adoption among implementers is crucial. A lack of understanding of strategy was one of the obstacles in strategy implementation observed in this study. Surprisingly, many organizational members typically recognized strategic issues as being important and also understood their content in generic terms. Problems in understanding arose, when the strategic issues had to be applied in everyday decision making.

## **2.5 Application of Credit Scoring and Information Sharing Characteristics**

Credit allows accessing of resources today with an agreement to repay over a period of time, usually at regular intervals. The resources may be financial, or they may consist of products or services. Credit has now turned into a very important component in everyday life. Although credit cards are currently the most popular form of credit, other credit plans include residential mortgages, auto loans, student loans, small business loans, trade financing and bonds, among others.

The main risk for banks and financial institutions comes from the difficulty to distinguish the creditworthy applicants from those who will probably default on repayments. The recent world financial crisis has aroused increasing attention of financial institutions on credit risk prediction and assessment. The decision to grant credit to an applicant was traditionally based upon subjective judgments made by human experts, using past

experiences and some guiding principles. Common practice was to consider the classic 3 C's, 4 C's or 5 C's of credit: character, capacity, capital, collateral and conditions (Abrahams and Zhang, 2008). This method suffers, however, from high training costs, frequent incorrect decisions, and inconsistent decisions made by different experts for the same application.

These shortcomings have led to a rise in more formal and accurate methods to assess the risk of default. In this context, automatic credit scoring has become a primary tool for financial institutions to evaluate credit risk, improve cash flow, reduce possible risks, and make managerial decisions (Thomas et al, 2002). Credit scoring is the set of decision models and their underlying methods that help lenders determine whether credit should be approved to an applicant. The ultimate goal of credit scoring is to assess credit worthiness and discriminate between 'good' and 'bad' debts, depending on how likely applicants are to default with their repayments (Lim and Sohn, 2007).

From the seminal reference to credit scoring in the introductory paper by Altman (1968), many other developments have been subsequently proposed (Baesens et al, 2003; Bahrammirzaee, 2010; Abdou and Pointon, 2011). After the Basel II recommendations issued by the Basel Committee on Banking Supervision in 2004 in the United States, it has become almost a regulatory requirement for banks and financial organizations to utilize advanced credit scoring models in order for enhancing the efficiency of capital allocation. The effects of Basel II on the competitive advantage of an institution are so

large that research on the adequacy, applicability, and validity of the adopted systems is set to be a cardinal research initiative (Crook et al, 2007).

Information system literature often views data, information, and knowledge as an interrelated hierarchy (Tuomi, & Ilkka, 2000). According to (Simatupang, & Sridharan, 2001), meaning attached to data leads to information and information can be used to create knowledge. Data form a representation of the real world such as events, phenomena, attributes, names, and so forth. They may be presented as alphas, numeric, alphanumeric, or pictures that exist on paper and in databases. Data become information when people acquire them in the course of their daily activities and assign meaning to them through interpretation. Information exists in the collective mind of people.

Information becomes knowledge when a person internalizes it to a degree that it is available for immediate use for problem solving or explanation. ( Simatupang, & Sridharan, 2001) further states that Information sharing facilitates data collection, documentation, and the storing, retrieving, and transferring of private information. (Bao , & Bouthillier, 2007), Information-sharing behavior is a type of information behavior in which two groups of actors who are connected by a certain type of relationship collaborate to exchange information in order to achieve individual or common interests.

## **2.6 The Role of Credit Reference Bureaus in Credit Information**

### **Sharing**

Consumer credit bureaus are organizations that compile and disseminate reports on the creditworthiness of consumers (Jappelli & Pagano, 2002). Firms that lend to consumers provide the underlying data to the bureaus. In the United States today, there is at least one credit bureau file, for every credit-using individual in the country. Over 2 billion items of information are added to these files every month, obtained from 30,000 lenders and other sources, and over 3 million credit reports are issued every day. In many instances, real-time access to credit bureau information has reduced the time required to approve a loan from a few weeks to just a few minutes.

A consumer credit report typically includes four kinds of information. First, there is identifying information such as the person's name, current and previous addresses, Social Security number, date of birth, and current and previous employers. Next, there is a list of credit information that includes accounts at banks, retailers, and lenders. The accounts are listed by type, the date opened, the credit limit or loan amount, outstanding balances, and the timeliness of payments on the account. There may also be information gleaned from public records, including bankruptcy filings, tax liens, judgments, and possibly arrests or convictions. The file will typically include a count of the number of inquiries authorized by the consumer but will not contain any information about applications for credit or insurance that were denied (Cayseele, Bouckaert and Degryse 1995).

Nowadays, there is hardly a country that does not have a credit information sharing system in place, whilst international organizations such as the World Bank are working to implement at least one in those few emerging economies that still do not have one (Andreeva, Ansell, & Crook, 2004). Such systems have integrated themselves thoroughly in the credit granting practices of western economies, at times differing from country to country only for some minor aspect. In general terms, though, it may be synthesized that Credit Reference Agencies (CRAs) collect a variety of both positive and negative financial information on individuals, producing a so-called 'credit report' that contains details of the payment and credit history of an individual, his or her financial accounts and the way these have been managed, as well as other information of interest to the credit industry.

Source and type of data normally include detailed information about mortgages, bank accounts, store cards, charge cards, credit cards, loan accounts, and in many jurisdictions even mail order accounts as well as telecom and other utilities accounts (Avrey, Calem & Canner, 2004). Such information, then, is usually integrated with data from other sources, such as, for example, electoral rolls, Court judgments, bankruptcies and voluntary arrangements, and other private information provided by other organizations, which compile additional information referring to an individual, thus forming a single file. Significantly, consumer credit reporting is not mandated by law and the underlying sharing devices rely on the voluntary provision to CRAs of customers' data from an indefinite number of lenders, which in turn are the same CRAs' own clients (Bradford, 2004). CRAs ultimately maintain a full data sharing mechanism based on the collection

of information from the various lenders about their customers and, at the same time, supply for a fee those same lenders with consumer credit reports. As CRAs rely on the voluntary provision of data by their client members, they also rely on the reporting lending institutions to voluntarily review and correct erroneous data (Jappelli & Pagano, 2002).

CRAs have evolved as organizations providing information sharing devices in the financial system in order to meet the problem of asymmetrical information between borrowers and lenders (Love & Mylenko, 2003). By making available rapid access to standardized information on potential borrowers, they represented the response to the demands of the market for such type of data, i.e. the needs of banks and other financial intermediaries. The rapid development and sophistication of information systems and highly technological statistical models, coupled with the increasing competition between lenders and issues of borrowers' indebtedness, have made data sharing mechanisms in the credit market a topic of recent interest among academics in a number of disciplines (Dell'Ariccia, 2001).

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

This chapter sets out various stages and phases followed in completing the study. It involves a blueprint for the collection, measurement and analysis of data. It discusses on the approach that was applied to conduct the research. It was composed of the research design, data collection and data analysis.

#### **3.2 Research Design**

Research design refers to the methods and procedures that are to be followed in order to conduct the study. The research design for this study was case study. This is based on the fact that the unit being analyzed is one organization. Case studies allow an investigation to retain its holistic and meaningful characteristics based on real life events. The primary data applied in the study was more reliable and up to date. A case study design is most appropriate where a detailed analysis of a single unit of study is desired as it provides focused and detailed insight to phenomenon that may otherwise be unclear.

In this regard the importance of a case study is emphasized by (Young, 2001) and (Kothari, 2006), who both acknowledge that, a case study is a powerful form of qualitative analysis that involves a careful and complete observation of a social unit, irrespective of the type of unit under study. The study involved a complete and careful observation of the social units.



This research was conducted through a case study aimed at determining the effects of implementation of credit rating scoring strategies in National Industrial Credit Bank as well as the response strategies to application of credit score rating challenges. The case has been chosen since it enables the researcher to have an in-depth understanding of the implementation of credit rating scoring strategies at National Industrial Credit Bank. The main aim of this study was qualitative. The research design emphasized on the full analysis of the study based on a limited number of interrelations. This is based on its depth rather than breadth nature.

### **3.3 Data Collection Method**

Executive management at National Industrial Credit Bank which comprises of 7 executives was interviewed directly using an already set interview guide so as to access their opinion on what they perceived to be the implementation of credit rating scoring strategies and the measures they have taken to mitigate the application of credit score rating challenges. The study used primary data that was collected using interview guide containing both structured and unstructured questions.

### **3.4 Data Analysis and Presentation**

Both the primary and secondary data was qualitative in nature. Given this fact, content analysis was used to analyze the data. Content analysis is a technique for making inferences by systematically and objectively identifying specified characteristics of messages and using the same to relate trends. The data obtained was compared with existing literature in order to establish areas of agreement and disagreement. After the

data has been collected, it was edited, coded, ranked, classified and tabulated following the variables in the study. Data classification reduced data into homogeneous attributes that enable establishment of meaningful relationships between variables.

Descriptive statistics was used to summarize general information as well as challenges affecting application of credit rating scoring at National Industrial Credit Bank. Mean scores were used to determine the relationship that exists between the research question and the collected data. Descriptive statistic using mean and mode was be used to understand and interpret variables. Data was consolidated, content analyzed and narrative report used to depict interview's views.

## **CHAPTER FOUR**

### **DATA ANALYSIS AND PRESENTATION OF FINDINGS**

#### **4.1 Introduction**

The research objective was to establish the application of credit rating scores by the National Industrial Credit Bank; the chapter presents the analysis and findings with regard to the objective and discussion of the same. This chapter discusses the interpretation and presentation of the research findings drawn from the research instrument by way of data analysis. This chapter presents the analysis and findings of the study as set out in the research methodology. The study findings are presented on the implementation of credit rating scoring by commercial banks in a case study of the National Industrial Credit Bank.

#### **4.2 The Interviewees' Profile**

The interview's comprised of the top management at NIC bank, some of whom were instrumental in the adoption of credit scores by NIC bank. The respondents comprised top level managers of the bank and the researcher managed to interview seven top level managers at the bank. Most of the interviewees had worked over a period of five years in the organization a condition that showed they were knowledgeable enough for the research. In-depth information was gathered from senior most managers of the NIC bank. The management teams interviewed are directly responsible for adoption of credit scores at the National Industrial Credit Bank.

#### **4.2.1 Gender of Interviewees**

The study sought to find out the gender of the respondents. Gender was important in the study because gender will enable us to deduce how the different genders of respondents perceive the challenges of strategy implementation. It was noted from the study that five of the respondents were male while two were female. The male interviewees were noted to carry approximately seventy one percent of the total interviewees while the female interviewees carried approximately twenty nine percent of the interviewees. The findings indicate that males are more than females but the difference is not significant enough to skew the findings based on gender imbalance.

#### **4.2.2 Years of service with the National Industrial Credit Bank**

The study sought to establish the length of service for the respondents. The length of service is important for this study so as to establish for how long the employee has been working in the organization. This is because the longer an employee has worked for the organization, the more conversant he/she was with the organization's policies and practices. Approximately twenty nine percent of the interviewees had worked for 3-5 years; forty two percent had worked for between 6-9 years, while approximately twenty nine percent of the interviewees reported having worked for 10 or more years. This shows that the organization maintains a combination of both new and experienced workers to ensure faster induction, succession planning, training and multi-generational interactions at the workplace. Secondly, majority of the respondents have worked for above 5 years which is an indication of a motivated and dedicated workforce. The study

concludes that the length of service is significant towards implementation of credit rating scoring strategies at the National Industrial Credit Bank in Kenya.

### **4.2.3 Level of Education**

The interview sought to establish the level of education of the interviewees. From the interview guide it was evident that majority of the interviewees had a post graduate qualification as their highest education level. This was noted to tie with the interviewees who specified their highest level of education to be a master's degree. Interviewees who stated that their highest level of education was a bachelor's degree had a frequency of only one. From the analysis of the interview guide, it was evident that there was no interviewee out of those in the study who stated that they had a diploma as their highest level of education. From this we can deduce that the interviewees were well educated and knowledgeable and had the capability of answering the questions pertaining to application of credit rating scoring at NIC bank. We can also come to the conclusion that the interviewees had gone further to master in business and finance related courses.

### **4.3 Variables Influencing the Application of Credit Rating Scoring Strategies**

This section sought to establish the factors that may influence effective application of credit scores by commercial banks in Kenya; in the case study of National Industrial Credit Bank. The interviewer noted four major variables that seemed to influence the implementation of credit rating scoring at National Industrial Credit Bank. The variables established were mainly competition within the banking industry, technological

advancement, leadership within the bank and change in management. Proper consideration of these variables will lead to effective implementation of credit rating scoring strategies. Each of the variables was studied in detail in the next sub headings.

### **4.3.1 Competition in the Industry**

The interview guide sought response on the effect of competition in application of credit rating scoring strategies at National Industrial Credit Bank. It was noted from the analysis that majority of the respondents agreed that competition within the industry had a significant influence on the application of credit rating scoring strategies at NIC bank. The interviewees observed that increased competition reduces intermediaries' rents and decreases their overall incentives to generate information, thereby affecting both the pricing and the allocation of credit.

The interviewees noted that these effects have two direct consequences. First, intermediaries compete more aggressively because the reduction in private information for each bank implies that their competitors suffer less from adverse-selection problems. Second, however, less information production means that banks are more prone to make errors in their lending decisions as competition intensifies.

The study noted that intermediaries devote too many resources to screening activities relative to the social optimum. This over investment occurs because all banks attempt to gain market share from their rivals through their investments in information acquisition. Because all banks follow similar strategies, they invest too much in screening without effectively increasing their captive market inequilibrium. These results suggest that

policies that constrain banks' ability to invest in information may in fact increase social welfare by reducing the resources spent on these activities. The interviewees also noted that banks compete for borrowers by deciding whether to screen a loan applicant, whether to offer credit, and on what terms. Lastly, borrowers choose the bank with the best quote and therefore competition within the banking industry is definitely noted to affect the adoption of credit rating scores strategies at National Industrial Credit Bank.

#### **4.3.2 Technology in Adoption of Credit Rating Scoring Strategies**

The study enquired the influence technological advancement in the adoption of credit rating scoring strategies at National Industrial Credit Bank. The interviewees noted that over the last two decades, consumer lending has become increasingly sophisticated as lenders have moved from traditional interview-based underwriting to a reliance on data-driven models to assess and price credit risk. The interviewees also observed that despite the availability of new credit scoring data and analytics, loan underwriting has become costly because lenders have been focused on new regulatory compliance requirements that consume information technology (IT) spending resources. The interviewees also agreed that NIC Bank need add credit scoring technology to their IT and find solutions that are relatively easy to operationalize.

The interviewees also agreed that in today's increasingly complex credit and compliance risk management environment, lenders are already inundated with IT projects to collect new data and documents, integrate ancillary systems into their core loan origination system (LOS), and implement new risk management calculations and processes.

Fortunately, systems changes to order, obtain, and process supplemental credit bureau information can be straightforward. Many leading LOS vendors have already modified their systems to store and utilize supplemental bureau information. Minor modifications are required, such as new data field definitions, screen/web page view, storage, and a new document type to incorporate the supplemental credit report. Next, lenders can modify an existing interface used to order credit reports from the two primary credit bureaus or credit reporting companies. Organizations using a standardized, merged format for their credit reports today may be able to incorporate supplemental data with minimal IT effort if the data is incorporated into the standardized format.

The level of technology advancement and adoption in NIC bank influence the adoption of credit rate scoring strategies at NIC Bank.

#### **4.3.3 Leadership in Adoption of Credit Rating Scoring Strategies**

From the study majority of the interviewees noted that leadership was an important factor to adoption of credit rating scoring strategies at NIC bank. The interview guide results indicated that there is a general consensus that leadership is at the core of the implementation of credit rating scoring strategies at the bank. The study noted that while the strategic plan may have good ideas and guidelines, the challenge is in translating the ideas and following the guidelines that lead to a concerted well guided effort to lead the change. According to Kroon (2005), leadership is the human factor that leads an institution towards realizing goals through voluntary co-operation of all the people in the business. The interviewees consented to the fact that an organization often succeeds or fails because of the presence or absence of good leadership.



The interview results also pointed out that leadership consists of the interaction between personalities and circumstances, as interpreted by the group. The interview results noted that there exists a particular relationship develops between a leader and his followers. The relationship implies that subordinate willingly strive to achieve the leaders aims and that leaders influence their subordinates. The leader also determines how subordinate should carry out assignments. In such a case subordinate are urged to a level of activity that they themselves never thought possible.

The interviewees noted that an essential part of management is co-ordinating the activities of people and guiding their efforts towards the goals and objectives of the organisation. The study noted that this involves the process of leadership and the choice of an appropriate form of action and behaviour. Leadership is noted to be a central feature of organisational performance. The manager must understand the nature of leadership influence and factors which determine relationships with other people, and the effectiveness of the leadership relationship.

The interviewees agreed that the manager's responsibility lies in the use of power in such a way that subordinates are influenced to work harder and strive to achieve mutual objectives. The interviewees agreed also that leadership depends on an ability to acquire and use power from both positional and personal sources. The interviewees therefore generally accepted on the fact that effective adoption of credit rating scoring strategies is influenced by the leadership exercised by the top level management of the bank. If taken

into consideration, leadership may prove to be an important tool in the implementation and adoption of credit rating scoring strategies at National Industrial Credit Bank.

#### **4.3.4 Effects of Organizational Culture to the Adoption of Credit Rating Scoring**

The study also sought to establish the effects of the organizational culture in the implementation of strategies at NIC bank. The interviewees noted that for a strategy within an organization to develop and be implemented successfully, it must fully align with the organizational culture. The interviewee also noted that culture dictates what groups of people pay attention to. It guides how the world is perceived, how the self is experienced and how life itself is organized. This is noted to go in accordance with Kroon (2005) who indicates that management philosophy determines the business culture. Each business has its own culture, just as each individual has his or her own personality. Business culture is the shared values, expectations and norms that are established in a business over time. It determines how things are done in the business, for example how problems are approached and priorities determined in the execution of the work. Successful implementation of a strategy demands a compatible business culture.

Culture, the interviewees added provides overall framework for strategy implementation, however it is not in itself sufficient to ensure successful execution. Within the organizational culture, individuals, groups and units are the mechanisms of organizational action, and the effectiveness of their actions is a major determinant of successful implementation. In this context, two basic factors encourage or discourage effective action-leadership and culture.

The study noted that the organizational culture was so impacting that it can result to the success or failure of an organization. This was noted by the high level of agreement in the responses from the interviewees on the statement; a strong organizational culture is one of the most sustainable competitive advantages a company can have. This also goes in accordance with Burnes (2003) suggested that the strategic management of change is 'essentially a culture and cognitive phenomenon' rather than an analytical, rational exercise. Clarke (2004) stated that the essence of sustainable change is to understand the culture of the organization that is to be changed. If proposed changes contradict cultural biases and traditions, it is inevitable that it will be difficult to embed the changes in the organization. The study therefore noted that the organizations' culture if not taken into a keen consideration and all its factors taken into account, it may consequently prove to be a challenge in efficient implementation of strategies at NIC bank.

#### **4.4 Other Challenges of Application of Credit Scoring Rating at NIC bank**

According to the interviewees, NIC bank faces other challenges in the implementation of its strategies in addition to those explained above. At NIC Bank, the interviewees identified different factors that have hindered effective strategy implementation. These challenges as indicated by the interviewees ranged from: high cost of operation, organizational structure, inadequate resources, sophisticated customers, product differentiation, and political environment.

## **CHAPTER FIVE**

### **SUMMARY, CONCLUSIONS AND RECOMMENDATIONS**

#### **5.1 Introduction**

This chapter provides a summary of the findings, conclusions and recommendations of the Implementation of Credit Rating Scoring Strategies at NIC Bank and what NIC Bank is doing to overcome the challenges. Based on the above objectives, data was collected and analyzed using content analysis. This chapter also includes a section on limitations of the study and recommendation for further research. This chapter provides the summary of the findings from chapter four, and it also gives the conclusions and recommendations of the study based on the objectives of the study. The objective of this study was to determine factors affecting implementation of credit rating scoring strategies at NIC Bank.

#### **5.2 Summary of Findings**

The study inquired on how implementation of credit scoring rating strategies affects NIC bank. From the study it was noted that majority of the respondents agreed that competition within the industry had a significant influence on the implementation of credit rating scoring strategies at NIC bank. The interviewees observed that increased competition reduces intermediaries' rates and decreases their overall incentives to generate information, thereby affecting both the pricing and the allocation of credit. The interviewees also noted that Banks compete for borrowers by deciding whether to screen a loan applicant, whether to offer credit, and on what terms. Lastly, borrowers choose the bank with the best quote and therefore competition within the banking industry is

definitely noted to affect the adoption of credit rating scores strategies at National Industrial Credit Bank.

The study enquired the influence technological advancement in the adoption of credit rating scoring strategies at the National Industrial Credit Bank. The interviewees noted that over the last two decades, consumer lending has become increasingly sophisticated as lenders have moved from traditional interview-based underwriting to a reliance on data-driven models to assess and price credit risk. The study therefore noted that the level of technology advancement and adoption at NIC bank influence the adoption of credit rate scoring strategies in NIC Bank.

From the study majority of the interviewees noted that leadership was an important factor to adoption of credit rating scoring strategies at NIC bank. The interview guide indicated that there is a general consensus that leadership is at the core of the implementation of credit rating scoring strategies at the bank. The study noted that while the strategic plan may have good ideas and guidelines, the challenge is in translating the ideas and following the guidelines that lead to concert well guided effort to lead the change.

The study also sought to establish the effects of the culture in the implementation of strategies at NIC bank. The interviewees noted that for a strategy within an organization to develop and be implemented successfully, it must fully align with the organizational culture. Therefore for effective adoption of credit rating scores, the culture of the bank should be taken into consideration.

### **5.3 Conclusion of the Study**

The study concludes that there were various challenges affecting NIC bank in its implementation of credit score rating strategies. These included structure, culture, technology, leadership, competition in the industry, high cost of operation, political environment and inadequate resources.

The study concludes that the organization had in a way been able to amend its implementation of credit score rating strategies as per the challenges. This was through application of all management functions that is planning, controlling, organizing, motivating, leading, directing, integrating, communicating, and innovation to the implementation process.

From the findings, the study also concluded that over 90% of the challenges faced by NIC bank while implementing their strategy are largely attributable to the internal environment. These challenges revolve around the organizational resource and organizational processes. This clearly shows that managers place little or no emphasis on implementation phase while they are drafting their strategies. Most of these challenges are avoidable if they have been accounted for during the analysis and formulation stages. It is obvious that many strategies fail to realize the anticipated benefits due to challenges encountered during implementation. The study also concludes that for a successful strategy implementation, firms in Kenya should adopt such measures as; spending more time on analysis so as to identify problems that could surface in implementation phase.

## **5.4 Recommendations for Policy and Practice**

The study recommends that in order for NIC bank to be able to effectively implement their strategies, there is need to have an organized organizational structure, improved information systems, improved leadership styles, timely assignment of key managers, effective budgeting and offer rewards, and control systems.

The study also recommends that the management appoints a small number of professional staff but effective instead of having a big pool of people who may not be in a position to deliver on the strategy. The recruit of some employees can be outsourced to professional recruiters. Communication channels within the organization should be improved from top to bottom such that there is flow of decisions from the management to employees. It is also recommended that the management consults the employee representatives whenever they want to implement a strategy so that there is no resistance on the part of the employees as this can delay the achievement of desired objectives.

Managers in organizations in Kenya should put more emphasis on planning phase and strategy analysis. This will make them be aware of the challenges that may surface during implementation period. They should also have a flexible strategy that can be changed or adjusted based on the strengths, weakness, opportunities and threats, arising in the environment. All stakeholders should be included within and outside the organization during the strategic planning process and get their input. Communication is one of the key requirements for effective strategy implementation. Organizations should therefore be structured in a way as to open all the communication channels in the organizations. Roles should be defined clearly to remove ambiguity.

## **5.5 Limitations of the Study**

Data collection was a bit of a challenge due to tight schedules by the interviewees, some interviewees were skeptical about the purpose of the research hence took time to answer, non-responsive interviewees failed to respond to questions adequately due to fear of the unknown or fear of discrimination.

Every study inevitably encounters certain levels of limitations due to a variety of factors. Resource availability both in time and finances constrained researchers. Respondents who are chief executives or senior managers are usually very busy hence the tendency not to give in-depth attention to the interview process. Interviewing managers at this level in organization on strategy implementation is like asking them for a self-evaluation, expected responses therefore are likely to be more positive than the true situation.

The study focused only on the implementation of credit scoring rating strategies at NIC Bank. Thus it did not focus on other aspects of the strategic management process which includes formulation as well as the control, monitoring and evaluation aspects. These are important components of the strategic management process and should therefore not be ignored. The study was also limited by financial and time constraints. The period over which the study was to be conducted was short, hence exhaustive and therefore comprehensive research could not be undertaken on the challenges of implementation of credit scoring rating strategies at NIC bank.



## **5.6 Suggestions for Further Research**

Implementation of credit scoring rating is widely embraced in the developing countries such a Kenya. In Kenya, it has gained acceptance mainly in the banking industry, however other financial institutions such as SACCOs are slow in incorporating it as a key management strategy in lending. Given that this study only covered implementation of credit score rating strategies at NIC Bank, studies need to be done on challenges of implementation of credit score ratings strategies in other financial organizations that offer credit facilities.

The study also recommends further studies should be carried out to determine the impact of external factors as a major challenge to the implementation of credit rating scores in financial institutions. These studies should find out the success factors in credit rating score strategies implementation. This can then be used by other financial firms that are carrying out implementation of credit score rating strategies to ensure they come out successful.

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## APPENDICES

### APPENDIX I: LETTER OF INTRODUCTION

Dear Respondent,

#### **RE: DATA COLLECTION**

This interview guide is designed to gather information on “Implementation Credit Rating Scoring Strategies at NIC Bank”. The study is being carried as a research project in partial fulfillment of the requirements for the award of the degree of Master of Business Administration at the School of Business University of Nairobi.

The information in the interview guide is treated with utmost confidentiality and at no instance will your name be mentioned in this research. The information will not be used for any other purpose other than for this research.

A final copy of the report was available to you at your request.

Your assistance in facilitating the same was highly appreciated.

Yours sincerely,

.....

Clive Asande

Student.



## APPENDIX II: INTERVIEW GUIDE

Interviewee's managerial position: \_\_\_\_\_

1. Interviewee's gender: \_\_\_\_\_
2. Level of education: \_\_\_\_\_
3. Years with the bank : \_\_\_\_\_
4. Years in the current position: \_\_\_\_\_
5. What is your role in the bank's business strategic position?
6. What factors did NIC Bank consider in its implementation of credit rating scoring strategies?
7. How do the following factors influence the credit rating scoring strategies?

Explain.

- a. Competition in the industry
- b. Technology
- c. Leadership
- d. Change management
- e. Customer needs and preferences
- f. Substitute products/services

Any

other.....?

8. What has been the implication of the adoption of credit rating scoring strategies on the banks operations?

9. How has the bank been able to amend its implementation of credit score rating process as per the factors explained in (8) above?
10. Overall, how effective is the adoption of credit rating scoring strategies relative to the banks mission, vision and objectives?