THE RELATIONSHIP BETWEEN TECHNIQUES FOR MANAGING NON PERFORMING LOANS AND THE LEVEL OF NON PERFORMING LOANS OF COMMERCIAL BANKS IN KENYA

BY,

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DECLARATION

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

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DEDICATION

This research study is dedicated to my parents Mr. Stephen Kiragu and Mrs. Nancy Kiragu, my brothers and sister, friends and relatives for their moral support throughout the entire MBA program and especially during this research project.

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TABLE OF CONTENTS

Declaration ii

Dedication iii

Acknowledgement iv

Table of contents v

List of tables viii

List of Figures ix

Abstract ..... **x**

CHAPTER ONE 1

INTRODUCTION 1

1.1 Background of the study 1

1.1.1 Non performing loans 2

1.1.2 Management of non-performing loans in commercial banks 3

1.1.3 Commercial banks in Kenya 5

1.2 Statement of the problem 5

1.3 Research questions 7

1. 4 Objectives of the study 7

1.4.1 General objectives 7

1.4.2 Specific objectives 7

1.5 Importance of the study 7

CHAPTER TWO 9

LITERATURE REVIEW 9

2.1 Introduction 9

2.2 Causes of non performing loans 9

2.2.1 Lack of balance mechanism for power and weak monitoring system 12

2.2.2 Decentralized operation management mode, and missing capital restriction mechanism 13

2.2.3 Lack of internal revenue distribution process, performance assessment mechanism and accountability system 14
2.2. 4. Rigid human resource management system 15
2.3 Classification of non-performing loans 15
2.4 Theories of non performing loans 16
2.4.1 Agency theory 16
2.4.2 Transaction cost theory 17
2.5 Empirical review on non performing loans 17
2.6 Non performing loans in Kenya 21
2.7 Non performing loans management techniques 23
2.7.1 Transforming the operation mechanism comprehensively 23
2.7.2 Adoption of centralized, specialized and scientific management 24
2.7.3 Independent credit review 24
2.7.4 Establishment of professional teams 25
2.7.5 Borrowers personality profile assessment 25
CHAPTER THREE 28
RESEARCH METHODOLOGY 28
3.1 Introduction 28
3.2 Research design 28
3.3 Target population 28
3.4 Validity 28
3.5 Reliability of instruments 29
3.6 Data collection instruments 29
3.7 Data analysis 29
CHAPTER FOUR 31
DATA ANALYSIS AND INTERPRETATION OF FINDINGS 31

4.1 Introduction 31

4.2 General information 31

4.2.1 Distribution of respondent by gender 31

4.2.2 Distribution of respondent by age 32

4.2.3 Respondent level of education 33

4.2.4 Working period 34

4.3 Problem of non performing loan 35

4.3.1 Extent of factors that causes non-performing loans 36

4.3.2 Factor contributes most to non-performing loans 38

4.3.3 Management techniques for non-performing loans 39

4.3.4 Importance of managing non-performing loans 41

4.4 Regression analysis 41

CHAPTER FIVE 46

SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS 45

5.1 Introduction 45

5.2 Summary of findings and conclusions 45

5.2.1 Summary of findings 45

5.2.2 Conclusions 48

5.3 Recommendations 49

5.4 Limitations of the study 50

5.5 Suggestions for further research 51

REFERENCES 52

APPENDICES 60

Appendix 1: Letter of introduction 60

Appendix I1: Questionnaire 61

Appendix III: List of commercial banks in Kenya 65

LIST OF TABLES

Table 4.1: Age of the respondents.. 32

Table 4.2: Working period 34

Table 4.3: Extent of factors that causes non performing loans 36

Table 4.4: Factors that contributes most to non performing loans.. 38

Table 4.5: Management techniques for non performing loans.. 39

Table 4.6: Model summary 42

Table 4.7: Regression coefficients results... 42

LIST OF FIGURES

Figure 4.1: Gender of the respondent 31

Figure 4.2: Respondent’s level of education 33

Figure 4.3: Extent to which non performing loans lead banks failure 35

ABSTRACT

It is argued that non-performing loans are one of the major causes of banks failure and hence economic stagnation. In response to the problem of non-performing loans, banks have to adopt effective management techniques for non performing loans. This study sought to establish the relationship between techniques for managing non performing loans and the level of non performing loans of commercial banks in Kenya.

Causal design was chosen as the study sought to establish the relationship between techniques for managing non performing loans and level on non performing loans of commercial banks in Kenya. Causal design was chosen because it enables the researcher to generalise the findings to a larger population. The population of this study consisted of all the forty three commercial banks in Kenya. Primary data was collected using structured questionnaires while secondary data was collected from journals, magazines and banks' annual reports. To enhance reliability of data, test-retest method was used by administering questionnaires twice to the same respondents.

The research used both quantitative and qualitative data and statistical package for social sciences (SPSS version 17) package was used for data analysis. Regression analysis was used to establish the relationship between techniques for managing non performing loans and the level of non performing loans of commercial banks in Kenya.

The study concludes that effective management of non performing loans in commercial banks helps to improve the financial performance of banks as interest on loans is the biggest income of banks and increases the liquidity position of banks, helps in protecting the banks reputation and reduces loan losses and leads to quality of loan portfolio for better return to the shareholders and it reduces time wastage on unproductive resources being diverted towards loan recovery whereby such resources can be channelled to other more productive areas.

The study also concludes that non performing loans leads to commercial banks failure to a greater extent, banks experiences borrower's inability to pay loans due to business failure and also the challenge of the institutions not having an effective follow up in the arrears.

The study further concludes that there is a negative relationship between techniques for managing non performing loans and the level of non-performing loans of commercial banks in Kenya, which implies that effective techniques of managing non performing loans leads to decrease in the level of non performing loans in commercial banks.

CHAPTER ONE

INTRODUCTION

1.1 Background of the study

While non-performing loans are a phenomenon that is permanently present in the balance sheets of banks and other lending institutions, the significant rise of non-performing loans in banks' balance sheets and the emergence of a non-performing loan (NPL) market are a temporary phenomenon. Several economies have experienced such distressed debt cycles. In the USA, the non and sub-performing loans resolution was embedded into the savings and loans crisis from 1989 to 1994. In Japan, the NPL cycle began in 1997, China and the rest of Asia has dealt with non performing loans and SPLs since 1999. In Germany, the first publicly known transaction occurred in 2003 (Herr and Miyazaki, 1999). The issue of non-performing loans (NPLs) has gained increasing attentions in the last few decades.

The immediate consequence of large amount of NPLs in the banking system is banks failure. Non-performing loans in commercial banks are one of the major causes of the economic stagnation problems in developing countries Kenya included. Each non-performing loan in the financial sector is viewed as an obverse mirror image of an ailing unprofitable enterprise. From this point of view, the eradication of non-performing loans is a necessary condition to improve the economic status of a country and lender commercial banks profitable. The most profound impact of high non-performing loans in banks' portfolio is reduction in the banks' profitability especially when it comes to their disposals. According to the International Monetary Fund (IMF 2002), banks' net profits had been sluggish for the last ten years. According to Nagarajan (2003), a general awareness of the significance of structured risk management system is discernible. In the wake of mounting level of non-performing loans and sporadic instances of scams and systemic hiccups, the area of risk management has caught the closer attention of regulators. He points out that the Reserve Bank of India has set out detailed guidelines for the management of credit risk.

Commercial Banks in Kenya need not be contented with traditional measures such as exposure limits and credit rating, and are in the process of overhauling their entire system of

risk management. Banks need to move towards Risk-Adjusted Return on Capital framework for appraising loans which calls for data on portfolio behavior and allocation of capital commensurate with credit risk inherent in loan proposals (Nagarajan, 2003). Goulet and David (1996) stated that the banking industry has changed dramatically over a relatively short period, from being a virtual cartel to a highly competitive market. Financial deregulation and increasing globalization have brought new competition to domestic banking, and allowed considerable diversification by banks, insurance companies and co-operatives. Information technology has provided many opportunities for creating new financial products and distribution methods, for example Automatic Teller Machines (ATMs), Telephone Banking and Computer Banking, and reduced the need for investment in conventional branch infrastructure (Goulet and David 1996).

1.1.1 Non performing loans

There is no global standard to define non-performing loans at the practical level. Variations exist in terms of the classification system, the scope, and contents. Such problem potentially adds to disorder and uncertainty in the NPL issues. Se-Hark Park (2003), during 1990s, there were three different methods of defining non-performing loans in Japan: the 1993 method based on banking laws; the "Bank's Self-Valuation" in March 1996; and the "Financial Revival Laws-Based Debt Disclosure" in 1999. These measurements have gradually broadened the scope and scales of the risk-management method. Similar to the trend in Japan, more countries, regulators, and banks are moving towards adopting and adapting better and more consensus practices. For example, in the U.S., federal regulated banks are required to use the five-tier non-performing loan classification system according to BIS which are Pass, Special mention, Substandard, Doubtful, and Loss. The five-tier system is the most popular risk classification method, or, in some cases, a dual system of reporting according to their domestic policy guidelines as well as the five-tier system (Herr and Miyazaki 1999).

The immediate consequence of large amount of non-performing loans in the banking system is bank failure. Many researches on the causes of bank failures find that asset quality is a

statistically significant predictor of insolvency (Siems 1994), and that failing banking institutions always have high level of non-performing loans prior to failure.

It is argued that the non-performing loans are one of the major causes of the economic stagnation problems. The occurrence of non performing loans in the banking sectors is a clear indicator that banks' profitability will decline. From this point of view, the eradication of non-performing loans is a necessary condition to improve the banks' performance and consequently improve country's economic status (Kieso et al., 2001).

Non-performing loans can lead to efficiency problem for the banking sector. It is found by a number of economists that failing banks tend to be located far from the most-efficient frontier, because banks do not optimise their portfolio decisions by lending less than demanded. What is more, there is evidence that even among banks that do not fail; there exist a negative relationship between the non-performing loans and performance efficiency (Krueger et al, 1999).

1.1.2 Management of non-performing loans in commercial banks

Since banking crises in emerging economies has multiple causes, there is no single solution to their occurrence (Tirapat 1999). However, Goldstein and Turner (1996) suggest that there are several measures that can significantly reduce the incident of each of the factors underlying banking crises. For example, greater macroeconomic stability, the wider use of market-based hedging instruments and higher levels of bank capital would help to make the consequences of non performing loans in the domestic banking system less damaging. Limiting the allocation of bank credit to particularly interest-rate-sensitive sectors, close monitoring of lending by weakly capitalized banks and employing the right mix of macroeconomic and exchange rate policies would similarly limit vulnerability to lending booms, asset price collapses and surges of capital inflows, (Goldstein and Turner, 1996). Strict asset classification and provisioning practices could reduce the increases of bad loans and protection against loan losses. Tirapat (1999) agrees with Goldstein and Turner on the role of Government in determining to a great extent the success of efforts to managing such crises. It starts out by reviewing the banking structure, problems faced and some of the

causes of recent banking crises. According to the Bank of Japan (2003), the remedies to the problem of Non-performing loans can be grouped into three broad categories, all of which work towards enhancing the banks' earning power. First is to further improve efficiency through cost reduction. Secondly is to pursue a new lending strategy backed by appropriate credit risk evaluation, and third is to provide new financial services to increase fee income.

From an accounting perspective, loans should be recognized as being impaired and necessary provisions should be made, if it is likely that the bank will not be able to collect all the amounts due, principal and interest according to the contractual terms of the loan agreement(s). Loan loss provisioning is thus a method that banks use to recognize a reduction in the realizable value of their loans. Bank managers are expected to evaluate credit losses in their loan portfolios on the basis of available information, a process that involves a great deal of judgement and is subject to opposing incentives. Sometimes banks may be reluctant to account for the whole amount of incurred losses because of the negative effect of provisions on profits and on shareholders' dividends. In other cases, if provisions are tax-deductible, banks have an incentive to overstate their loss provisions and to smooth profits over time in order to reduce the amount of tax liability (Laurin and Majnoni, 2003).

Making provision stemmed from the credit transactions such as credit sales. Sales on any basis other than for cash make possible the subsequent failure to collect the account. An uncollectable account receivable is a loss of revenue that requires, through proper entry in the accounts, a decrease in the asset accounts receivable and a related decrease in income and stockholders' equity. Recording the bad debt expense recognizes the loss in revenue and the decrease in income. Of the two methods of recording uncollectible accounts receivable, the allowance method is appropriate in situations where it is probable that an asset has been impaired and that the amount of the loss can be reasonably estimated since the collectability of receivables is considered a loss contingency. A receivable is a prospective cash inflow, and the probability of its collection must be considered in valuing this inflow (Kieso et al., 2001).

1.1.3 Commercial banks in Kenya

The Companies Act, the Banking Act, the Central Bank of Kenya Act and the various prudential guidelines issued by the Central Bank of Kenya (CBK), govern the Banking industry in Kenya. The banking sector in Kenya was liberalised in 1995 and exchange controls lifted. The CBK, which falls under the Ministry for Finance's docket, is responsible for formulating and implementing monetary policy and fostering the liquidity, solvency and proper functioning of the financial system. The CBK publishes information on Kenya's commercial banks and non-banking financial institutions, interest rates and other publications and guidelines. Commercial banks have come together under the Kenya Bankers Association (KBA), which serves as a lobby for the banks' interests and addresses issues affecting its members (Kenya Bankers Association Annual Report, 2008).

There are forty three commercial banks, fifteen micro finance institutions and forty-eight foreign exchange bureaus in Kenya. The banking industry in Kenya is dominated by a few large banks most of which are foreign-owned, though some are partially locally owned. Nine of the major commercial banks are listed in the Nairobi Stock Exchange. Commercial banks and non-banking financial institutions offer corporate and retail banking services but a small number, mainly comprising the larger banks, offer other services including investment banking (Kenya Bankers Association Annual Report, 2008).

1.2 Statement of the problem

According to Brown Bridge (1998), most of the bank failures were caused by non-performing loans. Arrears affecting more than half the loan portfolios were typical of the failed banks. Many of the bad debts were attributable to moral hazard which includes adverse incentives on bank managers to adopt imprudent lending strategies, in particular insider lending and lending at high interest rates to borrowers in the most risky segments of the credit markets.

The high level of non performing loans impacts on public confidence in the deposit system. The most profound impact of high non-performing loans in banks portfolio is reduction in in-house restructuring unit to manage the distressed debt itself and synthetic sale transaction

for the entire portfolio to transfer to investors, which are mainly opportunity funds or investment banks.

In a high NPL condition, banks increasingly tend to carry out internal consolidation to improve the asset quality rather than distributing credit. Further, the high level of non performing loans requires banks to raise provisions for loan loss that decreases the banks' revenue and reduces the funds for new lending. The cutback of loans impairs the corporate sector as they have difficulties in expanding their working capital, blocking their chances of resuming normal operation or growing. Unavailability of credit to finance firm's working capitals and investments might trigger the second round business failure which in turn exacerbates the quality of bank loans, resulting in re-emerging of banking or financial failure. Unfortunately, commercial banks in Kenya are still burdened with presence of NPLs and fresh non performing loan are being recorded and therefore management of NPLs must be multi-pronged, with different techniques pursued at the different stages through which a credit facility passes. Measures should be in place for both prevention and resolution. With regard to preventive measures, emphasis needs to be placed on credit screening, loan surveillance and loan review functionaries both at individual bank levels and in the central bank of the country.

Resolution measures must be accompanied by legal measures that is improving the efficiency of the legal and the judicial system and developing other out of the court settlement measures like compromise settlement schemes, incentive packaging, formation of asset management companies, factoring and asset securitisation. Non-performing loans are still being experienced in the balance sheets of commercial banks in Kenya as in 2002, non performing loan was 76.1 billion and 74.0 billion in the year 2003. There is a need for commercial banks to adopt best management techniques to manage non-performing loans which are major causes of the economic stagnation problems in an economy.

Most local studies have focused on factors causing non performing loans in commercial banks. Chemjor (2007) studied the significance of the factors contributing to non performing loans problems in commercial banks in Kenya. There has been no known study focusing on

the relationship between techniques of management of non performing loans and the level of non performing loans of commercial banks in Kenya .This study therefore seek to fill this gap of knowledge by analyzing the relationship between techniques of management of non performing loans and the levels of non performing loans of commercial banks in Kenya.

1.3 Research Questions

The study seeks to answer the following research questions

i How does commercial banks manage non- performing loans?

ii What is the relationship between techniques for management of non performing loans and level of non performing loans of commercial banks?

1. 4 Objectives of the Study

1.4.1 General Objectives

The general objective of the study is to establish the relationship between techniques for managing non performing loans and the level of non-performing loans of commercial banks in Kenya.

1.4.2 Specific Objectives

i To determine how commercial banks manage their non performing loans.

ii To establish the relationship between techniques of management of non performing loans and the level of non performing loans of commercial banks in Kenya.

1.5 Importance of the Study

The study is invaluable to the management of commercial banks as they will be able to uncover the causes and effective ways of managing non performing loans and able to take appropriate measures to reduce them. The study will unveil both specific factors such as customer failure to disclose vital information during the loan application as well as main banks' specific causes such as lack of aggressive debt collection policy and ways to mitigate commercial banks against risks to maximize on their profitability. The study will provide an insight on the best approaches commercial banks should adopt in order to effectively

manage and enhance profitability. Managers in banking industry will find this study significant as it will recommend the best approaches that should be taken to manage loans and therefore prevent their organizations from collapsing.

The study will be useful to the government in policy making regarding the loan requirements and also for the supervision of commercial banks. The policy makers will obtain knowledge on the best mechanisns that should be adopted to curb the occurence of non perfoming loans and the responses that are appropriate should they occur. This study will therefore act as a guide in designing appropriate policies that will regulate commercial banks in managing their loans.

The study will also be significant to scholars who will find this study useful as it will provide information on causes of non performing loans in commercial banks and how they arise as well as better approaches that should be adopted to manage them. It will also be of significance to researchers as it will provide basis upon which further studies on broad subjects of non performing loans in commercial banks can be carried out as well as provide reference for scholars.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter reviews the past literature on the study. The causes of non performing loans in commercial banks are critically reviewed. The chapter also reviews classification and theories of non performing loans. Management techniques for managing non performing loans by commercial banks are well reviewed. Empirical study and conclusion of the chapter are presented.

2.2 Causes of non performing loans

Westermann and Frand (2003) investigate the relationship between the loan supply and real lending capacity, lending rates, real out put, bank's capital ratio, and non-performing loan. The results show that the coefficients of non performing loans are negative and significant, which indicate that bank credit supply declines with the worsening of the non performing loans problem. Westermann (2003) compares the cases of Germany after the credit boom of the late 1990s and Japan aftermath of the bubble burst in early 1990s. He argues that even though the German banks were in a better condition than Japanese banks, as the path of German's aggregate credit looks so similar to that of Japan, it is at least unlikely that the German credit slowdown was entirely driven by demand, while that of Japan was mostly caused by lack of supply. There must at least be some supply side changes that affect the aggregate credit, and differences only exist in the magnitude of the problem. He further points out that the one of the main reasons in Germany for the credit crunch is the increased risk of non-performing loans after the credit boom.

According to Gorter and Bloem (2002), non-performing loans are mainly caused by an inevitable number of wrong economic decisions by individuals and plain bad luck (inclement weather, unexpected price changes for certain products). Under such circumstances, the holders of loans can make an allowance for a normal share of non performance in the form of bad loan provisions, or they may spread the risk by taking out insurance. The problem of NPL's is widespread. Nishimura, Kazuhito, and Yukiko, (2001)

state that one of the underlying causes of Japan's prolonged economic stagnation is the non-performing or bad loan problem.

They explain that some of the loans made to companies and industries by financial institutions during the bubble era became non-performing when the bubble burst. This delayed structural reforms and prevented the financial intermediary system from functioning properly. In their study, Fernández, Jorge and Saurina, (2000) state that the growth of bank credit in Spain and its prudential implications is an ever-present item on the agenda of banking supervisors, since most banking crises have had a direct cause on the inadequate management of credit risk by institutions. They further assert that even though bank supervisors are well aware of this problem, it is very difficult to persuade bank managers to follow more prudent credit policies during an economic upturn, especially in a highly competitive environment. They claim that even conservative managers might find market pressure for higher profits very difficult to overcome. According to a World Bank report (1994) in Uganda, the country's banking industry was described as extremely weak, with huge non performing loans and .banks teetering on the verge of collapse. Mukalazi (1999) notes that reeling from years of economic mismanagement and political interference, Uganda's banking industry posted huge losses in the early 1990s.

Banks lack effective measures to identify, quantify and control the regional and industrial risk, constrained by obtaining historical data, decentralized information systems, and immature portfolio management skills, so they have to make judgment mainly based on personal experience and consequently have weak management measures on concentrated and systematic risk. McNulty, Akhigbe, and Verbrugge, (2001) indicated that banks are short of quantitative measures on specific customers' risk, the underlying reasons are: firstly, insufficiency of fundamental information system support. Secondly, the accumulation of historical information on risk revaluation is not enough, quality of data needs to be enhanced, quantitative modeling technology in risk revaluation standard needs to be improved, and relationship between customers rating and five degrees classification results should be established. Thirdly, it is short of effective measures to calibrate the matching between risk and revenue.

During pre-loan investigation, some relationship managers put little emphasis on authenticity and integrality review on related materials; they have not clarified the true intended usage of the loan (especially when extending short-termed credit); the review is too optimistic, which does not analyze the potential influence of changes in related factors, no deep review of the market, no enough understanding of enterprises' operation management situation, and no thorough risk revaluation; assessment is inaccurate and the risk of loans is not fully covered; the risk on group customers and affiliated enterprises are not identified effectively (Kieso et al., 2001).

Furthermore, some banks neglect the fact that loan procedures are not completed and the review materials are not enough; some operate anti-procedure, for instance, extending credit before enterprises' application, signing loan contract before approval of the loan, issuing letter of credit or bank acceptance before approval; consolidated credit is not fully realized, and credit to some group members is not included in the consolidated credit management; extending credit against the rules, that is, exceeding authority to offer loans, splitting one big number into several small pieces to avoid the authority constraint, issuing bank acceptance to fund enterprises on a rolling basis, or issuing acceptance, discount without actual trade background.

No full consideration on possible loss of potential risk and having not realized business expansion, which are constrained by capital. Focusing on the possible revenue from business growth will lead to issuance of loans based on savings only and develop business blindly. Secondly, some relationship managers ignore the review on fundamental information, admittance conditions and collateral revaluation of customers, which impair the authenticity and reliability of pre-loan investigation information (Laurin and Majnoni, 2003). Additionally, some risks managers unduly rely on the materials provided by relationship managers and only review the written reports and financial reports. They do not make risk review from the second angle objectively so as to damage the independence of review conclusions. Misunderstanding in credit conception may arise due to the market share which may be the most important, loaning method to strive for other business, it is safe to rely on

the government, customers approached by other banks are good customers and foreign enterprises are good customers.

2.2.1 Lack of balance mechanism for power and weak monitoring system

According to Brownbridge (1998), the single biggest contributor to the bad loans of many of the failed local banks was insider lending. In at least half of the bank failures, insider loans accounted for a substantial proportion of the bad debts. Most of the larger local bank failures in Kenya, such as the Continental Bank, Trade Bank and Pan African Bank, involved extensive insider lending, often to politicians. The threat posed by insider lending to the soundness of the banks was exacerbated because many of the insider loans were invested in speculative projects such as real estate development, breached large-loan exposure limits, and were extended to projects which could not generate short-term returns, with the result that the maturities of the bank's assets and liabilities were imprudently mismatched.

There was no balance mechanism for power in banks, whose governance structures were similar to the SOEs before the recent transformation of commercial banks in China. There is no difference between Board of Director and Senior Management, so the internal monitoring systems on decision making do no exist. The obvious shortcomings of this arrangement are: firstly, the quality of important decision making such as strategy planning is not high; secondly, the moral hazard risk of senior management is easy to appear (Herr and Miyazaki, 1999). Frankly speaking, there is strong and direct relationship between deficiency in monitoring system and levels of non-performing loans, which should be the powerful method to enhance the control power inside the banks, and reduce many serious problems that have appeared. The fundamental reasons are: independent audit and monitoring are not strong; monitoring, review and post-assessment on subsidiaries are not well-located; risks are not identified timely; qualities of asset are not authentic and provisions are not enough.

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

2.2.2 Decentralized operation management mode, and missing capital restriction mechanism

Past extensive strategic management mechanism leads to over-extending credit in some regions and industries and exacerbating risk for banks. Firstly, strategic management focuses only on the analysis of market opportunity and neglects huge potential risk, so the business development strategy and risk management strategy are disconnected seriously.

Bonin, John, Huang, Yiping,(2000) argued that bureaucratic thinking, internal resource distribution and power allocation are entirely based on bureaucratic levels of institutions, not on the real demand and contribution. Some institutions with low growth potential, poor credit environment, and weak management capability, can have large business scale and high credit approval authority, for the sake of their high bureaucratic level. There are separate plans for operation, decentralized information systems, and no uniform management on industries and regional risk, so the capability to resist systematic risk in industries and regions is weak. There is no integration of marketing resources and weak interaction between marketing and business growth among institutions, so it is difficult to unify all the resources to marketing the strategic valuable customers for banks (Ding, Shandre and Qing 2001).

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

2.2.3 Lack of internal revenue distribution process, performance assessment mechanism and accountability system

It is difficult to inspire the initiative of institutions at the aspects of different territory loans and group and affiliated enterprises' loans, and post-loan management and monitoring, since the internal revenue distribution process is not perfect. Performance assessment mechanism has obvious orientation effect. Incomplete assessment may lead institutions to deal with operation management mistakenly, wrongly grasp the key points of the task, breed plenty of moral hazard risk, and impair the security of credit assets (Kroszner, 2002).

The main disadvantages of past assessment mechanism are as follows: firstly, no deep analysis on macro economic trend, characters of regional economy, structure of customers groups, and extent of competition in the same business, and no combination between the above factors and banks' strategic plan when decomposing assessment tasks. Secondly, no risk-adjusted revenue is assessed (The East African 2001). Thirdly, institutions prefer growth to risk in order to perform well in assessment, since there is strong relationship between business growth indicators and short-term financial indicators. Fourthly, people tend to pursue short-term performance through expanding market share at the cost of banks' security of credit asset, since there is no assessment on medium and long term benefit and credit business is risk lagged in nature (Westermann, 2003).

The major shortcomings of current accountability system are: firstly, some managers are not fearless and determined to take responsibilities. Secondly, sometimes it is difficult to apply accountability because there are no clearly defined descriptions of relevant departments and processes in credit business. Thirdly, based on the above analysis of NPLs, there are various reasons concerning pre-loan period and post-loan management, but the current accountability measures mainly focus on approval process since the measures are not comprehensive, clear and scientific. Fourthly, there is no integration between accountability and quality of loans and no dynamic accountability system, so the accountability is often applied late after the actual loss (Sultana, 2000).

2.2. 4. Rigid human resource management system

Human resource management in banks is still planned economy pattern that has been found to contribute to occurrence of non performing loans in banking industry**.** Firstly, the quality of personnel in the credit business is not guaranteed, since there is no admittance and exit management of qualification of those people. Secondly, lack of effective motivation, cannot fully inspire employees' enthusiasm and responsibility. Thirdly, it is difficult to allocate a suitable person to a suitable position because of the so called "only promotion, no demotion" management system of leaders. Fourth, the human resource deployment is often behind the actual demand of business development and management function reform, so there are no enough people in credit business, which directly affects the quality and effect of the tasks relative to supporting functions (Tirapat, 1996).

2.3 Classification of non-performing loans

Banks and other financial institutions that provide different types of loans are now in a better position regarding the non-performing loans (The East African, 2001). These institutions have seen worst period in terms of non-performing loans in 1990s, when the problem was quite acute. Each bank and other financial institutions were adversely affected by non-performing loans. In the year 1997, overall non-performing loans in the Japanese banking sector amounted to $1 trillion. Similarly, other nations were also badly hit by non-performing loans. Thus, need for the securitization of non-performing loans was being felt.

When accounts have been dormant for six months or more and the outstanding amount is in excess of the approved limit, it is classified as non-performing. For an active account which has breached the approved limit, the account shall be classified as non-performing only when the amount in excess of the approved limit is not fully settled within six months from the date the approved limit was breached. Where the overdraft facility has been recalled, the account shall be classified as non performing loan immediately (Bonin et al 2001).

Subsequently, if the account is reinstated, without full settlement of the amount outstanding, the facility shall be regarded as a rescheduled facility. For the purpose of this Guideline, 'approved limit' refers to the current approved line of credit granted to the borrower. A reduction in the limit would lower the 'approved limit' accordingly. An unadvised line of

credit shall not be regarded as the 'approved limit'. In the case of overdrafts secured by shares, the 'approved limit' would be the original approved pre-set limit and not the drawing limit (which fluctuates depending on the value of shares deposited). For Banker's acceptances, trust receipts, bills of exchange, other trade-related bills and other instruments of similar nature, the facility is non performing when the instrument is due and unpaid for three months or more from the first day of default (Westermann and Frand, 2003).

Credit cards are said to be non-performing when the credit card holder fails to settle his minimum monthly repayments for three months or more from first day of default. A significant part of the growth in personal loan and credit card fees was due to strong growth in exception fees, consistent with the growth in non-performing unsecured personal loans during the year. Exception fees on credit cards made up the largest share of exception fees paid by households (Central Bank of Kenya, (2009), and the expectation was that the removal of or reduction in exception fees by some institutions will see a reduction in these costs in the current year's Term loans, revolving credit facilities, leasing loans, block-discounting facilities, hire-purchase loans and other loans (Yousaiken, 2001).

2.4 Theories of non performing loans

2.4.1 Agency theory

According to the agency theory, the principal agency problem can be reduced by better monitoring such as establishing more appropriate incentives for managers. These are lacking in Malaysia for the following reasons; firstly, market take-over of poorly managed firms by raiders is more difficult in Malaysia because of various government restrictions on corporate equity ownership. Market takeover serves as a check on the behavior of managers. Secondly, many major banks in Malaysia are owned by the government through various government-owned agencies. The principal-agent problem becomes worse when a bank is owned by government (McColgan, 2001). This is because the principal of the bank now is the government, and directors are appointed to run the bank based on political allegiance instead of competence. Thirdly, stock options are rarely used in Malaysia to award bank managers. When bank managers are given remuneration in terms of stock options they will make decisions which will increase the price of the company in the stock market .Fourthly

.Managers' horizon is short in Malaysia because their gratuity is not tied to the long term performance of the bank (Bonin et al 2001).

2.4.2 Transaction cost theory

Transaction cost theory has proven an essential framework for decisions on the vertical boundaries of a firm. In that context, this research paper analyses under what conditions workout of distressed real estate debt should be done as an internal service of the bank or rather externally by an external loan servicer. Transaction costs are the costs associated to the division of work. Williamson (2000), indicated that transaction occurs when a good or service is transferred across a technologically separable interfaces. One stage of activity terminates and another one begins. Variables that describe a transaction are, among others, the specificity, the uncertainty, and the frequency of the transaction, whether an asset or a service is only or much more valuable in the context of a specific transaction. In the following, human capital specificity (the workout managers), the asset specificity (on loan and real estate level) and the site specificity (the location of the collateral) are taken into account, Reddy (2002).

Goods and services are of a high specificity, if the supply is limited and unique and if there is no comparability. A threat to breach the contract can be seen as untrustworthy, since there is no alternative. A lock-in of one transaction party leads to a hold up. Low specificity exists, if there is a range of homogeneous services or goods and supply is secured. Since goods or services are comparable and competition exists, there is no pricing problem. Further more, high competition may imply motivation and quality (Yousaiken 2001).

2.5 Empirical review on non performing loans

It can be said unequivocally that NPLs are the result of economic slowdown. For instance, Shiozaki (2002), have identified Japan's high level of NPLs as an outcome of prolonged economic stagnation and deflation in the economy since the bursting of the "bubble" in the early 1990s. In addition, Hanazaki et. al. (2002) and Yanagisawa (2001) highlight cross-shareholdings, stock market volatility, virtual blanket guarantee of bank debts and the system of "relationship banking" as factors responsible for the prolonged fragility of the

Japanese banking sector. According to the definition of the Financial Reconstruction Law (FRL), the total amount of NPLs of all banks in Japan as of the end of March 2003 was 35.3 trillion yen, although there are claims that the actual amount of NPLs might have exceeded 100 trillion yen.

On the other hand, the causes of the financial and exchange rate crisis that erupted in East Asia (Thailand, Taiwan, Malaysia and Indonesia) in 1997 are viewed as high short term external debts, excessive loans for real estate, large current account deposits, high international interest rates and weaknesses in the balance sheets of financial institutions (Government of Japan,2001). In addition, Kwack (2000) finds that the 3-month LIBOR interest rate and nonperforming loan rates of banks were the major determinants of the Asian financial crisis. Huang and Yang (1998) report that unlike the other countries of East Asia, China did not face financial fragility because of the size of its foreign exchange reserve, its current account surplus, the dominance of foreign direct investment in capital flows and the control of the capital account. As of June 2003, China recorded only 5.68% of its total loans as non-performing while, in contrast, Thailand, Indonesia, Philippines and Malaysia recorded NPLs at 15.29%, 8%, 15% and 8.7% respectively. Unfortunately, the rate of NPLs in China had increased to 8.6% in the year 2005.

In the Indian subcontinent (India, Pakistan, Sri Lanka, Bangladesh and Nepal), the causes of non-performing loans are usually attributed to the lack of effective monitoring and supervision on the part of banks (as required by the BASEL principles of bank monitoring and supervisions), lack of effective lenders' recourse, weaknesses of legal infrastructure, and lack of effective debt recovery strategies. Among the countries in the Indian sub-continent, the rate of NPLs as a percentage of total loans disbursed in 2005 is seen to be minimal in India (5.2%), followed by Sri Lanka (9.6%). Bangladesh, however, still records a staggering rate of 13.56% (Reddy 2002).

The issue of non-performing loans in Bangladesh is not a new phenomenon. In fact, the seeds were cultivated during the early stage of the liberation period (1972-1981), by the government's "expansion of credit" policies on one hand and a feeble and poor banking infrastructure combined with an unskilled work force on the other. Moral et al. (2000) argue

that the expansion of credit policy during the early stage of liberation, which was directed to disbursement of credit on relatively easier terms, did actually expand credit in the economy on nominal terms.

However, it also generated a large number of willful defaulters in the background who, later on, diminished the financial health of banks through the “sick industry syndrome”. Islam et al. (1999) add that despite the liberalizing and privatizing of the banking sectors in the 1980s with a view to increasing efficiency and competition, the robustness of the credit environment deteriorated further because of the lack of effective lenders’ recourse on borrowers. Choudhury et al. (1999) find that Government direction towards nationalized commercial banks to lend to unprofitable state owned enterprises, limited policy guidelines (banks were allowed to classify their assets at their own judgments) regarding “loan classification and provisioning”, and the use of accrual policies of accounting for recording interest income of NPLs resulted in malignment of the credit discipline of the country.

The German non-performing loan market is still young in comparison to more mature markets in the US and several Asian countries. A make, buy or sale decision of non-performing loans and its workout can be seen as a question on the outsourcing potentials in the loan granting process. Lautenschlager, Mettler and Volkart (1998), indicated that inclusion or exclusion of the workout unit into a bank’s business and balance uncertainties related to this potential organisational transformation of the lending institution.

The large German banks are the biggest group holding distressed assets in Germany. This is due to the bank’s strong business relationship with the Mittelstand, a sector strongly hit by the recessional environment. Further on, they visualize a matrix of distressed investment targets concerning internal/ external workout and whether it is resolvable/ irresolvable by a fund. In the context of the ongoing crisis, Klingebiel and Daniela, (2000) discusses recent developments in the German banking and real estate sectors. She points out three factors; the restructuring in the German banking sector, the economic slowdown and the typical real estate cycle. Garthe and Turner (1996) argues that German banks have to solve the distressed debt issue during the next three years aiming to comply with the Basel II

regulations and successfully restructure the over-banked sector with the result of a “more sophisticated and innovative real estate lending in the future”.

The US non-performing loan cycle is embedded in the Saving & Loan Crisis from 1989 to 1994. Distressed real estate debt can be regarded as a sub-problem within the biggest banking crisis in the US. Woo and David, (2000) concentrated on the valuation of complex distressed real estate and real estate loans and derived a valuation methodology which is especially designed for that asset class. Cargill et al (2004) published probably the most distinguished collections of associated publications on the Saving & Loan Crisis and distressed debt resolution. Focus is the complex combination of causes that led to and fostered the banking crisis.

Bank Committee of Banking Supervision (2005) concentrates on the role of the governmental institutions, the FDICs and the Resolution Trust Corporations (RTCs), and their experiences in the resolution of troubled banks as well as the asset management and workout of distressed assets. The renegotiation and restructuring of distressed debt is subject to pay-off-model (Hardings and Sirmans 2002). They determine the different reactions of borrowers (underinvestment/ over-investment) with regard to the different workout strategies and identify renegotiation strategies regarding the maturity being most efficient to the debtor due to a decreasing risk profile.

Berger and DeYoung (1997) analyses the relationship between cost efficiency and non-performing loans in an ambivalent way. The higher the NPL volume, the lower the cost efficiency; nevertheless, mismanagement also lead to a rising amount of bad loans. analyse outsourcing potentials of real estate function with respect to the agency problem related to that. Those findings may have important implications for the outsourcing of servicing and workout of real estate loans. Peiser and Wang (2000) analyze the resolution strategy of distressed debt in China through the foundation of state-owned asset management companies for the four biggest state-owned banks. They also identify the country specific problems of China by comparing the situation to the United States, where the Resolution Trust Corporation (RTC) was established to foster a quick workout of the engagements (Krueger, Anne and Tornell, 1999).

A study on securitization of non-performing loans in China was conducted (Nishimura, Kazuhito andYukiko (2001). His examination of the legal and economical framework concerning securitization of non-performing loans results in a call for government participation via policy adjustments and debt restructuring plans, which are crucial for successful large scale securitization.

Herr and Miyazaki (1999) address the non-performing loans problem and suggest securitization as a solution by transferring the distressed debt into securities and therefore achieve a positive balance sheet effect. As result, they also mention the necessity of the involvement of politicians who can foster the scheme of securitization on the private banks side and in the Ministry of Finance. The Japanese market of non-performing loans and the role of Governmental intervention are also subject of securitization, (Barseghyan, 2004). He identifies a link between the Japanese government's reluctance to solve the bad loan problem and the economic slowdown. He opines that the Governments behaviour deteriorated the economic situation of Japan and affirms this hypothesis by a normative study. A more general comparative study on the structuring of asset management companies was undertaken (Klingebiel 2000). She analyses and compares the use of asset management companies in the resolution of banking crisis in a cross country comparison and identifies success stories and drivers for different types of asset management companies of distressed debt.

China evidences active non-performing loans resolutions since 1999. The origin of the Chinese non-performing loans crisis is a political matter. During the centrally planned economy from 1949 onwards, loans were granted by state owned banks to state owned companies without proper credit due diligence at predetermined standardized conditions by the government. Especially, in the overheated economy of the 1990s domestic credits extended enormously and grew by 30% per year between 1992 and 1995 (Kroszner, 2002).

2.6 Non performing loans in Kenya

The central bank of Kenya defines NPLs as those loans that are not being serviced as per loan contracts and expose the financial institutions to potential losses (CBK, 2003). It is important to note that non-performing loans refer to accounts whose principal or interest

remains unpaid ninety days or more after due date. According to the Central Bank of Kenya Supervision Report (CBK, 1999), the level of non-performing loans has been increasing steadily from Kshs.56 billion in 1997, Kshs.83 billion in 1998 to Kshs.97 billion in 1999. This high level of non-performing loans continues to be an issue of major supervisory concern in Kenya.

According to a study by Brownbridge (1998), most of the bank failures were caused by non-performing loans. Arrears affecting more than half of the loan portfolios were typical of the failed banks. Many of the bad debts were attributable to moral hazard: the adverse incentives on bank owners to adopt imprudent lending strategies, in particular insider lending and lending at high interest rates to borrowers in the most risky segments of the credit markets.

According to the Central Bank of Kenya Supervision Report (Central Bank of Kenya Supervision Report, 1999) profitability of the banking sector declined sharply from Kshs.4.4bn in 1998 to only Kshs 0.2 billion in 1999. This was due to increased provisions for the non-performing loans by most institutions. Non-performing loans remained a major problem for the Co-operative Bank of Kenya Ltd, for instance. Although the volume of total non-performing loans declined, provisions on loan losses increased in 2002. The bank made provisions to the tune of Kshs 4.7 billion indicating that it is still adversely weighed down by non-performing loans. Besides the impact of these provisions on profitability, the concentration of such loans made recovery difficult owing to the poor state of the economy (Central Bank of Kenya, 2003).

In his address to the Annual General Meeting, Kenya Commercial bank's Chief Executive, Davidson (2003) observed that the bank had reported a loss principally caused by an increase in loan loss provisions, which increased from Kshs 2.8 b in 2001 to Kshs. 4.9 billion in 2002. These provisions were largely related to the non-performing loans that were booked in the nineties. Davidson (2003) further observed that KCB had gone further and segregated the non-performing loans into a separate area. The aim was to centralize all the non-performing loans into one unit in order to be accounted for separately. The end result was a computerized debt management system, which would enable the bank to monitor progress far more accurately.

According to Brownbridge (1998), the single biggest contributor to the bad loans of many of the failed local banks was insider lending. In at least half of the bank failures, insider loans accounted for a substantial proportion of the bad debts. Most of the larger local bank failures in Kenya, such as the Continental Bank, Trade Bank and Pan African Bank, involved extensive insider lending, often to politicians. The threat posed by insider lending to the soundness of the banks was exacerbated because many of the insider loans were invested in speculative projects such as real estate development, breached large-loan exposure limits, and were extended to projects which could not generate short-term returns, with the result that the maturities of the bank's assets and liabilities were imprudently mismatched.

The high level of non performing loans impacts on public confidence in the deposit system. The most profound impact of high non-performing loans in banks portfolio is reduction in bank profitability especially when it comes to disposals, (International Monetary Fund, 2002). Much of Local studies have focused on the effects of credit risk management and significance of factors leading to occurrence of non performing loans.

2.7 Non performing loans management techniques

In response to the challenge of non-performing loans, banks have been forced to become innovative in their efforts to remain in business. According to Chudasri (2002), retail customers have now taken centre stage in Bangkok in banking business. State banks have moved aggressively to increase new lending.

2.7.1 Transforming the operation mechanism comprehensively

The starting point of transforming the operation mechanism is to enhance the corporate governance structure, so as to push banks to become internationally active commercial banks with abundant market value and great influence. According Woo and David (2000), commercial banks can minimize occurrence of non performing loans by improving governance structures and construct a healthy and responsible Board of Directors, which will form the core part of commercial banks corporate governance. The management of commercial banks should set up committees such as audit committee, risk management committee, remuneration committee, and nomination committee to make sure all operations

are carried out positively. This will lead to establishment of scientific and clear business development strategy and risk management strategy, adjust and improve the strategies according to the changing situations and make sure there is implementation of strategies and plans. Kroszner, (2002) found that capital constraint mechanism, dual mechanism of constraint on risk asset scale and orientation of value-added of economic capital are effective measures to improve the efficient allocation of credit resource, financial resource and to optimize the asset structure and profit mode. Complete motivation and constraint mechanism, through enhancing monitoring, assessment, accountability and remuneration mechanism improve credit decision mechanism and control the quality of newly issued credit asset under reasonable level (Kroszner, 2002).

2.7.2 Adoption of centralized, specialized and scientific management

Decentralized management is one of the major reasons of formation of NPL according to the above analysis. So it is necessary to change the decentralized management to the centralized one controlled by the head office of banks. The sophisticated, specialized and scientific management is the basis of high level centralized management (Kwack Sung and Yeung. 2000). So it should integrate and unify the business process, bring forward capital constrained risk asset management, improve limited management on industrial and regional risk, enhance quantitative management skills, based on deep data mining & analysis and advanced risk management instruments. And it introduces systems of relationship managers, product managers, risk managers, specialized credit committee members and specialized approvers so as to guarantee the centralized and scientific management. In the coming few years, it is the inevitable choice to move towards the centralized, specialized and scientific management for banks facing rapid developing, high risk and non-standard outside environment, in order to achieve sustainable healthy development (Mikiko, 2003).

2.7.3 Independent credit review

Banks have to deepen the independent credit review process and avoid blind lending. On one hand, banks should have correct and clear understanding on national policies and local governments' behaviors to grasp the true commercial opportunities and avoid the risk. On the other hand, banks should assign high quality person with excellent capability of

independent review to the credit review positions (Sinkey and Joseph 1999). However, there are still many difficulties ahead. For example, in the near future, the Chinese economy will still be government-dominated, and some local governments will continue to intervene into banks' credit extending process, especially on municipal and below level. So it urges banks to enhance the independent review as soon as possible.

2.7.4 Establishment of professional teams

The management and credit personnel should have not only the favorable moral ethics, but also enough professional knowledge, skills and experience to solve problems to analyze and judge the strategic location and credit business correctly, and solve the existing problems suitably (Bonin *et al* 2001). Commercial banks professional teams are profound strategic eyesight, to enhance capability of management through powerful marketing ability, excellent risk management skills, and correct conception of revenue, personal value and power. Good commercial bank managers should enhance the unification and effectiveness of banks based on the organic combination of personal authority and post authority. Commercial banks management should also enhance construction of employee teams through providing training to improve the business knowledge by employees, train and attract persons with compound abilities to enhance the capability to prevent and mitigate the financial risk, strengthen the admittance and exit management of qualification of credit business people, and establish capable and self-disciplined teams based on the combination of employee team building and construction of credit culture and motivation mechanism (Cargill *et al*. 2004).

2.7.5 Borrowers personality profile assessment

Banks have suffered loan losses through relaxed lending standards, unguaranteed credits, the influence of the 1980s culture, and the borrowers' perceptions. It was suggested that bankers should make a fairly accurate personality-morale profile assessment of prospective and current borrowers and guarantors. Besides considering personal interaction, the banker should try to draw some conclusions about staff morale and loyalty, study potential borrowers' personal credit report, do trade-credit reference checking, check references from present and former bankers, and determine how the borrower handles stress. In addition,

banks can minimise risks by securing the borrower's guarantee, using Government guaranteed loan programs, and requiring conservative loan-to-value ratios. Bloem and Gorter (2001) suggested that a more or less predictable level of non-performing loans, though it may vary slightly from year to year, is caused by an inevitable number of 'wrong economic decisions by individuals and plain bad luck for example inclement weather and unexpected price changes for certain products

2.8 Conclusion

Management of non-performing loans is very important for both the performance of an individual bank (McNulty, Akhigbe, and Verbrugge, 2001) and the economy's financial environment**.** In response to the challenge of non-performing loans, banks have been forced to restructure and become innovative in their efforts to remain in business. According to Chudasri (2002) retail customers have now taken centre stage in Bangkok in banking business. State banks have moved aggressively to increase new lending, in line with government policy. All banks, private and state-owned alike, have also sharply increased their efforts in the consumer market, leading to a boom in credit cards, personal loans and hire-purchase lending. In a high NPL condition, banks increasingly tend to carry out internal consolidation to improve the asset quality rather than distributing credit. Further, the high level of non performing loans requires banks to raise provisions for loan loss that decreases the banks' revenue and reduces the funds for new lending to difficulties in expanding their working capital, blocking their chances of resuming normal operation or growing. Non-performing loans can lead to problem in efficiency operations of commercial bank**.** The immediate consequence of large amount of NPLs in the banking system is bank failure.

There is a need for commercial banks to adopt best management techniques to manage non-performing loans which are major causes of the economic stagnation problems in an economy. The management of non-performing loans is a necessary condition to improve bank profitability and lead to economic efficiency.

The Bank of Japan (2003) documented one of the remedies to the problem of Non-performing loans as the pursuance of a new lending strategy backed by appropriate credit

risk evaluation used successfully in Japan. The Central Bank of Kenya (2002) has also documented that interest rates in Kenya have reduced significantly. The adoption of specific areas of credit risk assessment to check on occurrence of non performing loans such as the use of specific limits and ratios, based on cash flows as well as the use of forecasts and feasibility studies, the use of a standard lending procedure and the use of clear loan files to monitor the quality of loans.

The success in the use of non performing loans management techniques and remedies at the disposal of banks to ensure debtors paid their debts was good. There is a need for governments in countries such as Kenya to strengthen their judicial systems if Banking crises are to be minimized. Bank managers should also take action to reduce the default rate and the perceived level of success of such actions in an emerging economy which may be able to reduce their levels of non performing loans.

The effects of large amount of non-performing loans in the commercial banks is bank failure and therefore there is needs for a study to address what management techniques commercial banks should adopt to minimise the occurrence of non performing loans in banks. Previous studies had not adequately address issues on management techniques that can be adopted by commercial bank to minimise the commercial bank crises. Mutwiri (2003) analyzed the use of 6 C's credit risk appraisal model and its relationship with the level of non performing loans of commercial banks in Kenya, Chemjor (2007) studied the significance of the factors contributing to non performing loans problems in commercial banks in Kenya and found out that there is a need for banks to manage their existing non performing loans. This study seeks to establish the relationship between techniques for management of non performing loans and the level of non performing loans of commercial banks in Kenya.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter discusses the research design and methodology; highlights a full description of the research design, the research variables and provides a broad view of the description and selection of the population. The research instruments, data collection techniques and data analysis procedure have also been presented.

3.2 Research Design

The research design according to Chandran, (2004) provides answers for questions such as; what techniques were used to gather data, what kind of sampling strategies and tools were used and how will time and cost constraints be dealt with. Research design refers to the way the study is designed, that is the method used to carry out the research (Mugenda and Mugenda (2003). Causal design was chosen as the study sought to establish the relationship between technique of management of non performing loans and level of non performing loans in commercial banks in Kenya. Causal research design was chosen because it enables the researcher to generalise the findings to a larger population.

3.3 Target Population

Target population is that population to which a researcher wants to generalize the results of a study (Mugenda and Mugenda, 2003). The target population in a research study comprises all those potential participants that could make up a study group (Kothari, 2004). The population of this study consisted of all the forty three commercial banks in Kenya (Central Bank of Kenya 2010)

3.4 Validity

Validity is the degree to which results obtained from the analysis of the data actually represent the phenomena under study (Mugenda, 1999). To enhance content validity, the researcher's supervisor was asked to appraise the instruments.

External validity which has to do with the representation of the sample with regard to the target population was done on pilot study in five commercial banks and five bank managers were used in the pilot study. Bank managers used in the pilot study were not used in the main study.

3.5 Reliability of Instruments

Reliability is used to focus on the degree to which empirical indicators or measures are consistent across two or more attempts (Mugenda and Mungenda, 2003). The researcher used the test-retest method whereby questionnaires were administered twice to the same group of bank managers. A time lapse of two weeks was allowed before the questionnaires were administered again. A comparison between the two sets was made using Pearson's correlation co-efficient to determine the reliability of the questionnaires.

3.6 Data Collection Instruments

Primary data was collected using structured questionnaires. The questionnaires were appropriate as research tools for the study because of less time required in the collection of data as compared to carrying out direct interviews. Questionnaires with both open and closed ended questions were administered to the respondents using the drop and pick method. Secondary data was collected from journals, magazines and annual reports of banks.

3.7 Data Analysis

The research used both quantitative and qualitative data. Collected data was checked for completeness ready for analysis then coded. Data was analyzed through the statistical package for social sciences (SPSS version 17) package. Spreadsheets were used to determine appropriate charts and tables for data presentation, while total scores were used to rank the responses. Simple regression analysis was used to test the relationship between the techniques for management of non-performing loans (independent variables) and level of non performing loans (dependent variable) of commercial banks. The relationship between

techniques for management of non performing loans and level of non performing loans was determined through the following regression equation.

$Y = \alpha + \beta X_1 + \beta X_2 + \beta X_3 + \beta X_{4} + \beta X_{5+}$

Y= Dependent variable, level of non performing loans

α = Constant

β= Coefficient

$X_{1=}$ Transforming the operation mechanism comprehensively

$X_{2=}$ Adoption of centralized, specialized and scientific management

$X_{3=}$ Independent credit review

$X_{4=}$ Establishment of professional teams

X_5= Borrowers personality profile assessment

CHAPTER FOUR
DATA ANALYSIS AND INTERPRETATION OF FINDINGS

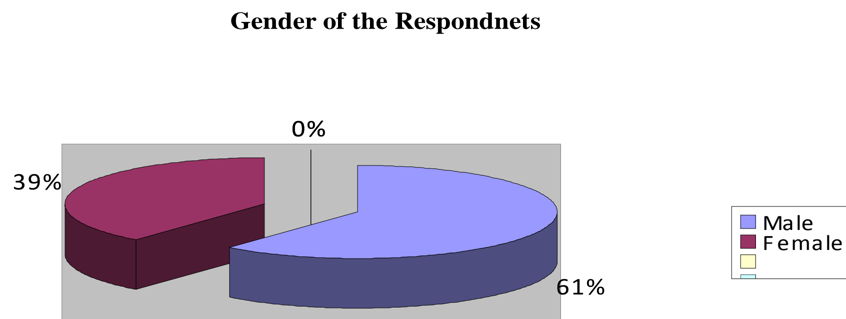
4.1 Introduction

This chapter presents the discussions and conclusion of the study. From the study, the target population was forty three; thirty six respondents returned the questionnaires. This constituted 83.7 % response rate.

4.2 General information

4.2.1 Distribution of respondent by gender

Figure 4.1: Gender of the respondent



Source: Research Data

The respondents were requested to indicate their gender as indicated in the figure. From the findings, majority of the respondents were male as indicated by 61.1% while 38.9% of the respondents were female. This implies that commercial bank employs both male and female as part of their professional teams.

4.2.2 Distribution of respondent by age

Table 4.1: Age of the respondents

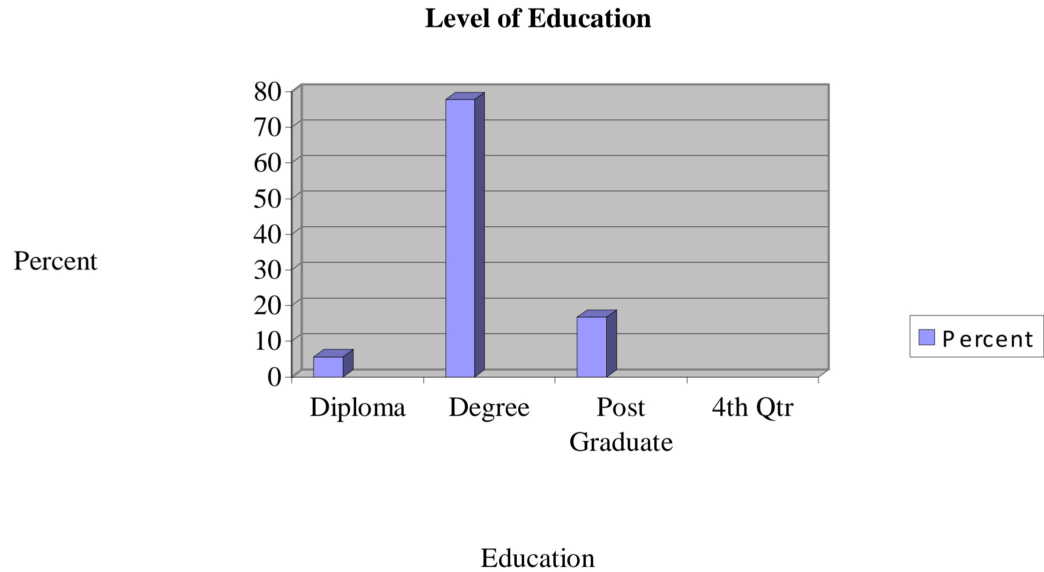
	Frequency	Percent
26 -30years	16	44.4
31 - 35years	10	27.8
36 - 40years	2	5.6
0ver 40 years	8	22.2
Total	36	100.0

Source: Research Data

The study sought the age of the respondents. From the findings, most of the respondents were aged between 26-30years as indicated by 44.4 0%, 27.8 % of the respondents were aged between 31-35 years. 22.2% of the respondents were aged over 4 years while 5.6 % of the respondents were aged between 36-40 years. This implies that majority of the respondents were mature and were in a position of offering information on the relationship between techniques for management of non performing loans and the level of non performing loans in commercial banks in Kenya.

4.2.3 Respondent level of education

Figure 4.2: Respondent level of education



Source: Research Data

The figure 4.2 indicates the level of education attained by the respondents. From the findings, majority of the respondents were university graduates as indicated by 77.8 %, 16.7 % were post graduates while 5.6% of the respondents had attained diploma certificates. This implies that most of commercial banks had employed qualified staff in terms of education.

4.2.4 Working period

Table 4.2: Working period

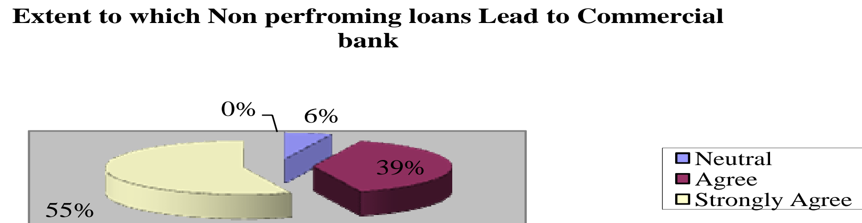
	Frequency	Percent
less than one year	2	5.6
1-3years	14	38.9
4-7years	12	33.3
over 10 years	8	22.2
Total	36	100.0

Source: Research Data

The respondents were requested to indicate the period of time they had worked in the commercial banks as indicated in table 4.2. From the findings, 38.9% of the respondents had worked in their respective commercial banks for 1-3years, 33.3 % of the respondents indicated that they had worked in their respective commercial banks for 4-7 years while 5.6 % of the respondents indicated that they had worked in their respective commercial banks for less than one year. This clearly indicates that majority of the respondents had worked in their respective banks between one and three years and therefore had experience on the relationship between techniques of management of non performing loans and the level of non performing loans of the commercial banks.

4.3 Problem of non performing loan

Figure 4.3: Extent to which non-performing loans lead bank failure



Source: Research Data

The respondents were requested to indicate the extent to which non performing loans lead to commercial banks failure. From the findings, majority, 55.0% of the respondents strongly agreed that non performing loans lead to commercial banks failure to a greater extent, 39% of the respondents agreed that non performing loans lead to commercial banks failure while 6% of the respondents were neutral on whether non performing loans lead to commercial banks failure. This implies that non performing loans lead to commercial banks failure. The respondents explained that banks experiences borrower's inability to pay the loans due to business failure and also the challenge of the institution not having an effective follow up in the arrears. The respondents also explained that banks most of the time has laxity in credit assessment as well as employing untrained personnel to head credit departments.

4.3.1 Extent of factors that causes non-performing loans

Table 4.3: Extent of factors that causes non performing loans

	Strongly disagree	Disagree	Neutral	Agree	Strongly agree	Mean	Std dvt
lax credit assessment and untrained personnel	0	0	8	15	13	4.13	.76
lack of aggressive credit collections	6	0	3	7	20	3.97	1.48
banks negligence in monitoring loans	0	6	0	4	26	4.38	1.12
the speedy process in granting loans	0	2	19	15	0	3.36	.59
insider lending and owner concentration	0	1	2	12	21	4.47	.73
incomplete assessment mechanism and accountability	0	0	7	6	23	4.75	.80
bank strategic management focuses only on the analysis of market opportunity	0	6	1	20	9	3.88	.97
moral hazards risk and impair security of credit assets	0	1	6	5	24	4.64	.87
poor quality of human resource who have not undergone training on credit information	0	0	3	23	10	4.19	.57
legal and economic framework concerning securitization of nonperforming loan results into a government participation	0	6	8	15	7	3.63	.99

bank's internal resource distribution and power allocation are based on bureaucratic levels of institutions	6	7	15	4	4	2.80	1.19
weak bank independent audit and monitoring	0	1	1	10	24	4.58	.69
wrong timing of risks identifications	0	6	1	25	4	3.75	.87
failure of bank managers to follow prudent credit policies during an economic upturn	1	0	1	1	33	4.80	.74
under staffing in banks particularly in credit section	1	2	12	9	12	3.80	1.06
lack of effective motivation	0	1	0	13	22	4.55	.652

Source: Research Data

There are various factors that cause non performing loans for the commercial banks. The study sought to establish the extent to which the factors cause non performing loans in commercial banks in Kenya. From the findings, majority of the respondents strongly agreed that failure of bank managers to follow prudent credit policies during an economic upturn, incomplete assessment mechanism and accountability, moral hazards risk and impair security of credit assets and weak bank independent audit and monitoring causes non performing loans in commercial banks to a very great extent as indicated by a mean of 4.80, 4.75, 4.64 and 4.58 respectively. The study also found that most respondents agreed that insider lending and owner concentration ,banks negligence in monitoring loans, poor quality of human resource who have not undergone training on credit information, lax credit assessment and untrained personnel, lack of aggressive credit collection and bank strategic management focuses only on the analysis of market opportunity and wrong timing of risks identifications causes non performing loans to a greater extent as indicated by mean of 4.47, 4.38 , 4.19 ,4.13, 3.97 ,3.88 and 3.63 . The study further found that the speedy process in granting loans, bank internal resource distribution and power allocation based on

bureaucratic levels of institutions causes non performing loans for the commercial banks to a moderate extent as indicated by a mean of 3.36 and 2.80 respectively. From the findings, it was further found out that loans being an asset to the bank and being funds for customers can cause banks' failure if unpaid. These loans end up being written off by most of the commercial banks thus having a negative impact on the banks profitability and also weaken the liquidity position of the institutions. The loan interest is the biggest income for the banks, if the loans are not paid then the interest is suspended lowering interest income and eventually lowering banks' profitability.

4.3.2 Factor contributes most to non-performing loans

Table 4.4: Factors that contributes most to nonperforming loans

	Yes	Per cent
Clients start new business without experience	34	95.1
the simultaneous operation of many kinds of business	17	47.2
the inappropriate use of loans	35	97.2
debtors conceal vital data in their application	35	97.2
insufficient collaterals	21	58.3
wrong economic decisions for example unexpected price changes	7	19.4
lack of clear assessment framework of managing non performing loans	28	77.8
failure by a manager to review prevailing market conditions during loan appraisals	35	97.2

Source: Research Data

The respondents were requested to indicate factors that contribute most to non performing loans in commercial banks. From the findings, majority of the respondents indicated that the inappropriate use of the loans, failure by a manager to review prevailing market conditions during loan appraisals and debtors concealing vital data in their loan applications contribute

most to the occurrence of non performing loans in the banks as indicated by 97.2 % in each case. The study also found that Clients start new business without experience, lack of clear assessment framework of managing non performing loans and insufficient collaterals mostly contribute to non performing loans as indicated by 95.1 %, 77.8%, and 58.3% of the respondents respectively. The study further found that wrong economic decisions for example unexpected price changes and simultaneous operation of many kinds of business contribute most to non performing loans as indicated by 19.4 and 42.2% of the respondents respectively.

4.3.3 Management techniques for non-performing loans

Table 4.5: Management techniques for non-performing loans

	No extent	Less extent	Moderate	great extent	Very great	Mean	Std dvt
government involvement in fiscal policy formulation	1	12	15	0	8	3.05	1.16
information sharing among banks about borrowers	1	0	0	13	22	4.52	0.77
use specific limits ratios in the evaluation	6	8	14	0	8	2.88	0.34
emphasis on forecasts and feasibility studies	1	12	3	12	8	3.38	1.24
use of specific lending and projects appraisal techniques	0	1	9	9	17	4.16	0.91
use of content of loan files to monitor loan quality	0	1	3	10	22	4.47	0 .77
transforming the operation mechanism comprehensively	1	0	6	20	9	4.00	0.82

adoption of centralized, specialized and scientific management	0	10	2	2	22	4.10	1.35
adoption of an independent credit review	1	3	0	13	19	4.27	1.03
increased use of credit reference bureaus	0	0	1	10	25	4.66	0.53
assessment of borrowers personality profile	0	0	0	9	27	4.75	0.43
loan securitization	0	1	2	2	31	4.75	0.69
transfer to loan recovery agency	1	2	6	24	3	3.72	0.81
restricting of loans	1	0	11	21	3	3.69	0.74
loans sales	6	9	7	11	3	3.88	0.25
establishment of professional teams	0	15	7	1	13	3.83	0.35

Source: Research Data

The respondents were requested to indicate the extent to which management techniques for non-performing loans influences the level of non performing loans in commercial banks. From the findings, majority of the respondents indicated that assessment of borrower’s personality profile, loan securitization, increased use of credit reference bureaus and information sharing among banks about borrowers influences the level of non performing loans to a very great extent as indicated by mean of 4.75, 4.75, 4.66 and 4.52 respectively. The study also found that use of content of loan files to monitor loan quality, adoption of an independent credit review, se of specific lending and projects appraisal techniques, adoption of centralized, specialized and scientific management and transforming the operation mechanism comprehensively influence the level of non performing loans to a greater extent as indicated by a mean of 4.47, 4.27, 4.16, 4.10 and 4.00 respectively. The study further found that loans sales, establishment of professional teams, transfer to loan recovery agency and restricting of loans influence the level of the non performing loan for the commercial

banks to a greater extent as indicated by the means 3.88, 3.83, 3.72 and 3.69 respectively. Other managing techniques for non performing loans adopted by the commercial bank influence the level of non performing loans to a moderate extent. From the findings, emphasis on forecasts and feasibility studies, government involvement in fiscal policy formulation and use of specific limits ratios in the evaluation influences the level of non performing loans to a moderate extent as indicated by mean of 3.38, 3.05 and 2.88 respectively.

4.3.4 Importance of managing non-performing loans

The study sought to find out the respondents' opinion on the importance of management of non performing loans for the commercial banks. From the findings it was found out that management of non performing loans improves the financial performance of banks as interest on loans is the biggest income of banks and increases the liquidity position of banks.

Also the respondents indicated that management of non performing loans helps in protecting the banks' reputation and reduce loan losses and leads to quality loan portfolio leading to better return to the shareholders. It also reduces time wastage on unproductive resources being diverted towards loan recovery whereby such resources can be channelled to other more productive areas.

4.4 Regression Analysis

A multivariate regression model was applied to determine the relationship between techniques for managing non performing loans and the level of non-performing loans in commercial banks in Kenya**.** The logistic regression used in this model was:

$$Y = \alpha + \beta X_1 + \beta X_2 + \beta X_3 + \beta X_4 + \beta X_5 + \varepsilon$$

Whereby Y= Dependent variable, level of non performing loans

α = Constant, β= Coefficient, $X_{1=}$ Transforming the operation mechanism comprehensively, $X_{2=}$ Adoption of centralized, specialized and scientific management, $X_{3=}$ Independent credit review, $X_{4=}$ Establishment of professional teams, X_5= Borrowers personality profile assessment and ε = Error term.

Table 4.6: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.097(a)	.009	.981	4.223	.009	.009	1	1	.938

Source: Research Data

Adjusted R^2 is called the coefficient of determination and tells us how the level of non performing loans in commercial banks varied with variation in transforming the operation mechanism comprehensively, adoption of centralized, specialized and scientific management, independent credit review, establishment of professional teams and borrowers personality profile assessment. From table 4.6 above, the value of adjusted R^2 is 0.981. This implies that, there was a variation of 98.1% of level of non performing loans in commercial banks varied with variation in transforming the operation mechanism comprehensively, adoption of centralized, specialized and scientific management, independent credit review, and establishment of professional teams and borrowers personality profile assessment at a confidence level of 95%.

Table 4.7: Regression Coefficients results

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	1.833	3.156		1.839	.017
	Transforming operation mechanism comprehensively	-1.771	.061	-.017	-.097	.038

	Adoption of centralized, specialized and scientific management	-0.286	.038	-.024	-.061	.023
	Independent credit review	-1.358	.311	-.011	-.090	.078
	Establishment of professional teams	-0.116	.018	-.023	-.094	.023
	Borrowers Personality Profile Assessment	-0.574	.418	-.097	-.097	.067

Source: Research Data

Predictors: (Constant), transforming the operation mechanism comprehensively, adoption of centralized, specialized and scientific management, independent credit review, establishment of professional teams and borrowers personality profile assessment. From the data in the above table, there is a negative relationship between the level of non performing loans in commercial banks with transforming the operation mechanism comprehensively, adoption of centralized, specialized and scientific management, independent credit review, and establishment of professional teams and borrowers personality profile assessment. The established regression equation was;

$Y = \mathbf{1.833 - 1.771\ X_1 - 0.286\ X_2 - 1.358\ X_3 - 0.116 X_4 - 0.574\ X_5}$

From the above regression model, it was found that the level of non-performing loans in commercial banks would be at 1.833 holding transforming the operation mechanism comprehensively, adoption of centralized, specialized and scientific management, independent credit review, establishment of professional teams and borrowers personality profile assessment to a constant zero. A unit increase in transforming operation mechanism comprehensively would lead to decrease in the level of non performing loans by a factor of 1.771, also unit increase in adoption of centralized, specialized and scientific management would lead to a decrease in the level of non performing loans in commercial banks by a factor of 0.286, a unit increase in independent credit review would result to a decrease in the

level of non performing loans by a factor of 1.358, also a unit increase in establishment of professional teams would result to decrease in level of non performing loans by factor of 0.116, further unit increase in borrowers personality profile assessment would result to decrease in level of non performing loans by factor of 0.574. There is therefore a negative relationship between non performing loans and the predictor variables as given that is, transforming the operation mechanism comprehensively, adoption of centralized, specialized and scientific management, independent credit review, establishment of professional teams and borrowers personality profile assessment.

CHAPTER FIVE

5.0 SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

From the analysis and data collected, the following findings, conclusions and recommendations were made. The responses were based on the objectives of the study. The researcher had intended to establish the relationship between techniques for managing non performing loans and the level of non-performing loans in commercial banks in Kenya.

5.2 Summary of Findings and Conclusions

5.2.1 Summary of Findings

On the extent to which non performing loans leads to commercial banks failure, the study found that non performing loans lead to commercial banks' failure to a great extent. The study further revealed that banks experiences loan borrowers' inability to pay loans due to business failure and also the challenge of the institution not having an effective follow up on arrears. Banks most of the time has laxity in credit assessment as well as employing untrained personnel to head credit departments.

On the various factors that cause non performing loans in commercial banks, the study found that factors causing non performing loans in commercial banks in Kenya to very great extent were; failure of bank managers to follow prudent credit policies during an economic upturn, incomplete assessment mechanism and accountability, moral hazards risk and impair security of credit assets and weak bank independent audit and monitoring. The study also found that most respondents agreed that insider lending and owner concentration, banks negligence in monitoring loans, poor quality of human resource who have not undergone training on credit information, lax credit assessment and untrained personnel, lack of aggressive credit collection and bank strategic management focuses only on the analysis of market opportunity and wrong timing of risks identifications causes non performing loans to a greater extent. The study further found that speedy process in granting loans, banks' internal resource distribution and power allocation based on bureaucratic levels of institutions causes non performing loans in commercial banks to a moderate extent. It was further established that loans being an asset to banks and being funds for customers can

cause banks failure if unpaid. These loans end up being written off by most commercial banks thus having a negative impact on the banks' profitability and also weaken the liquidity position of the institutions. The loan interest is the biggest income for banks, if the loans are not paid then the interest is suspended lowering interest income and eventually lowering bank profitability.

From the findings, it was found that majority of the respondents indicated that the inappropriate use of loans, failure by managers to review prevailing market conditions during loan appraisals and debtors concealing vital data in their loan applications contribute most to the occurrence of non performing loans in banks. The study also found that clients starting new business without experience, lack of clear assessment framework of managing non-performing loans in commercial banks and insufficient collaterals mostly contribute to non performing loans. The study further found that wrong economic decisions for example unexpected price changes and simultaneous operation of many kinds of business contribute most to non performing loans.

On the extent to which management techniques for non performing loans influences their level in commercial banks, the study found that assessment of borrowers' personality profile, loan securitization, increased use of credit reference bureaus and information sharing among banks about borrowers influences the level of non performing loans to a very great extent. The study also found that use of content of loan files to monitor loan quality, adoption of an independent credit review, use of specific lending and projects appraisal techniques, adoption of centralized, specialized and scientific management and transforming the operation mechanism comprehensively influence the level of non performing loans to a greater extent. The study further found that loans sales, establishment of professional teams, transfer to loan recovery agencies and restricting of loans influence the level of non performing loans in commercial banks to a greater extent. Other managing techniques for non performing loans adopted by commercial banks influence the level of non performing loans to a moderate extent. From the findings, emphasis on forecasts and feasibility studies, government involvement in fiscal policy formulation and use specific limits ratios in the evaluation influence level of non performing loans to a moderate extent.

On the importance of management of non performing loans in commercial banks, it was found out that management of non performing loans improve the financial performance of banks as interest on loans is the biggest income of banks and increases their liquidity position. Also, the respondents indicated that management of non performing loans helps in protecting the banks reputation and reduces loan losses and leads to quality loan portfolio which leads to better return to the shareholders. It also reduces time wastage on unproductive resources being diverted towards loan recovery whereby such resources can be channelled to other more productive areas.

The study also found that there was a variation of 98.1% of level of non performing loans in commercial banks varied with variation in transforming the operation mechanism comprehensively, adoption of centralized, specialized and scientific management, independent credit review, and establishment of professional teams and borrowers personality profile assessment at a confidence level of 95%.

The established regression equation was;

$Y = \mathbf{1.833 - 1.771\ X_1 - 0.286\ X_2 - 1.358\ X_3 - 0.116 X_4 - 0.574\ X_5}$

From the above regression model, it was found that the level of non performing loans in commercial banks would be at 1.833 holding transforming the operation mechanism comprehensively, adoption of centralized, specialized and scientific management, Independent credit review, and establishment of professional teams and borrowers personality profile assessment to a constant zero. A unit increase in transforming operation mechanism comprehensively would lead to a decrease in level of non performing loans by a factor of 1.771, also unit increase in adoption of centralized, specialized and scientific management would lead to a decrease in the level of non performing loans in commercial banks by a factor of 0.286, a unit increase in independent credit review would result to a decrease in the level of non performing loans by a factor of 1.358, also unit increase in establishment of professional teams would result to decrease in level of non performing loans by factor of 0.116, further a unit increase in Borrowers Personality Profile Assessment would result to a decrease in level of non performing loans by a factor of 0.574.

5.2.2 Conclusions

From the findings, the study concludes that non performing loans leads to commercial banks failure to a greater extent, banks experiences borrower's inability to pay loans due to business failure and also the challenge of the institution not having an effective follow up in the arrears. Banks most of the time has laxity in credit assessment as well as employing trained personnel's to heading credit departments.

From the findings, the study also concludes that factors that causes non performing loans in commercial banks are; failure of bank managers to follow prudent credit policies during an economic upturn, incomplete assessment mechanism and accountability, moral hazards risk and impair security of credit assets ,weak bank independent audit and monitoring causes non performing loans in commercial banks, insider lending and owner concentration, banks negligence in monitoring loans, poor quality of human resource who have not undergone training on credit information, laxity in credit assessment and untrained personnel, lack of aggressive credit collection and bank strategic management focuses only on the analysis of market opportunity and wrong timing of risks identifications.

The study also concludes that management of non performing loans for commercial banks helps to improve the financial performance of banks as interest on loans is the biggest income of banks and increases the liquidity position of banks, helps in protecting the banks reputation and reduces loan losses and leads to quality loan portfolio to better return to the shareholders and it reduces time wastage on unproductive resources being diverted towards loan recovery whereby such resources can be channelled to other more productive areas.

The study further concludes that there was a negative relationship between techniques for managing non performing loans and the level of non-performing loans of commercial banks in Kenya, which implies that increase in effective techniques of managing non performing loans leads to decrease in levels of non performing loans in commercial banks. The established regression equation was;

$$Y = \mathbf{1.833 - 1.771\, X_1 - 0.286\, X_2 - 1.358\, X_3 - 0.116 X_4 - 0.574\, X_5}$$

5.3 Recommendations

From the findings it was established that there was a negative relationship between the level of non performing loans in commercial banks with transforming the operation mechanism comprehensively, adoption of centralized, specialized and scientific management, independent credit review, and establishment of professional teams and borrowers personality profile assessment.

It was found out that non performing loans lead to commercial banks failure as bank experiences borrower's inability to pay the loans due to business failure and also the challenge of the institution not having an effective follow up in the arrears. The study therefore recommended that commercial banks management should adopt effective techniques for managing non performing loans to prevent occurrence of non performing loans in commercial banks, promoting effective operations of the commercial banks.

The study recommended that commercial banks should adopt techniques for management of non performing loans to improve the financial performance, helps in protecting the banks reputation and reduces loan losses and leads to quality loan portfolio to better returns to the shareholders as well as reducing time wastage on unproductive resources being diverted towards loan recovery whereby such resources can be channelled to other more productive areas.

The study recommended that commercial banks in Kenya should enhance transformation of their operation mechanism comprehensively, adoption of centralized, specialized and scientific management, independent credit review, and establishment of professional teams and borrowers personality profile assessment so as to reduce the level of non performing loans.

5.4 Limitations of the Study

The researcher encountered various limitations that tended to hinder access to information sought by the study. These included:

The researcher encountered problems of time as the research was being undertaken in a short period which limited time for doing a wider research particularly where the respondents delayed in filling the questionnaires and travelling to collect the filled ones

The respondents approached were reluctant in giving information fearing that the information sought would be used to intimidate them or print a negative image about the bank. The researcher handled the problem by carrying with him an introduction letter from the University and assured them that the information they gave would be treated confidentially and it was to be used purely for academic purposes.

The researcher also encountered problems in eliciting information from the respondents as the information required was subject to areas of feelings, emotions, attitudes and perceptions, which could not be accurately quantified and/or verified objectively. The researcher encouraged the respondents to participate without holding back the information they had as the research instruments did not bear their names.

Lack of sufficient funds was also another challenge faced by the researcher. The researcher limited himself to one manager in every commercial bank due to inadequacy of funds.

Most of the respondents were busy throughout. Due to official duties time was a major concern. The researcher had to continuously remind them and even persuaded them to provide the required information by showing them the importance of their participation in the study assuring them that they could be provided with a copy of the final project on request.

5.5 Suggestions for Further Research

The study investigated the relationship between techniques for management of non performing loans and level of non performing loans of commercial banks in Kenya.

The financial industry in Kenya however is comprised of various other financial institutions which differ in their way of management and have different settings all together. This warrants the need for another study which would ensure generalization of the study findings for all the financial institutions (both banking and non banking) in Kenya. The study therefore recommends another study be done with an aim to investigate the relationship between techniques for management of non performing loans and level of non performing loans of financial institutions in Kenya.

The study also recommends that a study be carried out to establish the challenges facing management of non performing loans in commercial banks to find out what effective measures should be taken to mitigate occurrence of non performing loans

The study also recommends that a further study should be carried out to determine the effects of quality asset management on profitability of the commercial banks.

A further study should be undertaken to investigate the effects of management practices of the non performing loans and profitability of commercial banks in Kenya to determine the effects of management practices for non performing loans on profitability of commercial banks.

The study further recommends that a further study should be carried out to determine the effects of techniques for management of non performing loans on financial performance of commercial banks in Kenya.

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APPENDICES

Appendix 1: Letter of Introduction

Appendix I1: Questionnaire

1. Gender Male [ ] Female [ ]

2. Indicate by ticking your age bracket

   i. 20- 25 years of age [ ]
   ii. 26-30 years [ ]
   iii. 31 -35 years [ ]
   iv. 36 -40 years [ ]
   v. Above 40 years [ ]

3 What is your highest level of Education? (Tick as applicable)

a).Diploma [ ]

b).Degree [ ]

c).Post graduate [ ]

d).Others (specify)

…………………………………………………………………………...

4 .Indicate the period in years you have been working in your bank.

a) Less than one year [ ]

b) 1-3 years [ ]

c) 3-7 years [ ]

d) 8-10 years [ ]

e) Above 10 years [ ]

SECTION B

5. Does your bank experience problems of non performing loans?

Yes [ ] No [ ]

Explain your answer……………………………………………………………………………….

6 To what extent do you agree with the statement, non performing loans lead to commercial banks failure?

i. Strongly Disagree [ ]

ii. Disagree [ ]

iii. Neutral [ ]

iv. Agree [ ]

v. Strongly Disagree [ ]

Explain

………………………………………………………………………………………………

7. The following are factors considered as causes of non-performing loans among commercial banks. To what extent do you agree with the statement? (1-means strongly disagree, 2-disagree, 3-neutral, 4-agree and 5- strongly agree).

Statement	1	2	3	4	5
Lax credit risk assessment and untrained personnel					
Lack of aggressive credit collection methods					
Banks negligence in monitoring loans					
The speedy process in granting loans					
Insider lending and Owner Concentration					
Incomplete assessment mechanism and accountability					
Bank strategic management focuses only on the analysis of market opportunity and neglects huge potential risk,					
Moral hazards risk and impair security of credit assets					
Poor quality of human resource who have not undergone training on credit information's, and rigid human resource management system in banking institutions					

legal and economical framework concerning securitization of non-performing loans results in a call for government participation via policy adjustments and debt restructuring plans					
Bank internal resource distribution and power allocation are based on bureaucratic levels of institutions					
Weak banks independent audit and monitoring					
Wrong timing of risks identifications					
Failure of bank managers to follow prudent credit policies during an economic upturn, especially in a highly competitive environment					
Under staffing in banks particularly in credit sections					
lack of effective motivation					

8. The following are causes of non performing loans from the client point of view. Which of the following factors contribute most to non performing loans to your bank?

	Yes	No
i. Clients start new business without experience	[ ]	[ ]
ii. The simultaneous operation of many kinds of businesses	[ ]	[ ]
iii. The inappropriate use of the loan	[ ]	[ ]
iv. Debtors conceal vital data in their applications	[ ]	[ ]
v. Insufficient collaterals	[ ]	[ ]
vi. Wrong economic decisions for example unexpected price changes	[ ]	[ ]
vii. Lack of clear assessment framework of managing non-performing loans	[ ]	[ ]
viii. Failure by bank manager to review prevailing market conditions during loan appraisal	[ ]	[ ]

Any other, please specify…………………………………………………………………………

9 To what extent do the following management techniques for non performing loans influences their level in commercial banks? (Where 1-Not at all, 2-Less extent, 3-Moderate Extent, 4 –Great extent and 5 -Very Great extent)

Statement	1	2	3	4	5
Government involvement in fiscal policy formulation					
Information sharing among banks about borrowers					
Use specific limits, ratios in the evaluation process					
Emphasis on forecasts and feasibility studies					
Use of specific lending and project appraisal techniques					
Use of contents of loan files to monitor loan quality.					
Transforming the operation mechanism comprehensively					
Adoption of centralized, specialized and scientific management					
Adoption of an Independent credit review as a foundation					
Increased use of credit reference bureaus					
Assessment of Borrowers Personality Profile					
Loan securitization					
Transfer to loan recovery agency					
Restructuring of loans					
Loans sales					
Establishment of professional teams					

10. In your own opinion, indicate the importance of management of non performing loans to commercial banks.

i…………………………………………………………………………………………

ii………………………………………………………………………………………..

iii………………………………………………………………………………………

Appendix III: List of Commercial Banks in Kenya

1. African Banking Corporation Ltd
2. Bank of Africa Kenya Ltd
3. Bank of Baroda (K) Ltd
4. Bank of India
5. Barclays Bank of Kenya Ltd
6. CFC Stanbic Bank Ltd
7. Charterhouse Bank Ltd (Under- Statutory management)
8. Chase Bank (K) Ltd
9. Citibank N.A. Kenya
10. Commercial Bank of Africa Ltd
11. Consolidated Bank of Kenya Ltd
12. Co-operative Bank of Kenya Ltd
13. Credit Bank Ltd
14. Development Bank Kenya Ltd
15. Diamond Trust Bank (K) Ltd
16. Dubai Bank of Kenya Ltd
17. Ecobank Kenya Ltd
18. Equitorial Commercial Bank Ltd
19. Equity Bank Ltd
20. Family Bank Ltd
21. Fidelity Commercial Bank Ltd
22. Fina Bank Ltd
23. First Community Bank Ltd
24. Giro Commercial Bank Ltd
25. Guardian Bank Ltd
26. Gulf African Bank Ltd
27. Habib Bank A.G. Zurich
28. Habib Bank Ltd
29. Imperial Bank Ltd
30. I&M Bank Ltd
31. Jamii Bora Bank Ltd
32. Kenya Commercial Bank Ltd
33. K-rep Bank Ltd
34. Middle East Bank (K) Ltd
35. National Bank of Kenya Ltd
36. NIC Bank Ltd
37. Oriental Commercial Bank Ltd
38. Paramount Universal Bank Ltd
39. Prime Bank Ltd
40. Standard Chartered Bank (K) Ltd
41. Trans National Bank Ltd
42. Victorial Commercial Bank Ltd
43. UBA Kenya Bank Ltd.