

**DOWNSCALING OF CREDIT RISK POLICIES AS A STRATEGIC  
CHOICE TO GAINING COMPETITIVE ADVANTAGE FOR NIC  
BANK LTD IN THE SME SECTOR IN KENYA**

**BY**

**NYAMBURA S. GATHURU**

**A RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILMENT OF THE  
REQUIREMENT OF THE AWARD OF THE DEGREE OF MASTER OF  
BUSINESS ADMINISTRATION, SCHOOL OF BUSINESS; UNIVERSITY OF  
NAIROBI**

**October, 2012**

## DECLARATION

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

**Signature**..... **Date:** .....

**NYAMBURA S. GATHURU**

**D61/P/8877/2004**

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

**Signature**..... **Date**.....

**DR. Z. B. AWINO, PHD**

Senior Lecturer, Department of Business Administration

School of Business

University of Nairobi

## **DEDICATION**

This project is dedicated to Michelle Lisboa with love. Thank you for your unfailing encouragement in my journey.

## **ACKNOWLEDGEMENT**

There are many people that I feel profound gratitude towards for their contribution towards my undertaking the MBA course. I am deeply indebted to my supervisor Dr. Z. B. Awino, Senior Lecturer, Department of Business Administration, School of Business who patiently and diligently guided me through this research. Without his invaluable advice, this project would not have become a reality.

I am deeply grateful to Sam Nyaoke, who diligently proof read my document every step of the way and encouraged me to press on even when I felt under immense pressure. I acknowledge NIC Bank for allowing me to carry out this study and my research assistants for being so timely with the data collection process.

I also wish to thank all members of staff of the School of Business for their support and advice. I am grateful for the emotional and financial support that my immediate family accorded me through this journey, for their unfailing love and their belief in me.

Thank you.

## LIST OF TABLES

<b>Table 1</b> : Prerequisites for SME Lending.....	37
---	----

## LIST OF FIGURES

<b>Figure 1:</b> Definition of SME.....	8
<b>Figure 2 :</b> Strategic Choice.....	14

## **ABBREVIATIONS AND ACRONYMS**

**CBK** - Central Bank of Kenya

**CRB** - Credit Reference Bureau

**EABL** - East Africa Breweries Limited

**NIC** – National Industrial Credit

**NPL** - Non Performing Loans

**SMEs** – Small Medium Enterprises

## **ABSTRACT**

A firm must have strategic intent on becoming a market leader through deliberate selection of good strategic choices (Pearce & Robinson, 2007). Organizations are increasingly challenged to make sound strategic choices if they expect to gain competitive advantage and return sustainable profits to satisfy the expectations of the shareholders. Cut throat competition coupled with the desire to post positive results has forced banks to begin to look at other sectors which have not been attractive and/or have risks. A good example of such sector is the small and media enterprises (SME) which the banks have avoided for a long time for fear of default. Emerging trends show that banks which embrace SMEs tend to return above average profits. Such banks have to downscale their credit risk policies to remain attractive to the SME sector. NIC Bank has been touted to be the leader in Asset Financing in the country as it controls 30% of the Asset Financing business in the country. It is for this reason that the study sought to investigate down scaling of credit risk policies as a strategic choice to gaining competitive advantage by NIC Bank in the SME sector. Results of the study show that it is important for NIC Bank to downscale credit risk policies. However, it is also imperative that the bank must keep up to speed with advertising to maintain brand loyalty as well as visibility. The study also concluded that NIC Bank should not compromise on the risks inherent in SME loans but pursue strategies such as partnerships to keep SME business in control so as to avoid default.



# TABLE OF CONTENTS

<b>DECLARATION</b> .....	ii
<b>DEDICATION</b> .....	iii
<b>ACKNOWLEDGEMENT</b> .....	iv
<b>LIST OF TABLES</b> .....	v
<b>LIST OF FIGURES</b> .....	vi
<b>ABBREVIATIONS AND ACRONYMS</b> .....	vii
<b>ABSTRACT</b> .....	viii
<b>CHAPTER ONE: INTRODUCTION</b> .....	<b>1</b>
1.1 Background of Study .....	1
1.1.1 The Concept of Strategic Choice .....	3
1.1.2 Competitive Advantage .....	4
1.1.3 Credit Risk Policies.....	5
1.1.4 Banking Industry in Kenya .....	6
1.1.5 NIC Bank Limited.....	7
1.1.6 Small and Medium Enterprises (SME) Sector.....	8
1.2 Research Problem .....	9
1.3 Research Objective .....	11
1.4 Value of the Study .....	11
<b>CHAPTER TWO: LITERATURE REVIEW</b> .....	<b>13</b>
2.1 Introduction.....	13
2.2 Strategic Choice .....	13
2.3 Competitive Advantage .....	14
2.4 Environmental Challenges .....	15
2.5 Downscaling of Credit Risk Policies .....	15
<b>CHAPTER THREE: RESEARCH METHODOLOGY</b> .....	<b>18</b>
3.1 Introduction.....	18
3.2 Research Design.....	18
3.3 Data Collection .....	18
3.6 Data Analysis .....	20

<b>CHAPTER FOUR: DATA ANALYSIS AND INTERPRETATION OF RESULTS</b>	<b>21</b>
4.1 Introduction.....	21
4.2 The Respondents.....	21
4.3 Competitive Advantage .....	21
4.4 SMEs and Non Performing Loans at NIC Bank.....	321
4.5 How NIC Bank is scaling down the Credit Risk Policies.....	33
4.6 Discussion.....	40
<b>CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS</b>	<b>40</b>
5.1 Introduction.....	40
5.2 Summary of Major Findings.....	40
5.3 Conclusions.....	41
5.4 Recommendations.....	42
5.5 Limitations of the Study.....	43
5.6 Suggestions for Further Research .....	43
5.7 Implication on Policy, Theory and Practice.....	43
<b>REFERENCES.....</b>	<b>45</b>
<b>APPENDICES.....</b>	<b>49</b>
<b>Appendix I: List of Commercial Banks Operating in Kenya - 2012.....</b>	<b>49</b>
<b>Appendix II: Interview Guide.....</b>	<b>52</b>
<b>Appendix III: University of Nairobi’s Request Letter for Data Collection.....</b>	<b>55</b>
<b>Appendix IV: NIC Bank’s Approval Letter for Data Collection.....</b>	<b>56</b>

# CHAPTER ONE

## INTRODUCTION

### 1.1 Background of Study

Birger Wernefelt (1984) advanced the idea that strategy of a firm is a function of the complement of the resources held. Many organizations follow strategies that imitate the industry leader. Imitation does not lead to competitive revitalization or competitive advantage but rather preoccupation with catching up. A firm must have strategic intent on becoming a market leader through deliberate selection of good strategic choices (Pearce & Robinson, 2007).

Good strategic choices have to be challenging enough to keep ahead of competitors but also have to be achievable. Strategic choice selection entails an assessment of the available options for markets and products (Pearce & Robinson, 2007). Further, an assessment on available resources, capabilities, and organizational competencies should also be considered.

Competitive advantage is created when resources that are owned exclusively by a firm are applied to developing unique competencies (Wernefelt, 1984). The resulting advantage can be sustained due to lack of substitution and imitation by the firm's competitors. Competitive advantage ultimately can be attributed to ownership of valuable resources that enable the company perform its activities better than competitors.

Commercial Banks in Kenya which have a large portfolio of Small and Medium Enterprises (SME) in their loan book seem to have competitive advantage and post above normal profits year on year (CBK, 2011). SME banking appears to be growing the fastest in emerging markets such as Kenya, where the 'missing middle', describing the gap in financial services provided to SMEs, has been widest (IFC, 2010).

The sector once considered as too difficult to serve by banks, has now become a sweet spot and a strategic oasis for wider profit margins, as larger corporations and retail firms now no longer foster attractive profit margins due to their strong bargaining power for cheaper credit.

NIC Bank has been touted as having achieved above normal average profits in Asset Financing for Small and Medium Enterprises (SMEs) over the last 50 years and thereby gained and sustained competitive advantage over its peer banks in Asset Financing. While this may be true of its Asset Financing strategic business lending unit, other lending areas could benefit from its strategic choice to downscale its credit risk policies and thereby serve this segment with greater success.

In many emerging markets, such as Kenya, access to financial services for SMEs remains severely constrained. Commercial banks have been bargaining with the issue of collateral for decades. Due to limited land ownership status in Kenya (Property Rights in Kenya), entrepreneurs are unable to provide the necessary collateral needed for loan requests.

According to International Labour Organization (ILO) report published in 2008 about 'Factors affecting Women Entrepreneurs in Micro and Small Enterprises in Kenya,' women make up nearly half of all small and medium enterprises owners and 40 percent of smallholder farm managers, yet they have less than 10 percent of the available credit and less than 1 percent of agricultural credit. Despite the fact that some provisions have been made towards gender mainstreaming, there is much more that could be put in place (ILO, 2008).

### **1.1.1 The Concept of Strategic Choice**

Strategic choice is part of the strategy formulation process where the best strategy is picked for implementation. It is a decision point which relates to the process of selecting one option out of various suggestions to be implemented (Ansoff, 1987). Strategic choice is an attempt by an organization to select the scope of operation (Porter, 1985). Porter looked at scope to relate to a choice of either broad (tackling the entire market) or narrow scope (operating in a selected market).

Achieving competitive advantage is made possible through a thorough formulation process and the choice of best option. It is the process of selecting the best option(s) which result into gaining strategic advantage. Strategic choice entails uncertainties in decision area of the organization. Strategic choice requires that the decisions are shaped, designed and redesigned, adequate comparisons made before the ultimate option is selected. (Friend & Hickling, 1987).

Porter, (1980) argued that strategic choice is a difficult process as it is heavily influenced by the environment and the environment is very turbulent. This makes the strategic choice process very complicated. Hrebiniak and Joyce, (1985) considers organizations to adapt to the environment through the right strategic choice. He also considers strategic choice to differ as the environment may dictate. He goes further to purport that whatever choice exist in the organization, focus is primarily placed on means and techniques to be used to transform inputs or produce outputs in more efficient ways so as to achieve competitive advantage.

### **1.1.2 Competitive Advantage**

Competitive advantage entails sustained above normal returns resulting from an organization's resources. It entails generating rent from resources of an organization (Peteraf, 1993). According to Barney (2002) a firm experiences competitive advantage when its actions in an industry or market create economic value. Competitive advantage is achieved when few competing firms are engaging in similar actions. Barney goes on to relate competitive advantage with performance, by emphasizing that a firm obtains above normal performance when it generates greater than expected value from the resources it employs.

Porter (1985) also emphasizes that firms need to build competitive advantage into their strategies. He alleges that competitive advantage is at the heart of a firm's performance in any free market and thus firms need to create and be able to sustain a competitive advantage in an industry in the long-run to remain profitable.

### **1.1.3 Credit Risk Policies**

Conford (2000) defined credit risk as the possibility that the actual return on an investment or loan extended will deviate from that, which was expected. Coyle (2000) looks at credit risk as losses resulting from the refusal or inability of credit customers to pay what is owed in full or in part and on time. Credit policies should set out the bank's lending philosophy and specific procedures and means of monitoring the lending activity (Rajan & Petersen, 1994).

Credit risk is caused by limited institutional capacity, lack of adequate credit policies by an institution, unpredictable or drastic change in interest rates, poor management of funds, poor laws to curb default, low capital and liquidity levels, massive licensing of banks, poor loan underwriting, reckless lending, poor credit assessment, poor loan underwriting, laxity in credit assessment, poor lending practices, government interference in credit assessment and loan issuance and inadequate supervision by the central bank among other (Kithinji, 2010).

Sound credit risk policies outline a set of policies and procedures that formalize a Bank's credit risk management process. The objectives of credit risk policies are to protect against any unwarranted customer or counterparty credit exposures, maintain credit risk at a manageable level, and identify and avoid a material credit failure (a significant value of which would impact earnings).

### **1.1.4 Banking Industry in Kenya**

Central Bank of Kenya (CBK) reports that there are 43 Commercial Banks in Kenya (Appendix 1). These banks divided into Tier I, II, and III with Tier I being the largest by asset base. Kenya Commercial Bank (KCB), Equity Bank, Barclays Bank of Kenya (BBK), Standard Chartered Bank (SCB), Co-Operative Bank of Kenya (Co-Op Bank) make up Tier I, whilst Tier II is made up of Citibank N.A, National Bank of Kenya (NBK), Commercial Bank of Africa (CBA) and National Industrial Credit (NIC).

The banking industry, being the back-bone of lending, has continued to drive the economy of the country. The industry boasts of impressive profits, with a majority of the banks posting positive results year on year. Further, different banks have varying strategies for segmenting and targeting SME sector. The banks which have the best credit risk policies in place for SME sector increasingly perform above the rest in the banking industry (CBK, 2011).

At the backdrop of this are the ever growing concerns on the rise of non-performing loans (NPL) and the high interests levied on credit facilities. The introduction of credit reference bureau (CRB) has had a positive contribution in the loan default rate and banks with time, generally expect to report a reduction on their NPL. The coming of CRB has given the SME sector some hope that banks can consider them for loans as long as they are not listed with CRB as bad debtors (Nyaoke, 2007).



However, the situation of high interest rates on loans has continued to be a hindrance in their access to credit. This topic has generated heated debate amongst the Kenyan public and Members of Parliament, with the Kenyan parliament making serious consideration to capping, through various bills, the rates of interest that banks can levy on loans.

### **1.1.5 NIC Bank Limited**

National Industrial Credit (NIC) bank was incorporated in Kenya in 1959, as one of the first non-bank financial institutions to provide hire purchase and instalment credit finance facilities in Kenya. NIC Bank became a public company in 1971 and is quoted on the Nairobi Securities Exchange with approximately 22,000 shareholders (NIC Bank, 2011).

The bank obtained a commercial banking license in 1995 and merged in 1997 with African Mercantile Bank Limited (AMBank) by way of a share swap in order to allow the bank to enhance its market position, provide a broader and more efficient range of services to its customers and increase the returns to shareholders. The bank has more than 22 branches East Africa (NIC Bank, 2011).

NIC Bank is supported by various sectors; Corporate Banking, Retail Banking (Retail SME and Retail Personal Banking sector) as well as Institutional Banking products. NIC Bank currently operates in three east African countries i.e. Kenya, Uganda and Tanzania with Kenya being the headquarters. NIC Bank serves middle to upper class segment of the social class and is reputed to be relying on technology driven products to meet the demanding needs of its customers. The key driver of success for NIC Bank has been its Asset Financing to SMEs, one of its most thriving strategic business units. The Bank has enjoyed both wider profit margins and larger volume in this line of business.

### 1.1.6 Small and Medium Enterprises (SME) Sector

Wanjumbi, (2007) considers SMEs to be small firms which employ between 1 to 50 employees. According to the SME Exchange presentation to the diaspora conference, (2011) the SME sector in Kenya is categorised as below.

<b>CATEGORY</b>	<b>NUMBER OF FULL TIME EMPLOYEES</b>	<b>TURNOVER</b>
Micro Enterprises	1-10	Kshs. 0-5 Million USD 0-50,000
Small Enterprises	11-50	Kshs. 5-50 Million USD 50,000-500,000
Medium Enterprises	51-100	Kshs. 51M-1Billion USD 0.5M-10Million

**Source:** SME Exchange: presentation to the Diaspora conference – Washington DC 8<sup>th</sup> - 9<sup>th</sup> October 2011

#### **Figure 1: Small and Medium Enterprises Categorization**

International Finance Corporation (IFC) believes SME is the centre of focus for development in the third world. They recommend availing credit facilities to SMEs to open up the economies of such nations. The SMEs in Kenya has been given prominence by donors as well as the government of Kenya. The government created supportive industries such as; Kenya Industrial Estates, the Export Promotion Council and Kenya Institute of Business Training. These industries and initiatives have been created to give necessary support to jumpstart this sector.

The fact that SMEs contribute about 45% of employment and up to 33% of Gross Domestic Product – GDP is of great importance showing that a lot of priority needs to be given to support its growth (BIIA, 2011).

## **1.2 Research Problem**

Strategic choice is at the heart of every strategy formulation process. From a practical standpoint, there will always be a limit on the continuum of possible choices that can be picked and implemented so as to gain competitive advantage. Porter believes that competitive advantage is a position that a firm holds within its competitive landscape. A firm is said to achieve competitive advantage if its profitability is above average profits posted by its peers in the same industry (Porter, 1980).

For a commercial bank to post an above average profits compared to its peers, it must strategically opt to serve a segment of the economy that can guarantee a growth in its revenue streams. Further, it must strategically manage its risk exposure in that market segment. Banks are also exposed to credit risk i.e. the risk of loan default, however, the need to remain profitable has pushed banks to delve into untested territories such as the SME sector. In order to profitably serve this segment, banks must scale down their credit risk policies to be able to accommodate the new business.

The SME sector in Kenya has historically been regarded as a high risk class of borrowers. This is a situation that has been aggrieved by a lack of collateral against which they can be funded, poor accounting practices, diversion of funds from core business, and inability to make periodic loan repayments in full and on time. Many banks have shunned this

sector for fear of loan defaults. Other banks have come up with very stringent conditions which discourage SMEs from seeking credit facilities (CBK, 2011). Ironically, banks which have a large portfolio of the SME in their loan book seem to perform very well as reflected in their profitability.

SME banking appears to be growing the fastest in emerging markets such as Kenya. The sector once considered as too difficult to serve by banks, has now become a sweet spot and a strategic oasis for wider profit margins and NIC Bank has not been left behind in the scramble to bank this segment. Being a bank whose niche is middle and upper middle class, NIC Bank has made an attempt to target the SME business through its Retail Banking offering.

Studies have been done to address how SMEs can be supported by financial institutions. Kithinji, (2010) concluded that banks are exposed to a variety of risks among them; interest rate risk, foreign exchange risk, political risk, market risk, liquidity risk, operational risk and credit risk. Muraguri, (2010) carried out a study on managing the challenges facing SMEs. Kwamboka, (2010) studied the relationship between lending to SMEs and non-performing loans (NPL) for the commercial banks in Kenya. Mutoria, (1995) discussed the factors influencing credit delivery systems to SMEs. Mwirigi, (2006) assessed the credit risk management techniques adopted by microfinance institutions in Kenya, while Mwaura, (2004) studied the environment as a moderator of the relationship between business strategy and performance for SMEs.

It is clear that none of these studies have managed to analyse a bank's strategic choice of scaling down its credit risk policies to gain competitive advantage in the SME sector. It is on this ground that this study is done so as to analyse how NIC Bank can have a competitive advantage by downscaling its credit risk policies for SME lending. Does downscaling of credit risk policies (as a strategic choice) by NIC Bank offer it a competitive advantage in SME business?

### **1.3 Research Objective**

The objective of this study was to determine how downscaling of credit risk policies may help NIC Bank in gaining competitive advantage in SME lending.

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

Fostering a dynamic and vibrant SME sector has been factored as a priority amongst the key sectors to deliver development in Kenya. This is because SMEs are a primary driver for job creation and Gross Domestic Product (GDP) growth. They greatly contribute to economic diversification and social stability and they play an important role in private sector development. This study will therefore contribute to the body of knowledge in academic literature on SME Banking in Kenya.

This study is of importance to NIC Bank Limited as well as the entire banking fraternity as the banking industry seek to understand, recognize and seize the untapped and profitable opportunity that the SME segment represents in the East African Market. This will empower the banks to critically reassess their positions and embrace change which comes through the need to downscale credit policies.

This study is also useful to the Government of Kenya in policy legislation. The Government of Kenya is committed to the economic health of this country. Its obligation towards creation of opportunities for its citizens has seen a shift in focus on more than macroeconomic conditions.

The government will be in a better position to develop policies which encourage ease of entry and exit of SMEs, flexibility in redeploying resources, and clarification of property rights, strengthening of market infrastructure such as credit information and collateral systems and consumer rights' protection can contribute to greater confidence as investors and entrepreneurs look to rebuilding the economy.

The study is important to bilateral and multilateral organizations, development banks, international financial institutions and non-profit institutions keen on expanding access to finance for sustainable private enterprises in developing economies such as Kenya. The monetary and technical expertise that these organizations provide can go a long way in helping commercial banks to better understand and cater to SME financial needs, to better manage SME risk, and to facilitate processing smaller transactions at lower cost and with better service quality.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Introduction**

This chapter looked at the literature related to the topic of discussion by first bring out the need of a firm to making strategic choice. In addition, it looked at the environmental challenges which force banks to resort to downscaling of credit risk policies so as to have a competitive advantage in the market place.

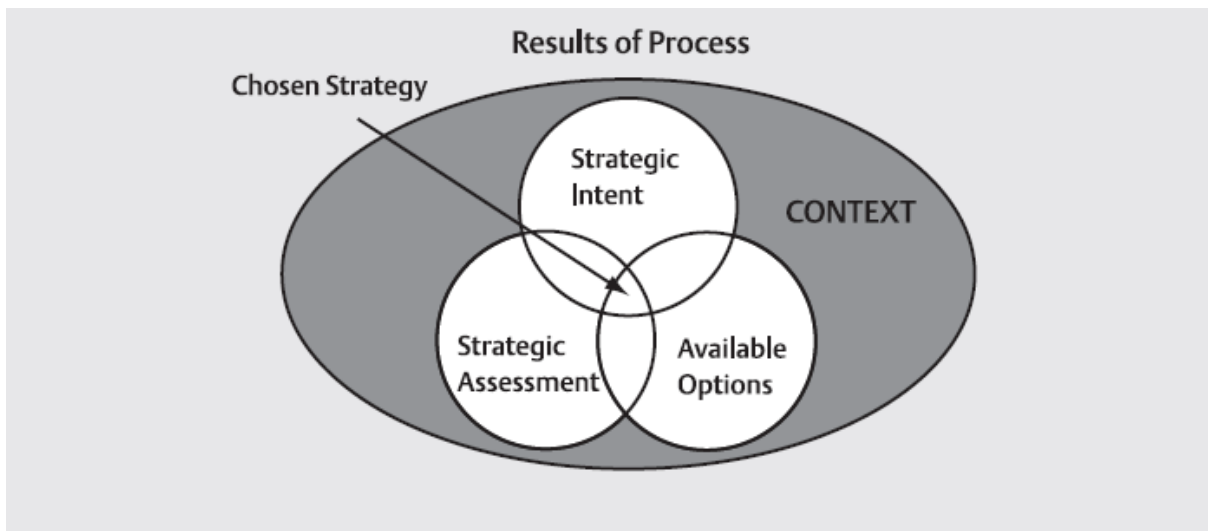
#### **2.2 Strategic Choice**

Aosa, (2000) considers strategic management to be the formulation and implementation of strategies to achieve corporate success. It involves formulation of a vision and mission(s) and objectives of the organization, conducting an analysis and making a choice of the best option to be implemented. The primary purpose of strategic management is to enable organizations achieve competitive advantage (Porter, 1985).

Strategic management refers to a bundle of decisions and actions which are undertaken and which decides the result of the firm's performance. Chandler, (1962) considered strategic management as the determination of the basic long-term goals and objective of an enterprise, and the adoption of courses of action and the allocation of resources necessary for carrying out these goals.

Strategic choice refers to the process of selecting one option for implementation. Strategic choice is one of the key logical elements of the strategy formulation process as

it is at the heart of strategy formulation process. If there are no choices to be made, there can be little value in thinking about strategy at all. On the other hand, there will always, in practice, be limits on the range of possible choices. A good strategic choice is one which is made consciously and is capable of propelling the organization forward to a better future. A good strategic choice is informed by the following characteristics; it is genuine, sound, actionable, and compelling (Martin, 1997).



**Source:** Strategy Management (Pearce & Robinson, 2007)

## **Figure 2 : Strategic Choice**

### **2.3 Competitive Advantage**

As the organization responds to the challenges posed by the environment, it is believed that the firm conquers the environment. This is a rare occurrence and whenever it happens, it is said that the organization achieves competitive advantage (Barney, 2002).



Organizations need to build competitive advantage in their strategy to be able to drive their performance (Porter, 1980). He further emphasizes the need for firms to achieve competitive advantage by pursuing; Cost leadership, Focus or Differentiation strategy; but not to pursue any of these three strategies jointly to avoid being “*stuck in the middle.*” Porter believes that competitive advantage is a position a firm holds within its competitive landscape. A firm is therefore said to achieve competitive advantage if its profitability is above average profits posted by its peers in the same industry.

## **2.4 Environmental Challenges**

Environment relates to all the conditions that affect an organization’s strategic options but which are beyond the organization’s control (Pearce & Robinson 1991). An organization operates within the confines of a surrounding and this is what makes up the environment. The environment is never static and is always changing thereby affecting the decisions made by the organization for survival. Changing environment brings about environmental turbulence due to the unpredictability nature of the environment.

Aosa (1992) noted that environmental turbulence brings about challenges to management as management has to redesign new ways of handling the challenge brought about by the environment. According to Porter (1996), the environment is important in providing initial insight that underpins competitive advantage. The required inputs, accumulated knowledge and skills over time are forces needed to keep progressing

## **2.5 Downscaling of Credit Risk Policies**

According to Financial Sector Team, (2005), downscaling by banks is necessitated by the need by banks to expand their client base and attract new business. Banks consider downscaling their credit risk policies due to market demands, competition from peer banks, pressure by shareholder's dividend demand – meaning raised profit targets, and legal and regulatory environments forcing banks to enter SME territory even when they are not prepared.

Coyle, (2000), considers credit risk management as the identification, measurement, monitoring and control of risk arising from the possibility of default in loan repayments. They observe that credit extended to borrowers may be at the risk of default even though banks extend credit on the understanding that borrowers will repay their loans, some borrowers usually default and as a result, banks income decrease due to the need to make provision for the loans. Credit risk policies are the general guideline put forth by a bank to govern the process of giving credit to its customers. These policies set the rules on who should access credit, when and why one should obtain the credit including repayment arrangements and necessary security (collaterals).

The method of assessment and evaluation of risk of each prospective applicant are part of a credit risk policy (Payle, 1997). Fisher, (1997), observed that banks credit policies should be in line with their strategy and lending policies. The credit policies of the bank should emphasize the fact that only borrowers who meet the requirements for a loan, including ability to repay, are issued with loan. (Rajan & Petersen, 1994) argue that:

*“... a sound credit risk policy would help improve prudential oversight of asset quality, establish a set of minimum standards, and to apply a common language and methodology (assessment of risk, pricing, documentation, securities, authorization, and ethics), for measurement and reporting of non-performing assets, loan classification and provisioning.”*

There is need to have a bank's lending policy be in line with its overall strategy and the factors considered in designing a lending policy should include; the existing credit policy, industry norms, economic condition in the country as well as the prevailing economic climate. According to Sasaki, (2006) sound credit policies would also help improve prudential oversight of asset quality, it will help establish a set of minimum standards, and apply a common methodology-assessment of risk, pricing, documentation, securities, authorization, and ethics, for measurement and reporting of non-performing assets, loan classification and provisioning.

A research by Business Information Industry Association-BIIA, (2011) suggested that there are close to 365 to 445 million micro and SMEs in emerging markets globally of which 25 to 30 million are formal SMEs. Close to 45 to 55 percent of the formal SMEs (about 11 to 17 million) in the emerging markets do not have access to formal institutional loans or overdrafts despite a need for one. The proportional size of the finance gap varies widely across regions and is particularly daunting in Asia and Africa. It is vied that the credit risk policies of banks are not favoring SMEs borrowing and need to be scaled down to accommodate this sector.

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

This chapter provided the appropriate research design for this study, data collection method and data analysis techniques employed.

#### **3.2 Research Design**

The study employed a case study design since it looked at one scenario of NIC Bank out of the entire 43 banks. Since the study sought to establish how downscaling of credit risk policies as a strategic choice of gaining competitive advantage in the SME sector in NIC Bank, a case study was the most suitable design to carry out this investigation.

The choice of case study as a design was appropriate in that it provided an avenue for establishing major themes and patterns in the qualitative data, establishing tentative hypothesis, and then developing theories and conclusion. This helped in offering better generalizability of NIC Bank to the entire banking industry (Mugenda & Mugenda, 2003). Earlier studies (Mwaura, 2004; and Kession, 1981) separately used a case study when investigating the SME sector and their studies were a success

#### **3.3 Data Collection**

This study used a qualitative approach to collect non-numerical data provided by the interview guide and as well as primary data received from the interview (Appendix II – see interview guide). Respondents or informants of the interview were the Business Banking Business Development Managers, Corporate Banking Relationship Managers,

Credit Analysts and Credit Risk Managers. The study also relied on secondary data from the company website, existing company publications such as the credit grading policies and the credit administration policies and product documents.

Previous studies have been done using similar data collection methods with outstanding results obtained. Muraguri, (2010) who carried out a study on managing challenges facing small and medium enterprises (SMEs) in central business district (CBD) of Nairobi as well as Wachira (2010) who carried out an investigation into the role of improvisation in information technology project management in SMEs in Kenya.

The interview guide sought to gather information related to downsizing of credit policies as a competitive advantage for the bank. The interviewers employed open ended questions which elicited respondent's ability to express their view in an articulate manner and to comprehensively address the questions.

The interview targeted respondents who are tasked with the responsibilities of business development and relationship management for the bank's lending products and solutions, credit risk analysts who are tasked with the responsibility of analysing and appraising each credit application and the credit risk managers who safeguard the bank's interest by ensuring all borrowers are compliant to the bank's credit risk policies. Secondary data was collected from the bank's publications (e.g. credit administration policy 2011, credit grading policy 2011, websites, advertising and product marketing materials) these complemented primary data received from the interview.

### **3.6 Data Analysis**

This study analysed the content of the data gathered from the interview as well as from the bank's published and unpublished materials such as credit risk policy documents, procedure manuals, bank's website-[www.nic-bank.com](http://www.nic-bank.com) , print media among other materials availed in the process of data gathering.

The data gathered was then coded, analysed and organized or categorized according to the themes and patterns that emerge. Major themes and patterns identified were related to the research questions or purpose of the study. The results of collated data were reported in narrative and tabular formats.

Presentation of the data was done to correlate credit risk policies of the bank with credit advanced to SMEs and credit risk policies of the bank and the competitive advantage that the bank enjoys in the industry. A thick description was used to paint a picture of the findings of the study and give an in-depth understanding of the discussions brought forth from the interviews.

Validity of the data i.e. the quality, accuracy and credibility of the findings was increased through encouraging of thick descriptions by respondents, keeping a detailed record of each response and checking back with respondents to clarify any unclear answers (Creswell, 2003).

## **CHAPTER FOUR**

### **DATA ANALYSIS AND INTERPRETATION OF RESULTS**

#### **4.1 Introduction**

This chapter presented the findings of the study based on the data collected. The study relied on content analysis since the interview guide generated qualitative data. The study analysed data collected from respondents with emphasis geared towards addressing the objective of the study which was to determine how downscaling of credit risk policies as a strategic choice would help NIC Bank gain competitive advantage in the SME sector.

#### **4.2 The Respondents**

Respondents to the study came from pool of NIC Bank's business development managers, corporate banking relationship managers, credit analysts and credit risk managers. These respondents regularly interface with the bank's SME clients and whose responsibilities include generating and sustaining the bank's lending business by generating viable loan requests, conducting a credit risk analysis on each application and managing the inherent risks involved with the said loans.

A total of 25 in-depth interviews were conducted. Priority was given to the SME lending arm of the asset financing division, this being the division with the largest SME portfolio in the bank. Respondents were encouraged to expound on their answers with thick descriptions and thorough check-back was used to ensure clarity of interview answers.

### **4.2.1 The Market**

The banking industry is wide and large as the sector offers a myriad of products and services ranging from bancassurance as the latest entrants in the banking vocabulary to personal accounts, corporate accounts, children accounts, lending (overdraft, term loan, letters of credit, guarantees etc), investment group affiliated accounts, deposit taking products, cash management, online banking services, custody services, agent banking services, business advisory services, investments services, institutional banking, business incubation services among many others. A whole range of products exist in this industry yet not all of these products or services are offered by all the banks.

The above means that some strategic choice must be made by respective banks, to see which sector they will target and which products or services will be offered to form the banks diversified product range. The choice made by each bank in line with the products or services they choose to offer defines the bank's perception in the market and is therefore a very important strategic process to make (strategic choice).

The banking industry boasts of being an economy driver. Individuals, businesses as well as governments view the bank as the key lender and custodian of the monetary funds of the country and therefore the ultimate driver of growth without which the country financial success is doomed. The banking industry controls about 30% of the economy currently and is therefore a very important component of the economy.



Banks offer loans which is used to support businesses, individuals also borrow from banks for personal development initiatives such as mortgages, asset financing, insurance premium financing as well as personal loans for general upkeep and support of financial obligations by individuals such as school fees payments among others. Of marked importance is also the role of banks to act as custodian of client funds where individual, businesses and corporations save their excess funds for higher interest. This industry is key in the development of a nation and should therefore be given credit on its role in national building.

The banking industry has been growing tremendously with the five major banks i.e. Kenya Commercial Bank, Equity Bank of Kenya, Standard bank of Kenya, Barclays Bank of Kenya and Cooperative bank of Kenya posting profits in billions. Even at the Nairobi Securities Exchange, the banking counters are a wash with investors as they are considered blue chip whose return on investment is always guaranteed to post good results.

#### **4.2.2 The Banking Environment**

The banking industry is made up of 43 banks. These banks are in constant competition as each of them tries to elbow the other for a larger wallet size of the bankable population. The leading SME bank, Equity Bank, enjoys the largest SME business, with its market share being up to 7 million individual accounts from the industry total of 14 million. The banking sector segments its products and market reach into four categories; corporate, retail, personal and SMEs.

Market Segmentation has seen many banks strategic opt to specialize in specific sectors or markets so as to capitalise on higher profit margins. NIC Bank being a major player in the industry is the leading asset finance specialist with 3 out of every 10 motor vehicles being financed by NIC Bank.

The banking industry is also very unique as it is made of customers who are multi banked. Consequently, these customers have the capability of knowing which banks offer the best interest rates as well as better services in each sector. This invariably gives the customer a bargaining edge and can greatly affect a bank's competitive advantage.

Competition is the norm within the and between banks as banks have become strategic in the way they serve their niche and therefore information which is considered vital is easily hoarded from leakage to the competitors. Despite these, the industry also has the highest record of turn over as staff move from one bank to the other freely leading to similarities in some bank products.

### **4.2.3 Strategic Choice**

Due to the proliferation of many products and services, the banks find themselves in a dilemma on which area or product to concentrate. As Porter (1985) suggested, it is not viable to pursue multiple strategy as one will be "stuck in the middle." With this in mind, NIC Bank has demonstrated that in the wider offering that banks make to their customers; it chooses to pursue asset financing as its niche.

Therefore the core driver of NIC Bank business is Asset finance. This choice puts NIC Bank on the driving seat of key asset finance business as the bank assumes a leadership role as the rest of the industry are left to pursue a follower perspective. This is a very strategic position for the bank as it now controls 30% of the entire assets business in the country.

The bank also pursues a differentiated strategy and attempts to do this within the precincts of its niche Asset Financing strength. This has been achieved through pursuing leasing, term loans, bank guarantees, invoice discounting and trade financing among other business support services. Looking at new business lines such as agent banking as well as bancassurance, NIC Bank has delivered tremendous business mileage compared to competition. It is through such choices that the bank is capable of expanding without the need to grow branch network.

Through partnerships with Postbank, NIC Bank has opened additional 105 branches despite having only 18 of its own. By working with dealers across the country, the bank has delivered services closer to the people hence making its offering attractive, viable and visible.

#### **4.2.4 Performance of NIC Bank**

As a public listed bank on the Nairobi Securities Exchange, NIC Bank forms one of the leading players in the financial sector. The bank has guaranteed its shareholders maximum wealth creation through a strong share price and favourable earnings per share. NIC Bank's long-term strategy has been to provide a one-stop shop for all financial

requirements of its esteemed customers. Today, the Bank stands on three pillars of strength which together form the NIC Group; NIC Bank (with nineteen branches in Kenya, three branches on Tanzania and a branch in Uganda), NIC Insurance Agency, NIC Securities and NIC Investment Bank.

The bank is a top performer when it comes to return on investment. The bank has posted above 2 billion profits in the past three years (2009, 2010, and 2011) and this figure keeps growing each year. The fact that shareholders are willing to invest in its counter at the stock exchange is due mainly to its profitability as well as the return on investment that its shares attracts.

In the results posted in 2012, the bank returned a whopping 3.6 billion shilling profit. This is an excellent result considering that the economic times are tough and interest rates were not stable then. These positive results are a manifestation that the strategies employed by the bank are bearing fruits.

### **4.3 Competitive Advantage of NIC Bank**

As a leader in asset financing, it is important to analyse why NIC Bank is considered attractive by its customers. The following are reasons why NIC Bank excels in asset finance over the other banks. These responses were as perceived by the banks staff interviewed.

### **4.3.1 Loan Processing Turn Around Time (TAT)**

In comparison with the industry, NIC Bank boasts of a shorter TAT as it has a short response to customer loan needs and this makes it appealing and attractive to customers. The bank gives TAT time of 48 hours to return a decision on whether they will lend or not. This is a market first as most bank will not have a clear timing and loans might take as long as a month for the decision to be made.

The Speed by which the banks processes loan needs of its customers is fast and most customers are impressed by this turn around time. This gives the bank an edge over its competition. It was observed that majority of small borrowers do not mind higher interest but are concerned about the time it takes to get a facility from a bank.

Further, it was evident that most SMEs seek loaning facilities immediately they secure a supply deal meaning that time is of essence and therefore any delay in availing the facility hurts their business opportunities.

### **4.3.2 Strategic Partnerships**

Having known that the SME business requires numbers, the bank evaluated its weaknesses of having just 18 branches. These branches were considered few and hence the need to do something towards busting its presence. The response of NIC Bank towards this is strategic partnerships through dealerships, agent banking, and bancassurance among other strategic initiatives has given the banks the much need boost in its regional presence or footprint.

This strategic positioning has given NIC Bank an edge above its competitors as customers find the bank's products accessible and closer to their reach. Services such as deposits and withdrawals can be done at any agent location such as Postbank. Further, strategic partnership with mobile operator, Safaricom through its innovative Mpesa service, the bank has perfected accessibility to its banking services and enhanced convenience-banking to enable customers even repay their loans from very remote locations.

The bank has equally entered into a relationship with dealers (in what it refers to dealership) where major motor vehicle dealers are equipped with banking equipment where asset booking or application is done. When this is done with the dealers, the application is availed immediately at NIC Bank hence reducing the time it would take to mail the application, sort and then analyse the application. As part of the process, the scanners and the use of technology to speed up the application process has made NIC Bank's asset finance business very attractive to the general public.

In addition to this, all the qualification procedures are availed with the dealers and therefore 95% of all applications done qualify for the loan as the evaluation process including financial spreadsheets which calculate the loan is availed to the applicant hence shortening the process and also gives the applicant an option to seek application only after qualifying for the same.

### **4.3.3 Extended Loan Repayment Period**

Benchmarking on the industry, most banks offers 60 months of loan repayment today. This is an ideal condition which always means that the monthly repayment must be high for the SMEs. What is attractive with NIC Bank is its ability to stretch this to 72 months or more considering the situation of its customer.

NIC Bank provides a reasonable and flexible repayment plan for its customers something with is very attractive to its niche business. NIC Bank is now considered a house hold name especially when the interest rates go up and become unbearable. With the current increase in interest rates, the bank was forced to adjust its repayment plans to beyond the 72 months to spread the risk of customer so that they do not default.

The strategy worked well and whilst other banks were posting increased Non Performing Loans (NPL), NIC Bank reported a reduced NPL between 2010, 2011 and 2012 (6 months results). This is a manifestation that the relaxation of repayment time has contributed to the reduced NPL book.

### **4.3.4 Credit Risk Policies of NIC Bank**

One of the outstanding issues that NIC Bank's customers have is the bank's rigid policy on lending. In the industry, NIC Bank is considered the most difficult bank when it comes to lending. This is attributed to its rigid credit policy as the bank is considered very risk averse. The risk department normally looks at various inherent risks associated to the credit facility before advancing any loans.

Amongst some of the credit risks analysed include; interest rates risk, foreign exchange risks, credit risks, operational risks, political risks, market risks, reputational risks, liquidity risks among many other risks. The bank's risk department must look at all these risks before advancing any loan and these risks when looked at from the flip side from the customer perspective are hindrances towards issuance of loans.

According to CBK (2010) report the commercial banks have faced difficulties over the years for a multitude of reasons; the major cause of serious financial problems continues to be directly related to credit standards for borrowers, poor portfolio risk management or lack of attention to changes in the economic circumstances and competitive climate. The credit decision should be based on a thorough evaluation of the risk conditions of the lending and the characteristics of the borrower.

The global credit crunch was caused by inability of banks to observe strict credit risks which is what made banks lend beyond what borrowers can afford to pay up. NIC Bank does not intend to contribute to such crunch and has therefore put in place a strong credit risk unit to look through its loan requests.

Despite the bank having stringent credit policies, this study also found out that the bank is attractive in asset financing and therefore needed to find out why this is the case since one of the obstacles that has contributed to this study is the need for banks to relax their credit risk policies to attract more customers.



### **4.3.5 Aggressive Marketing**

Attractiveness of NIC Bank can also be attributed to the bank's aggressive marketing campaign which has seen its brand image grow. The awareness has placed NIC Bank in the lips of both customers and dealers alike giving the bank the much needed visibility and millage.

NIC Bank has reserved a budget for marketing, something most banks don't do. The bank having know that it is a market leader in asset financing, continuously looks for opportunities to be visible. In this regard, the bank has sponsored golf tournaments, concur de elegant among other marketing opportunities. In addition, the bank has hired most strategic bill boards and placed advertisements to books its visibility further.

## **4.4 SMEs and Non Performing Loans at NIC Bank**

The NPL of NIC Bank was a challenge in the past especially before CRB was put in place by CBK and Kenya Bankers Association. Since the introduction of CRB, most customers have tried to pay up their loans so that they are not listed wit CRB. At the moment, NIC Bank has a vey small NPL book compared to the industry.

Maintaining the banks NPL ratio at single digit has been attributed to its credit policy as well as the aggressive nature of the debt recovery unit which work's closely with customers to monitor and assist customers through reminders and follow ups on their debts before they go stale.

NIC Bank, in addition, engages commercial agents such as the Credit Reference Bureaus and the Kenya School of Credit and Auctioneers to assist in debt recoveries. The above measures have assisted NIC Bank to contain and even lower its NPL book to the envy of other banks.

## **4.5 How NIC Bank is scaling down the Credit Risk Policies**

As a strategic choice, NIC Bank has deliberately opted to relax its credit policies in various ways and in several lending products to ensure that its strength in SME business is not eroded. The following are areas where NIC Bank concentrated on when it comes to relaxing its credit policies;

### **4.5.1 Regularly amending credit risk policies in line with market**

NIC Bank has over time been reviewing its credit risk policies to accommodate emerging business. The bank has shifted from offering purely secured loans to unsecured loans. This decision took a concerted effort by the business banking unit of the bank who are the main SME lending arm because of the loss of business to competition. The business unit was able to discern their success in other lending products such as Asset Financing with the view to replicating this in the credit risk policy across other tenable lending products for the SME sector.

This decision to consider non secured loans have given NIC Bank ammunition to target markets which were originally not a target for NIC Bank. The relaxing of risk policies in this case enables the bank enlarge its market niche hence expanding the bank's market.

### **4.5.2 Referral-Based Lending**

The bank has also relaxed its credit policy when a loan request has emanated from a referral from a know customer or a reputable personality such as a director of the bank, a major account holder or key bank supplier. This has seen the bank reduce its strictness when it comes to evaluating the requirements of the appraisal of the loan as opposed to the rigorous process it would put the lender if it was purely a walk in customer.

This looks discriminatory and unprofessional but on the contrary, such loans have been repaid without any hitch of default as the pressure the borrower find themselves in is adequate to ensure they do not disappoint the good will of the person whose name they managed to get the loan approved.

### **4.5.3 Group Lending**

A recent concept of borrowing that the bank has embraced is group lending. This is lending to a number of people who come up to form a group (marry go round, chama or Savings and credit cooperative - SACCO). Under this type of savings, the bank would provide its conditions for lending to the members by asking each member to beef up their savings portfolio to a certain amount of money such that when they need to borrow, they use the strength of the group as a guarantee.

This concept has proved successful as it has shown that due to peer pressure, members would not want to disappoint their colleagues by defaulting hence they pay up promptly. This concept has seen the bank not insist on security hence the relaxation of policy to

extend credit to groups that the bank would have avoided had it stuck with its rigid credit policies. This concept has given rise to a new product referred to as 'Chama' Accounts (Investment Group Accounts) which brings together groups of like minded people for the sake of saving to borrow on the strength of the group.

#### **4.5.4 Borrowing through Guarantees**

Borrowing through guarantees is a new concept which NIC Bank has adopted to enable individual as well as organizations, which do not have proper security, to take advantage of their network to acquire loans. Through this borrowing method, credit risk department of NIC Bank will require a borrowing firm to seek a written guarantee from another firm indicating how much the guaranteeing individual or organization is willing to pledge to support the borrowing individual or organization.

NIC Bank refers to this method of borrowing as network borrowing. It is gaining prominence and popularity. However, network borrowing comes with its challenges. Should the borrowing individual or organization fail to honour its obligation to pay up, the guarantor i.e. guaranteeing person or organization will have to part up with the guarantee equivalent.

Guarantees was initially not a means where NIC Bank was lending against but since it does this right now, is a manifestation that the bank is relaxing its stringent credit risk measures as it now shifts away from the traditional credit appraisal on the borrower to accommodating its network.

#### **4.5.5 Assessing Owners Reputation**

Character lending is a new concept that NIC Bank has adopted in which the person borrowing is put to scale on his or her behaviour scrutiny. This is one of the most subjective evaluation which this study found very difficult to manage even though NIC Bank makes use of it in its credit risk analysis when it comes to issuing loans to individuals as sole entrepreneurs.

The bank does character analysis by evaluating the borrowers standing in the community through leaders and known contacts. This the banks can achieve through talking to people you have referred to as your referrals as well as village elders, and church leaders. The most important benefit of this type of analysis is seen in the strengthening of Know your customer (KYC), a decision which helps when a loaner defaults and the debt recovery department now has adequate information to trace the physical residence and work place of the individual or company for repossession purposes.

#### **4.5.6 Collateral Lending**

This is the most popular security used by banks to extend lending. NIC Bank makes use of this requirement as it is a sure way of ensuring that funds borrowed are adequately covered by the pledged security. Of marked importance in this security is the fact that NIC Bank has relaxed the requirement to seek traditional security. Instead, the banks have toned down this requirement to include chattels, animals (hard of cows), and stationary plant machinery among others.

The relaxing of this stringent requirement of security has given the banks additional business as most SMEs who cannot afford the traditional security such as land title deed (prime land in major towns) are accommodated and in effect the borrowing pool is expanded thereby making the bank have increased client base to lend. This ultimately contributes to increased profits as a result of increased interest the bank charges on such borrowings.

#### **4.5.7 Supplier Based Lending**

In situations where there is a reputable firm such as East Africa Breweries Limited (EABL) or Kenya Shell who have distributors willing to borrow from the bank, the bank does engage the dominant customer into an arrangement where the bank may lend suppliers of the main company e.g. EABL or Kenya Shell without insisting on individualised collaterals. This way, the bank will have supported SME by structuring loans to them through the strength of the SME's main supplier.

Petro stations that are supplied with Kenya Shell can approach NIC Bank and have loans advanced to them in a way that Kenya Shell will channel all the repayments through NIC Bank. This way, the risk of default is mitigated and the bank's credit risk policy of insisting on secured loaning is relaxed at the strength of the dominant company. Supplier based lending has been one of growth tangents for the SME sector that the bank has taken advantage of as this type of lending greatly leverages off larger corporations who have solid and stable relationships with the bank. The bank has seen its SME portfolio grow considerably in this way.

#### **4.5.8 Scheme Lending**

These are loans offered by the banks to employees of an organization who banks at NIC Bank. What the bank does in such a case is to have special arrangement with these organizations such that the need to have collaterals by borrowers is removed and instead, the firm's financial strength is used as goodwill to borrowing.

In addition, the organization would provide a corporate guarantee or ascent to a check-off arrangement to ensure that employees that benefit from the loan products under this scheme do in fact honour their loan repayments. This has been beneficial to many people as whereas the bank would not lend such individuals they came directly to seek loans, the employees can now be granted loan based on the strength of their company. The bank's credit policy in this case is overlooked (relaxed) to accommodate the staff borrowing.

The bank has experienced an exponential growth in its lending through the Scheme Lending strategy. Further it has managed to contain its NPL book as a result of the backing of the guaranteeing organisation. It has seen greater goodwill and symbiotic relationships established with such organisations.

**Table 1 : Prerequisites for SME Lending**

	<b>How NIC Bank Evaluates SME Loans</b>
1	Previous history of any loans offered to the SME
2	Ability to repay the loan
3	Cash Flow Statement
4	Character of the owner
5	Succession of owner managed business
6	Availability of Collaterals
7	Nature of the Business
8	Customer Turnover
9	TAT of repayment by borrowers suppliers
10	Age of the firm
11	Size of the firm
12	Source of repayment
13	Management structure of the firm
14	Industry of operation
15	Challenges of competition borrower is exposed to
16	Reputation of the firm in the industry
17	Whether the firm is listed with Credit Reference Bureau (CRB)

The table above shows the several and important factors that NIC Bank considers before lending to the SMEs. This information is useful in carrying out credit analysis on borrowers. It further assists the risk managers take a sound credit decision on borrowers.



## **4.6 Discussion**

Based on the results of the content analysis collected from the interview process, it was clear that the banks efforts in relaxing credit risk policies have help build confidence in the SME business hence raising the stakes of NIC Bank in the new market. This has been demonstrated by the existing statistics which give credit to NIC Bank's Asset Finance client base in which the banks holds 30% of the Kenyan Asset Finance business.

Most SMEs are disadvantaged by their lack of security to be used as collateral for loans. The study found out that the biggest impediment to the collateral requirement is the rigid credit risk policies of the bank. The study further noted that in areas where the credit risks policies have been relaxed (such as use of group lending, use of multiple non traditional chattels and use of referrals and reputational lending); the bank's SME borrowing has surged up. This has demonstrated that downscaling of credit risk policies is a sure way of opening up the lending business to the SMEs therefore guaranteeing the bank's growth.

In summary, NIC Bank's competitive advantage has been in the SME sectors in the field of asset financing as demonstrated by the bank's collaboration with dealers and its concerted efforts to deliberately relax credit risk policies. This competitive advantage must be guarded by ensuring that the bank differentiates its products to ensure that their core business is not copied by competition.

## **CHAPTER FIVE**

### **SUMMARY, CONCLUSION AND RECOMMENDATIONS**

#### **5.1 Introduction**

This chapter summarized the findings based on the objective of the study. The purpose of the study was to study how downscaling of credit risk policies as a strategic choice gives NIC Bank competitive advantage in SME lending.

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

The study has positively supported the need for NIC Bank to relax its credit risk policies. However, these policies need to be relaxed in a selective manner not to lead to growth of NPL. The study demonstrated that credit risk policies alone cannot lead to competitive. As supported by Porter (1985), NIC Bank has shown that differentiation (through collaborations, strategic partnerships, and marketing) can keep the brand of the NIC Bank relevant and hence leading to comparative advantage.

Even as the bank scales down its credit risk policies, the study has shown that the bank attempted to use other strategies to ensure that the SME NPL book did not increase. NPL growth has been tamed through an aggressive proactive lending where relationship managers only source for quality lending to SMEs which have passed the requirements. In addition, setting up an aggressive debt recovery department and working closely with CRB as well as other banks to list and lock out 'serial' defaulters from borrowing helped further manage the bank's NPL book.

The bank has put various measures to ensure loans don't go bad and before they go bad, enough efforts have been put in place to seek early recovery and in effect reducing the exposure even if it means getting a small part of the loan and writing-off the accumulated interest. It was also evident from the findings that the introduction of CRB has contributed positively in lowering the NPL book of banks.

### **5.3 Conclusions**

This study would wish to commend NIC Bank for a work well done when it comes to courting the SME business. The performance of the bank has shown a lot of due diligent put in place before extending loans to SMEs. Adequate credit risk policies are also in place to guide the process of lending to SMEs. This has led the bank to operate on rules rather than on whims.

The bank has demonstrated that not all SMEs are the same and hence the need to come up with various measures of credit risk scales to appraise the various SME borrowers. NIC Bank has proactively and deliberately taken up credit risk friendly measures. It has severally reviewed its unfriendly perceived credit policies by replacing them with a more friendly ones thereby remaining relevant in the eyes of the borrowers.

The bank has also been put in place a clear communication with its customers such that whenever a loan request is declined. Quick turn around time on loans coupled with a faster communication with borrowers has given SMEs a reason to trust NIC Bank's credit decision as one which is objective and open.

The competitive advantage which NIC Bank enjoys is likely to last longer as the banks is regularly reviewing its credit risk policies as well as reinforcing it with other strategies in marketing and strategic partnerships. Aggressive marketing such as think biggest promotion has given NIC Bank an edge over competition and this will see the bank rake in SME customers for a long period of time as long as the bank remains as relevant as it is currently.

#### **5.4 Recommendations**

This study recommends that NIC Bank should ensure that as long as it needs to maintain the competitive advantage through downscaling of its credit risk policies, it must do this with care as the NPL book may grow if the quest to borrow is not strictly controlled through credit risk department.

The bank equally needs to enlist services of debt recovery personnel from private practice so as to beef up any would be debt recovery cases which the bank staff may not offer. In doing so, the bank will be guaranteed of a healthy loan book full of good loans. Strong debt recovery operational strategies also need to be put in place beyond the use of CRB to ensure the competitive advantage of the bank in offering SME loans lasts longer. In addition, debt recovery department needs to above all support credit risk as well as relationship management of the bank to be able to have a competitive advantage.

## **5.5 Limitations of the Study**

A good study would have come off this research had it have been conducted in on the entire banking sector. Due to time constraint, this would was not possible hence the choice of a case study.

It was also very difficult to believe that the staff of NIC Bank gave factual information as they are on oath of secrecy not to disclose bank sensitive information especially that which is related to market intelligence. It is our belief that some of the staff did not offer genuine information for fear of exposing the bank's ideas to competition.

## **5.6 Suggestions for Further Research**

This study suggests similar studies can be carried out to exhaust each downscaling strategy that a bank can use to gain competitive advantage. In addition further studies can be carried out to give a comparative analysis of downscaling strategies across the banking industry in Kenya.

A similar study can be carried with analysis on the effects of downscaling of credit risk policies on SME lending to juxtapose the finding with what this study came up with. Such studies will not only give a good read but will also cover grounds which this study might have omitted.

## **5.7 Implication on Policy, Theory and Practice**

The findings of this study will inform policy makers as they seek to develop sound policies and legislations which encourage ease of entry and exit of SMEs in their chosen industries, strengthening of market infrastructure such as credit information and collateral systems, flexibility in resource redeployment, clarification of property rights and consumer rights' protection.

The finding of this study will contribute to the body of knowledge in academic literature on SME Banking in Kenya. It will contribute towards literature on specific strategic choices that organizations can engage to gain competitive advantage. It will inform other literary academicians as they seek to expound and analyse of effects downscaling of credit risk policies as a strategic choice to gaining competitive advantage in SME lending.

The findings of this study will reiterate to NIC Bank those credit risk strategies that have guaranteed a growth in the SME portfolio thus far. The finding will also inform the bank on those downscaling strategies that can be further replicated alongside newly developed lending products to keep the bank ahead of its competition as it seeks to continually understand, recognize and seize the untapped and profitable opportunity that the SME segment represents in the East African Market. The finding of this study will also serve to inform bi and multilateral organizations, development banks, international financial institutions in their endeavour to expanding access to finance for sustainable private enterprises in developing economies such as Kenya.

## REFERENCES

- Aosa, E. (1992). *An Empirical Investigation of Aspects of Strategy Formulation and Implementation within Large Private Manufacturing Companies in Kenya*, Unpublished Thesis, Strathcycle University.
- Ansoff, I. (1987). *Corporate Strategy*, rev. edition. London: Penguin.
- Business Information Industry Association, (2011). *Scaling-up SME Access to Financial Services in Developing World*, Wilson House, 19-27 Wyndham Street, Central, Hong Kong. Retrieved from: [www.biaa.com](http://www.biaa.com) .
- Barney, J. B. (2002). *Gaining and Sustaining Competitive Advantage*, 2nd ed. Reading, Mass: Addison-Wesley.
- Brand Kenya, Capital Markets and Kenya Vision 2030, (2011), *SME Exchange*, Presentation to the Diaspora Conference – Washington DC. Retrieved from: <http://kenyaembassy.com/pdfs/diaspora/Kenya%20Vision%202030%20>.
- CBK, (2011). Prudential Report. Retrieved from: [www.cbk.co.ke](http://www.cbk.co.ke).
- Chandler, A. (1962). *Strategy and Structure: Chapters in the History of American Industrial Enterprise*, Cambridge, MA: The MIT Press.
- Conford A (2000). “The Basel Committee’s Proposals for Revised Capital Standards: Rationale, Design and Possible Incidence, G-24 Discussion Paper Series”, United Nations, No.3, May.
- Coyle, B. (2000). *Framework for Credit Risk Management*; Chartered Institute of Bankers, United Kingdom.
- Financial Sector Team, (2005). *Banking the Underserved: New Opportunities for*

Commercial Banks. Policy Division Department for International Development  
London.

Fisher S (1997). "Banking Soundness and the Role of the Fund" Paper Presented at the  
7th Seminar on Central Banking, Washington DC, IMF Publications Services.

Friend, JK. & Hickling, A. (1987). *Planning Under pressure: the Strategic Choice  
Approach*. 1987. Pergamon (Urban and Regional Planning Series, Volume 37).  
Oxford. Retrieved from:

<http://www2.ifm.eng.cam.ac.uk/dstools/choosing/strach.html>.

Hrebiniak, L. G., & Joyce, W. F. (1985). Strategic Choice and Environmental  
Determinism. *Administrative Science Quarterly*, Vol. 30, No. 3 (Sep., 1985), pp.  
336-34. Retrieved from:

[http://apps.business.ualberta.ca/mlounsbury/smo701/readings/hrebiniak%20joyce.  
pdf](http://apps.business.ualberta.ca/mlounsbury/smo701/readings/hrebiniak%20joyce.pdf).

Kession, J.K., (1981). A Study of the Problems Facing Small Businesses and The  
Effect of Management Training on the Performance of the Proprietors: A Case  
Study of the Nandi District. Unpublished MBA Project, School of Business,  
University of Nairobi.

Kithinji, M. A. (2010). Credit Risk Management and Profitability of Commercial Banks  
in Kenya. *Ibuma Journal of Management*.

Retrieved from: [www.ibuma.org/proceedings2011](http://www.ibuma.org/proceedings2011).

Kwamboka, N, K. (2010). A Survey of the Behavioural Factors Influencing the Choice of  
Financing Methods by SMEs: A Case Study of Study of Ruiru Municipality.

Unpublished MBA Project, School of Business, University of Nairobi



IFC, (2010). Scaling-Up SME Access to Financial Services in the Developing World

Retrieved from: [www.ifc.org](http://www.ifc.org).

Martin, R. (1997). *Strategic Choice Structuring*. Rotman School of Management.

Retrieved from:

<http://www.rotman.utoronto.ca/rogermartin/newScans/strategicChoiceStructuring.pdf>.

Mulandi, M.P. (2010). Assessment of the Impact of Microfinance Institutions on Micro, Small and Medium Enterprises in Kenya. Unpublished MBA Project, School of Business, University of Nairobi.

Mugenda, O.M & Mugenda A.G. (2003). *Research Methods: Quantitative & Qualitative Approaches*. Nairobi Acts Press.

Muraguri, P.K., (2010). Managing Challenges Facing Small and Medium Enterprises (SMEs) In Central Business District Of Nairobi, Kenya. Unpublished MBA Project, School of Business, University of Nairobi.

Mwaura, G.R., (2004). *Environment as a Moderator of the Relationship Between Business Strategy & Performance*. A case of SMES in Kenya. Unpublished MBA Project, School of Business, University of Nairobi.

Mwirigi. P.K., (2006). An Assessment of Credit Risk Management Techniques adopted by Microfinance Institutions in Kenya. Unpublished MBA Project, School of Business, University of Nairobi.

Payle D (1997). "*Bank Risk Management*", Working Paper No.272, University of California.

Pearce, J., & Robinson, R. (1991). *Strategic Management: Formulation, Implementation*

- and Control*, 4th Ed, USA: Pitman Publishing.
- Pearce & Robinson, (2007). *Strategic Management: Formulation, Implementation and Control*. New York: McGraw-Hill.
- Peteraf, M. A. (1993). “The Cornerstones of Competitive Advantage: A Resource-Based View”, *Strategic Management Journal*, 14, pp. 179–191.
- Porter, M.E. (1980). *Competitive Strategy*. New York, The Free Press. New York.
- Porter, M.E. (1985). *Competitive Advantage*. New York. The Free Press. New York.
- Porter, M.E. (1996), *What is strategy?* Harvard Business Review v74, pp.18.
- Rajan R.G. and Petersen M.A. (1994). “*Relationship Lending: Is It Incentives or Hidden Information?*” Retrieved from: <http://www.econ.puc-rio.br/pdf/td519.pdf>.
- Sasaki Y.N. (2006). “Japanese Banks’ Credit Allocation under the Requirement of *Basle Capital Standards and the Burden of Non-Performing Loans*”, Department of Economics, Meiji Gakuin University.
- Wachira, E. (2010). An Investigation into the Role of Improvisation in Information Technology Project Management in SMEs in Kenya. Unpublished MBA Project, School of Business, University of Nairobi.
- Wanjumbi M., (2007). Banking on Small Enterprises. Business in Africa. Retrieved from: <http://www.newtimesconsultants.com/Barclays%20Research.pdf>.
- Wernefelt, B. (1984). “A Resource-Based View of the Firm”, *Strategic Management Journal*, Vol. 5, Issue 2, p. 171-180 1984. Available at SSRN: <http://ssrn.com/abstract=1505260>.

## APPENDICES

### Appendix I: List of Commercial Banks Operating in Kenya - 2012

1	African Banking Corporation, Nairobi
2	Bank of Africa Kenya, Nairobi
3	Bank of Baroda, Nairobi
4	Bank of India, Nairobi
5	Barclays Bank of Kenya, Nairobi
6	CFC Stanbic Bank, Nairobi
7	Chase Bank Ltd, Nairobi
8	Citibank, Nairobi
9	City Finance Bank, Nairobi
10	Co-operative Bank of Kenya, Nairobi
11	Commercial Bank of Africa, Nairobi
12	Consolidated Bank of Kenya Ltd, Nairobi
13	Credit Bank Ltd, Nairobi
14	Development Bank of Kenya, Nairobi
15	Diamond Trust Bank, Nairobi
16	Dubai Bank Kenya Ltd, Nairobi
17	Equatorial Commercial Bank Ltd, Nairobi
18	Equity Bank, Nairobi
19	Family Bank, Nairobi
20	Fidelity (Commercial) Bank Ltd, Nairobi
21	Fina Bank Ltd, Nairobi
22	First Community Bank Ltd, Nairobi
23	Giro Commercial Bank Ltd, Nairobi
24	Guardian Bank, Nairobi

25	Gulf African Bank Ltd, Nairobi
26	Habib Bank A.G. Zurich, Nairobi
27	Habib Bank Ltd, Nairobi
28	Housing Finance Co. Ltd, Nairobi (gov)
29	Imperial Bank, Nairobi
30	I&M Bank Ltd (former Investment & Mortgages Bank Ltd), Nairobi
31	K-Rep Bank Ltd, Nairobi
32	Kenya Commercial Bank Ltd, Nairobi (gov)
33	Middle East Bank, Nairobi
34	National Bank of Kenya, Nairobi (gov)
35	National Industrial Credit Bank Ltd (NIC Bank), Nairobi
36	Oriental Commercial Bank Ltd, Nairobi
37	Paramount Universal Bank Ltd, Nairobi
38	Prime Bank Ltd, Nairobi
39	Southern Credit Banking Corp. Ltd, Nairobi
40	Standard Chartered Bank , Nairobi
41	Trans-National Bank Ltd, Nairobi
42	UBA Kenya Bank Ltd., Nairobi
43	Victoria Commercial Bank Ltd, Nairobi

**Source:** CBK, (2011)

## Appendix II: Interview Guide

### Section I: Information about Respondent & NIC Bank

1. Under which division(s) within NIC Bank do you work for?

---

What is your specific role?

---

2. How long would you say that NIC Bank has pursued SME Banking Business?

---

3. Does NIC Bank provide loans to SMEs?

---

4. What are the various lines of credit facilities/loans offered to the SME segment?

---

---

---

5. Do you consider NIC Bank a leader in the industry when it comes to availing credit facilities to SMEs?

---

6. Does NIC Bank have a Credit Risk Policy tailored specifically for the SME segment?

---

7. What are the key salient features of the SME Credit Risk Policy?

---

---

---

---

**Section II: Downscaling of credit policies as a competitive advantage for the bank.**

1. Would you say that the SME sector is an attractive and profitably bankable sector today?

---

2. What downscaling strategies and models of SME financing interventions have been adopted to achieve strong levels of outreach, scale, and sustainability?

---

3. How does NIC Bank overcome the challenges of NPL emanating from SMEs?

---

---

---

4. Considering that few banks focus on SME lending, how can banks successfully expand their SME banking operations?

---

---

---

5. How does NIC Bank relax its Credit risk to serve the SME sector adequately?

---

---

---

6. What factors do you consider before giving SME loans?

---

---

---

7. NIC Bank is known for being the market leader in Asset Financing especially for SMEs. What do you think gives NIC Bank this competitive edge?

---

---

8. Lending is normally controlled by decisions of credit risk. In your view, how do you rate credit risk policies of the bank in comparison with the other banks?

---

---

---

9. It is argued that the bank has managed to “go in bed” with motor vehicle dealers hence its success in the asset financing market for SMEs. In your view, is this partnership a strategic choice which is why the bank is successful in Asset Finance SME lending?

---

---

---

10. How would you rate the scaling down (relaxing) of credit risk policies to the success of NIC Bank in the SME lending?

---

---

---

11. Scholars believe that a firm needs to locate a market segment and make a strategic choice by sticking to that niche (focus). In your view, how would you relate this analogy to the success of NIC Bank in the SME sector?

---

---

---

12. How do you see NIC Bank in the coming 5 years when it comes to dominance in the SME sector considering the stiff competition in the industry?

---

---

---

~Thank You~



### **Appendix III: University of Nairobi's Request Letter for Data Collection**

## **Appendix IV: NIC Bank's Approval Letter for Data Collection**