THE RESPONSE OF NATIONAL BANK OF KENYA LIMITED TO THE CHALLENGE OF NON-PERFORMING LOANS

BY

MATHARA KELLEN

UNIVERSITY OF NAIROBI
LOWER KABETE LIBRARY

A MANAGEMENT RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENT FOR THE MASTER OF BUSINESS ADMINISTRATION DEGREE
SCHOOL OF BUSINESS
UNIVERSITY OF NAIROBI.

NOVEMBER 2007

University of NAIROBI Library
0500060 9

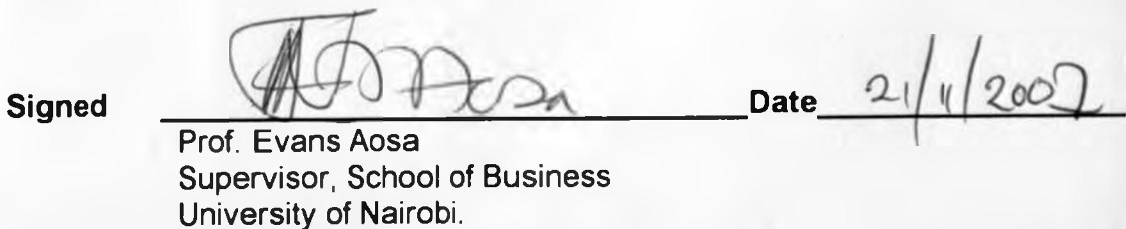
DECLARATION

This research project is my original work and has not been submitted for a degree course in this, or any other University.

Signed____________________ Date 20/11/07

Kellen Mathara

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



Signed ____________________ Date 21/11/2007

Prof. Evans Aosa
Supervisor, School of Business
University of Nairobi.

DEDICATION

To my son: for his patience and understanding. You persevered a lot throughout the duration of this course.

ACKNOWLEDGEMENTS

I express great appreciation to a number of people, who have played a very supportive role in completion of not only this research project but also the entire MBA project.

Deep gratitude to my husband and mostly my eight-year son for being extremely patient, loving and supportive, during the long hours I invested in the MBA program. Additionally, I am grateful to my extended family for being tolerant of my absences from many family gatherings in the course of the study.

To fellow MBA students Peter Ouma, Carol Makena, Fred Njuguna and Carol Ndolo, who helped inspire me and made the long study hours bearable. To my long time friend Pauline Kamangara, for her encouragement and moral support.

Last but not least to my academic supervisor, Prof. E.Aosa, whose patience I surely tested to the limit. For his guidance, criticism, suggestions and encouragement, without which I would not have come this far.

ABSTRACT

All firms exist in a complex network of environmental forces, which are so dynamic that they continuously present threats and opportunities. Consequently, all firms have to continuously monitor and adapt to the environment. In this environmental dependency, firms depend on the environment for inputs and also for a market for their output. The aim of adaptation is to align the firm's strategy and capability to the changing environment. Ultimately, a firm's strategy must match the environmental realities and at the same time, the firm's capabilities must match the strategy.

The objective of this study was to establish the causes and responses of National Bank of Kenya to the challenge of non-performing loans (NPLs). Towards this end, the study collected both primary and secondary data. The primary data was collected from six top managers of the bank, who comprised two general managers, two immediate retired general managers and two senior managers. Secondary data was largely collected from Central Bank of Kenya publications to augment and support the primary data.

The study established six external factors as the causes of NPLs, which include economic downturn, government interference on lending and debt collection, inflationary tendencies, limited supervision by the Central Bank of Kenya (CBK), inadequate government monetary policies and a slow judicial system. The internal factors include poor management, poor risk management practices, poor monitoring and evaluation systems, lack of management's accountability for bad debts, reckless lending, lack of adequate credit policy guidelines and a diversified loan portfolio.

The study also identified five major challenges posed by NPLs. These include liquidity problems, low profitability, bad public image, and problems with debt collection. The pressure to respond emanated from both the internal and external environment. Liquidity problem was the only internal force identified by the

respondents. The real impetus seems to have emanated from external sources. These forces include pressure from shareholders, Central Bank of Kenya, competitors, the stock exchange, bad publicity, and economic recession.

Further the study identified six responses of the bank to the challenge of NPLs. These include change of leadership, turnaround strategy comprising both retrenchment and restructuring of the bank, culture change, re-capitalization of the bank, technology enhancement and marketing initiatives.

It was conclusive that the bank had responded to the challenge of NPLs. However, most respondents did not consider the responses as having achieved optimum results owing to problems at implementation stage. The bank's strategies were mostly planned strategies, which originated from the top management, with little staff participation and involvement. Consequently, the implementation logistics took time to re-configure from the original strategy, in order to reflect operational realities. In essence what was eventually realized was an interplay between the planned and emergent strategies.

The study therefore recommends more staff involvement and participation in the strategy making processes. Additionally, the bank should be more proactive by ensuring prudent credit risk management and also closer monitoring of the existing debts in order to ensure that future incidences of NPLs are minimized.

Few studies have been previously conducted on the problem of NPLs. In particular, the researcher has no knowledge of any survey conducted on state owned banks to establish the causes of NPLs. The study therefore, recommends such a survey to be conducted on NBK, KCB, Co-operative Bank and Consolidated bank, in order to allow generalizations to be made. This may assist reduce future occurrences of NPLs in Kenya.

TABLE OF CONTENTS

Declaration II
Dedication III
Acknowledgements IV
Abstract V

CHAPTER 1- Introduction

1.1 Background of Study 1
1.1.1 Environmental Dependence 1
1.1.2 The Kenya Banking Industry 3
1.1.3 Non-performing Debts 5
1.1.4 National Bank of Kenya 9
1.2 Statement of the Problem 11
1.3 Objectives of the Study 13
1.4 Significance of the Study 13

CHAPTER 2 - Literature Review

2.1 Concept of Strategy 14
2.2 Strategic Management 16
2.3 Environment, Strategy & Organization Capability 17
2.4 Strategic Responses 20
2.5 Local Studies on Strategic Management 22
2.6 Local Studies on NPLs 23

CHAPTER 3 -Research Methodology

3.1 Research design 25
3.2 Data collection 25
3.3 Data analysis 26

CHAPTER 4 - Results and findings

4.1 The Respondents Profile 27
4.2 The Causes of non-performing debts 27
4.2.1 External Causes Of NPLs 28

4.2.2 Bank Specific Causes 30

4.3 The Challenge Posed by NPLs 32
4.4 Sources of Pressure to Respond to the Non-performing Loans 34
4.5 The Responses of the Bank to Non-performing loans.. 36
4.6 Strategic Fit.. 42

CHAPTER 5 - Summary, Recommendations and Conclusions

5.1 Summary 43
5.1.1 The Causes of NPLs 43
5.1.2 The Challenge Posed by NPLs.. 43
5.1.3 Responses of the Bank to the Challenge of NPLs... 44
5.2 Recommendations.. 44
5.3 Limitations of the study.. 45
5.4 Suggestions for Further Research.. 45

References.. 46
Appendix I – Letter of Introduction 51
Appendix I - Questionnaire.. 52
Appendix III- Letter of Introduction to Central Bank.. 55

LIST OF FIGURES

Figure 1 - Managing a Firm's Adaptation to the Environment 19

CHAPTER 1 - INTRODUCTION

1.1 Background

1.1.1 Environmental Dependence

Porter (1985) described the external environment as the conditions that affect a firm's competitive situation. All firms exist in a complex network of environmental forces. Because these forces are so dynamic, they continuously present threats and opportunities. Similarly, Ansoff (1979) and Ansoff & McDonnell (1990) described organizations as environmental serving, in that they depend on the environment for inputs, which they add value, and thereafter they output them into the environment in the form of products and services.

Pearce & Robinson (1997) observed that the environment is dynamic, which forces organizations to consistently evaluate their strategies so as to match the environment with internal capabilities. Howe (1986, p.35) argued that 'a knowledge and understanding of a firm's environment is likely itself to lead to more effective strategic decision making by permitting proactive strategy based upon forecast scenarios for the business. For most organizations, this involves adapting one's strategy to the environment'.

Ansoff & McDonnell (1990) proposed a formula that explains strategic success that postulates that organization capability must match strategy, and that the strategy must match the environment. In other words, an organization's strategy must be appropriate for its resources and must also match environmental circumstances for it to work successfully. A successful strategy therefore enables interaction between the internal and external environment. Similarly Aosa (1992) saw strategy as creating a fit between the external and internal conditions of a firm, in order to solve a strategic problem.

UNIVERSITY OF NAIROBI
LOWER KABETE LIBRARY

Byrars, Rue & Zahra (1996) described the environment as a significant source of change. Owing to the dynamic nature of the environment, firms have to adopt environmental scanning on a continuous basis. In reality, organizations regularly exchange feedback with their external environment. Scott (2002) argued that all organizations depend on the environment and are thus open systems. As open systems, organizations are highly engaged with their environments.

Mintzberg et al (2003, p.146) explained why it is necessary for organizations to constantly adapt their strategies to a changing environment. The environment 'continues to change, sometimes slowly, occasionally in dramatic shifts. Thus gradually, or suddenly, the organizations strategic orientation moves out of sync with the environment'. Mintzberg & Quinn (1996, p.50) point out that 'change in the environment of business necessitates continuous monitoring of a company's definition of its business; lest it falter, blur or become obsolete'

Courtney, Kirkland & Viguerie (1999) observed that under uncertainty, traditional approaches to strategic planning no longer work. Underestimating uncertainty can lead to strategies that neither defend against the threats nor take advantage of the opportunities that uncertainty may provide. Bourgeois, Duhaime & Stimpert (1999) noted that companies operating in rapidly expanding industries require managers who anticipate and respond quickly to changing consumer preferences and competitor moves.

Bani (1999) suggested that successful strategies are those where the company adapts to its environment. He further suggested that companies that fail to adapt to the environment are unlikely to survive in the long run. It is therefore crucial that organizations pay close attention to the external environment to ensure success.

Johnson & Scholes (2002, p.100) stated that 'environmental uncertainty increases the more that the environmental conditions are dynamic or complex'.

Hitt, Ireland & Hoskisson (2000, p.44) argued that 'most firms face external environments that are growing more turbulent, complex, and global, which makes them increasingly difficult to interpret. To cope with the ambiguous environment and increase their understanding of the general environment, firms engage in environmental scanning'

Mintzberg (1987, p.74) noted that 'strategic fit sees managers trying to develop strategy by identifying opportunities arising from an understanding of the environmental forces acting upon the organization and adapting resources so as to take advantage of these.' In a changing environment, firms require to adapt their activities, resources and strategy to the external circumstances so as to retain their market share.

Given that firms are environmental serving, in that they are interdependent with the environment, it then follows that they have to respond to the challenges posed by the external environment (Pearce & Robinson, 1997). Strategic response enables organizations to adapt their strategies to the environment, and also to match the strategy to internal capability.

1.1.2 – The Kenyan Banking Industry

The banks in Kenya are governed by the Companies Act, Banking Act, Central Bank Act and the Prudential Guidelines issued by Central Bank of Kenya (CBK). As at December 2006, there were 45 financial institutions down from 49 in June 2005, 41 of which were commercial banks, 2 mortgage finance companies, one non-bank financial institution and one building society (CBK, 2006).

The top four banks in terms of deposit holdings and market share are Kenya Commercial Bank, Barclays Bank, Standard Bank and National Bank Of Kenya Limited (NBK). Together they control over 50% of the market share in terms of total assets, while the remaining 37 banks share the rest.

Thirty-five of these banks are small and medium sized, which are locally owned. A few of the large banks dominate the industry some of which are partially or fully foreign owned (Musa, 2005). Currently, six banks are listed on the Nairobi Stock Exchange, namely Barclays Bank, Standard Chartered Bank, Kenya Commercial Bank, National Bank, National Industrial Credit Bank (NIC) and Credit Finance Corporation Bank (CFC).

The Kenyan Banking environment has been undergoing changes since the onset of liberalization in the early 1990's. Some of the changes include liberalization of the financial sector, stricter Central Bank regulations, monetary policy changes, privatization and commercialization of public sector banks, and intense competition (Musa, 2005).

The major challenge facing banks today is stiff competition, which has forced banks to re-design their services and products or introduce new services like E-Banking, ATM services and consumer loans in an endeavor to retain their market share (CBK, 2006). Among the rapidly growing applications is Internet banking or E-banking, which allows customers to monitor transactions of their accounts at the leisure of their offices (Kiarie, 2006).

There has also been emerging competition from Micro-Finance Institutions (MFI), Savings & Credit Co-operative Societies (SACCO's), Kenya Post Office Savings Bank and Development Financial Institutions like AFC, IDB and ICDC. Kiptugen (2003) noted that as a result of increasing competition in the banking industry, the number and diversity of financial products available in the market has increased.

The banking industry has also experienced a convergence of banking services and the distinct market niches that hitherto existed are threatened. The banking Act traditionally allows banks to provide diversified products and services. It is in this provision that the banks are going into mortgage, asset financing and

consumer loans. However, until recently, the banks made no effort to diversify into the related services, as the environment was relatively stable. All this has since changed, as a result of intense competition and monetary policy changes. Consequently banks have found themselves with excess liquidity prompting their search for more lending options.

Other services that have attracted the interest of commercial banks are investment banking and stock brokerage services. Today C.F.C group has a fully-fledged subsidiary that handles brokerage transactions. Moreover, many other banks are understood to have expressed interest in acquiring brokerage and investment banking license. The environmental change has pressurized banks to adapt their strategies to the environment in order to remain competitive.

1.1.3 Non- Performing Loans

Greuning & Bratonovic (2000) described non-performing loans (NPLs) as those assets that are no longer generating income. NPLs in general terms refer to bad debts, whose recovery is highly doubtful, because they are not being serviced as required (CBK, 1997).

The problem of NPLs is not unique to Kenya alone. Gupta (1998) observed that banking problems precipitated by NPLs are not confined to the developing world alone. Sweden, Japan and USA have at one time faced severe banking crisis. However, he pointed out that it is in the developing world that the problem wrecks the greatest havoc. This undermines the banks' financial intermediation function.

In 1989, the United States of America invented the Resolution Trust Corporation (RTC) to deal with it's own bad debts. Ten years later, RTC was credited with having retrieved US $ 347.6 billion (about 90%) of the NPLs. Similarly in 1998, the Chinese government wrote off 100 billion Yuan from the four state banks through injection of new capital. The government thereafter decided to try the

American approach by establishing the Cinda Assets Management Corporation, to mop up an estimated 200 billion Yuan in NPLs (Wen, 1999)

The Philippian government passed a new law known as the Special Purpose Vehicle Act (SPVA) in October 2003, to enable it sell some P14 billion worth of non-performing housing loans of the National Home Mortgage Finance Corporation (NHMFC). NHMFC's bad debts were estimated at 30% of total loans (Vanzi, 2003). In Thailand following the 1997 currency crisis, the NPLs ratio was as high as 47.7 % as at May 1999. Consequently, the Thai Asset Management Company (TAMC) was set up to promote financial restructuring at the recommendations of the World Bank (Keiichiro, 2002).

Japan's real estate market boom in the 1980's saw the value of land shot up nearly six times to $17.3 trillion. Many banks set up finance companies known as non-banks, to handle riskier loans for speculation in real estate, which they were not otherwise allowed to lend. This helped inflate property and stock market values. But in 1989, the governor of Central Bank of Japan was forced to intervene in order to curb the resultant inflation. Interest rates rose from 4.9% to 8.9%, which adversely affected the real estate market. 'Consequently, banks found themselves with huge NPL portfolios, as debtors could no longer keep up with repayments. The Ministry of Finance estimated that non-banks had lent Y90 trillion ($640 billion) by the end of March 1991' (Holden, 1991, p.48).

Pandey (1997) pointed out that banks play a crucial role of financial intermediation in the economy, by channeling funds from savers to investors. This is possible through mobilizing deposits and advancing credit, which consequently influences money supply. Savers have trust in the banks and therefore deposit their money with the hope of being paid back with interest. Banks on the other hand lend the money, trusting that the borrowers will repay with interest. Failure by borrowers to repay loans therefore has adverse effect on the banks capability to pay depositors and this undermines the banks'

intermediation role to the detriment of the economy.

Collapse of commercial banks in Kenya is attributed to various risks but the major ones are credit and liquidity risks. 'Credit risk arises from the possibility of default by borrowers. Credit losses cannot be fully eliminated with credit appraisals except in case of lending to government through purchase of government securities'. Only maintaining a diversified portfolio of lending can mitigate this risk. On the other hand 'Liquidity risk refers to an institution's inability to meet unexpected cash withdrawals. To hedge against this risk, banks are required to hold an adequate level of liquid assets' (CBK 2000, p.40).

These diverse risks may render a bank illiquid thereby causing instability in the whole financial industry. The collapse of one bank usually has a ripple effect on the stability of other banks. Various measures have been put in place to overcome the problem. These include supervision and regulation of banks in Kenya as provided by both the Banking Act and the Central Bank of Kenya Act. These two Acts grant Central Bank legal authority to supervise the banking institutions (CBK, 2000).

NPLs have been cited as the primary cause of bank's failure in Kenya. It is indicated that between 1984 and 1997 (a period of 13 years), there were a total of 29 bank failures reported. This is an alarming rate given that it represents on average two or more bank failures per year during that period. Though this trend has been reversed, NPLs continue to be a major challenge among banks (Njuguna & Ngugi 2000). Banks that collapsed during that period include Trust Bank, Kenya Finance Bank, Reliance Bank, Prudential Bank, and Bullion Bank. Further, NBK almost folded following a run on the bank on two separate occasions by panicky customers (Oloo, 2000). The most recent casualty is the Euro Bank limited, which was placed under liquidation in February 2003, following substantial losses as a result of huge NPLs among other things (Kanyiri, 2005).

When a bank classifies a facility as non-performing, CBK guidelines indicate that banks should start to make specific provisions (CBK, 2002). The specific provisions require banks to forego interest received besides allocating provisions for the NPLs from their own resources. Provisions for bad debts eat into banks profits. But the problem of NPLs goes beyond mere loss of income on the part of banks. Njuguna & Ngugi (2000) observed that to reduce credit risk, Kenyan banks charge a premium. This tends to increase the interest rate to borrowers, and in turn reduces the demand for loans. These factors produce an unstable macro-economic environment, which serves to widen the interest spread between the deposit taking and lending rate. NPLs therefore have repercussions for national economies.

NPLs in Kenya stood at Kshs.107.4 billion at the end of 2001. This represented 38% of the total loan of 281.7 billion in the banking sector. Such a high ratio of non-performing loans to advances is a reflection of imprudent lending practice and poor credit management (Oloo, 2003)

The ratio of NPLs to advances had improved as at June 2006. 'NPLs stood at Kshs. 102.0 billion or 23.1% of gross loans. NPLs net of loan loss provisions however, stood at Kshs. 24.0 billion. The asset quality measured by the ratio of net non-performing loans to gross loans was 5.4%.' (CBK, 2006, p34). Further, NPLs made a dramatic improvement by July 2007, according to CBK (2007) to an estimated Kshs 70.7 billion. The sharp reduction in the level of non-performing loans was attributed to write-offs against provisions held and recoveries by some of the banks during the period under review. Further the level of NPLs net of loan loss provisions stood at Kshs 22.5 billion and accounted for 4.7% of gross loans. The asset quality therefore improved marginally from 5.4% to 4.7% over the period.

But just how big is the problem of NPLs in Kenya? The problem is big enough to warrant government attention. In the budget speech in June 2003, the Minister for Finance indicated that 'the government was exploring the possibility of setting up a non-performing loan agency with judicial powers to deal with the issue of bad debts' (Oloo, 2003 p.9). Additionally, the minister also proposed the introduction of the 'in-duplum' rule, providing that interest on NPLs be stopped from accruing further interest, as soon as the interest already levied equals the principal sum borrowed. This bill was meant to check further escalation of NPLs (KPMG, 2003). However, it was not enacted into law until the banking (Amendment) Act, 2006 was assented by the President as at December 2006 (CBK, 2006).

Oloo (2001, p11) traced the genesis of NPL's in Kenya to the external environment in which the Kenyan banks operate. He argues that when the government was faced by the clamor for multiparty, it held an election in 1992 for which it was ill prepared. 'Out of desperation, the CBK was compelled to imprudently print money ostensibly to fund the elections. The result was a sharp increase in interest rates as the government thereafter sought to mop-up the excess liquidity. The domestic debt rose from Kshs. 45 billion in 1992 to Kshs. 166 billion in 1993.' The interest rates on Treasury Bills rose from 23% in early 1992 to 76% in 1993. This argument is an indication that the external environment had an influence on the level of NPLs in the banking industry in Kenya.

1.1.4 National Bank of Kenya

National Bank of Kenya (NBK) was the second locally owned bank incorporated in 1968 through an Act of Parliament. It was then a wholly government owned bank. The major aim behind its formation was to help indigenous Kenyans to get access to credit and control their economy after independence. The operations of NBK in line with government influence were largely biased towards public

sector, until the financial sector liberation in the 1990's.

The bank's Head Office is located at National Bank Building along Harambee Avenue. It has a branch network of 23 branches and 8 sub-branches/agencies. The average number of employees for the year 2006 was 934, compared to 882 in 2005.

It was incorporated with an initial authorized share capital of Kshs. 20 million. This has since increased to Kshs. 9 billion divided into 600 million ordinary shares of Kshs. 5 each and 1.2 billion non-cumulative preference shares of Kshs. 5 each. The current issued and fully paid up capital is Kshs. 6.675 billion.

The government's shareholding was reduced in 1994 and 1996, when the government through floatation at the stock exchange sold some of its shares. Following the floatation's, the shareholding structure changed and currently stands as follows: Government-22.50 %, National Social Security - 48.05 %, Public – 29.45 % (NBK, 2006).

Up to the late 1990's, NBK was guaranteed government support since government policy then dictated that all government and quasi-government institutions bank with NBK or Kenya Commercial Bank. However, with financial sector liberalization, monetary policy changes and competitive pressure in the 1990's, NBK was suddenly faced with challenges from the external environment.

NPLs have been one of the biggest challenges the bank has faced since inception. The annual report and financial statement (2006) indicates that approximately Kshs. 17.4 billion was non-performing loans in the period ending 2005, out of which the bank had made specific provisions of approximately Kshs. 14 billion. A slight increase in NPLs was recorded in 2006 to Kshs. 17.5 billion and provisioning to Kshs. 16 billion. Additionally, the bank indicated that Kshs. 20.4 billion representing government initiated advances, which were non-

performing, had not been provided for. However, the government had already acknowledged the bad debts and issued a government Long Term Non-negotiable Bond as at June 2007, for which the bank would obtain repayments from the interest paid periodically on these bonds.

1.2 Statement of the Problem

Organizations have been described as environment serving and environmental dependent. They depend on the environment for inputs, which they add value, and thereafter output value added products or services into the environment (Ansoff & McDonnell, 1990). Consequently, for any firm to be successful, they have to adapt their strategies to the environment. Successful firms constantly scan the environment in order to identify threats and opportunities that could affect their operations (Porter, 1980).

The 1990's saw a lot of challenges in the business environment in Kenya. These include poor economic performance, liberalization, privatization of state owned corporations, technological advancement and the emergence of a more intense competitive landscape (Musa, 2005)

Similarly, the banking industry has undergone some changes in the last fifteen years. Challenges facing the industry included financial sector liberalization, poor management, privatization of state owned banks, intense competition, monetary policy changes and worsening economic conditions in the 1990's. By 1999, over 13 banks had collapsed and NBK almost collapsed on two separate occasions following panicky withdrawals by customers (Oloo, 2000).

Various researchers have conducted studies on NPLs, the relationship between credit risk management and the level of NPL's, and the responses of Kenyan banks to the challenge of NPLs. These studies include Kabiru (2002), Kalani (2004) and Kanyiri (2005). The studies conclusively established that NPLs were

UNIVERSITY OF NAIROBI
LOWER KABETE LIBRARY

a problem not only to the banking industry but also to the government and ultimately their customers. NPLs therefore require adequate responses from affected banks in order to manage and minimize their impact.

To my knowledge, no case study research has been conducted on the responses of any local bank to the challenge of NPLs. My research therefore intends to fill the knowledge gap, by making an in-depth study of the responses of NBK to the challenge of NPLs.

NBK like the other players has been faced with environmental challenges. The most significant challenge has been that of NPLs. Because of the magnitude of the challenge, the government in 1998 pumped in Kshs.4 billion to avert a run on the bank due to liquidity problems. Again in 2002, the government pumped in an additional Kshs.2.0 billion as a loan. In September 2003, part of the government loans plus interest aggregating Kshs 4 billion was converted to preferential shares (Kalani, 2004). Additionally, in the last budget the minister for Finance proposed to issue a government Long Term Non-negotiable Bond towards payment of Kshs. 20.4 billion government initiated loans at the bank.

As at 2000, NBK's bad debts stood at Kshs. 23 billion while provisions and interest in suspense amounted to Kshs. 15 billion. These accounted for 27% and 33% respectively of the entire banking industry (Oloo 2000). Musa (2005) observed that by 31st December 2002, NBK had accumulated losses amounting to Kshs. 5.55 billion primarily due to provisioning of bad debts. With one of the largest non-performing loan portfolio in the banking industry, how has NBK responded to the challenge?

1.3 Objectives of the Study

The study has two pertinent objectives.

1. Establish the causes of non-performing loans.
2. Establish the responses of the bank to the challenge of non-performing loans.

1.4 Significance of the Study

The study will be useful to several groups. Firstly, it will assist in better management of the NPLs among Kenyan banks. Specifically, it will be useful to NBK's management to evaluate how effective they have been in responding to the challenge of NPLs. This may enable them identify gaps in their responses, which may enhance their strategic response.

Secondly, it will be useful to other researchers and scholars as a point of reference and source of secondary data on the response of a local bank to the challenge of NPLs. Additionally; it may form the basis for further research.

Thirdly, it may be useful to shareholders and other stakeholders in evaluating the effectiveness of NBK's management response to the much-publicized issue of NPLs. Finally, it may be useful to other corporate organizations on how strategic management can be applied to respond to environmental changes and the related benefits to an organization. It is expected that the study will offer useful insights on the environmental dependency of firm's and how changes in the environment necessitate a change in strategy and internal resource configurations for survival.

CHAPTER 2 - LITERATURE REVIEW

2.1 Concept of strategy

Thompson (1994) described strategy as a system approach, which considers the organization in relation to its environment. In this environmental dependency, firms depend on the environment for inputs and also for a market for their output. The aim of adaptation to the environment is to align the organization resources and values, so as to match these resources to the changing environment. Firms have to constantly adapt their operations and internal configurations to reflect the external realities (Hofer & Schendel, 1978). Consequently, strategy can be broadly defined as the match an organization makes between its own resources and the threats and opportunities presented by the external environment in which it operates (Bowman & Asch, 1987).

Thompson, Strickland & Gamble (2007, p.4), argued that strategy 'consists of the competitive moves and business approaches that managers are employing to grow the business, attract, and please customers, compete successfully, conduct operations and achieve targeted levels of organization performance' He further argued that firms use strategy to strike a fit between the firm's external and internal environments.

According to Ansoff (1979), strategy is a common thread that defined the essential nature of the business of a firm and its plans for the future. Similarly, Johnson & Scholes (2002) saw strategy as concerned with the long-term direction of the firm, which achieves competitive advantage for the firm through interplay of organizational resources and its strategy. Thus a strategy points the focus of the organization to the direction the company is to follow. A company's strategy is therefore 'the management's action plan for effective running of the business' Thompson et al (2007, P.3)

On the other hand Ansoff & McDonnell (1990, p.44) described strategy as a set of decision-making rules to guide organizational behavior. 'Objectives represent the ends which the firm is seeking to attain, while the strategy is the means to these ends. A strategy which is valid under one set of objectives may lose it's validity when the objectives of the organization are changed'. Levinki (1999) saw strategy as breaking the operations of the firm into sets of objectives and goals into a series of time frames for the company's action plan. This establishes a clear focus and direction for the organization and also provides a means of getting there (Thompson, 1994).

Another school of thought is that there is no universally accepted definition of strategy. Mintzberg (1987) argued that strategy is a multi-dimensional concept. In other words, strategy can be seen through different perspectives. Strategy can be planned (deliberately formulated) or emergent by nature (imposed on the organization by outside forces). Realized strategy is an interplay between the planned and emergent strategies. Johnson & Scholes (2002) supported this school of thought and categorized strategy through three different lenses. The design view is a logical analytical process, which views strategy development as a process of logical determinism. The experience lenses see strategy as the continuous adaptation of past strategies based on experience. Idea lenses places a strong emphasis on variety and diversity for innovation, in order to foster and encourage innovative thinking and creative development.

A more encompassing definition by Houlden (1996) is that strategy is a business plan, defining what kind of business a firm is in, the resources required to achieve this, the implementation steps, specification of who is responsible for implementation, methods used for evaluation and methods used in environmental scanning in order to ensure that strategy is reviewed as necessary.

2.2 Strategic Management

Pearce & Robinson (1997, p.3) defined strategic management as 'set of decisions and actions that result in the formulation and implementation of plans designed to achieve a company's objectives'. The strategic Management activity is concerned with 'establishing objectives and goals for the organization, and with maintaining a set of relationships between the organization and the environment which a) enables it to pursue it's objectives b) are consistent with the organization capabilities and c) continue to be responsive to the environmental demands' (Ansoff & McDonnell 1990, p 243)

According to Johnson & Scholes (2002) strategic management involves understanding the strategic position of an organization, making of strategic choices for the future and translating the same into action plans for implementation. Strategic management is intended to be a rational approach to help a firm respond effectively to the challenges of environmental change.

'In strategic management the aim is to ensure that management continuously set and achieve appropriate strategic objectives' (Judson, 1996 p.44). Strategic management is therefore concerned with arriving at decisions on what the organization ought to be doing and where it should be going. Chandler (1962, p.13) saw strategic management as the 'determination of the basic long-term goals and objectives of an enterprise and the adoption of courses of action and the allocation of resources necessary for carrying out these goals'

Strategic management ultimately involves making those decisions that define the company's mission and objectives, determine the effective utilization of a company's resources and seek to align the company's operations with its external environment (Byrars, 1991). Thus strategic management endeavors to align the internal operations of the organization and its resources, to be able to adapt and interact with the environment (Howe, Mason, Dickel, Mann & Mockler

1994).

2.3 Environment, Strategy & Organization Capability

All business firms are open systems. They are impacted and in turn impact on the external environment. Pearce & Robinson (1997) stated that a firm's external environment is made up of all the conditions and forces that affect not only its strategic options but also define its competitive situation. Similarly, Porter (1985) described the external environment of an organization as conditions that affect a firm's competitive landscape, which he terms as an Input – Throughput – Output process, whereby a firm processes inputs from the environment and the outputs are released back to the environment.

A successful strategy enables interaction between the internal and external environment. Successful implementation of strategy requires allocation of sufficient resources and capabilities. 'Strategy can be seen as the matching of the resources and activities of an organization to the environment in which it operates'. This alignment of the internal capabilities with the environment circumstances creates a strategic fit. (Johnson & Scholes, 2002)

Bennet (1999) described capability as the capacity for a firm to deploy resources to perform a task or activity. Wernerfelt (1984) pointed out that capabilities are specific to the firm and utilize resources within a firm. Successful strategies are dependent on the organization having the strategic capability to perform at the level that is required for success. Competitive advantage may be created by stretching and exploiting the organization's capability in ways the competitors find difficult to match (Johnson & Scholes, 2002). Through continued use, capabilities become stronger and more difficult for competitors to understand and imitate.

Ansoff & McDonnell (1990) outlined the building blocks of organizational capability as skills, technology, facilities, equipment, shared knowledge and know

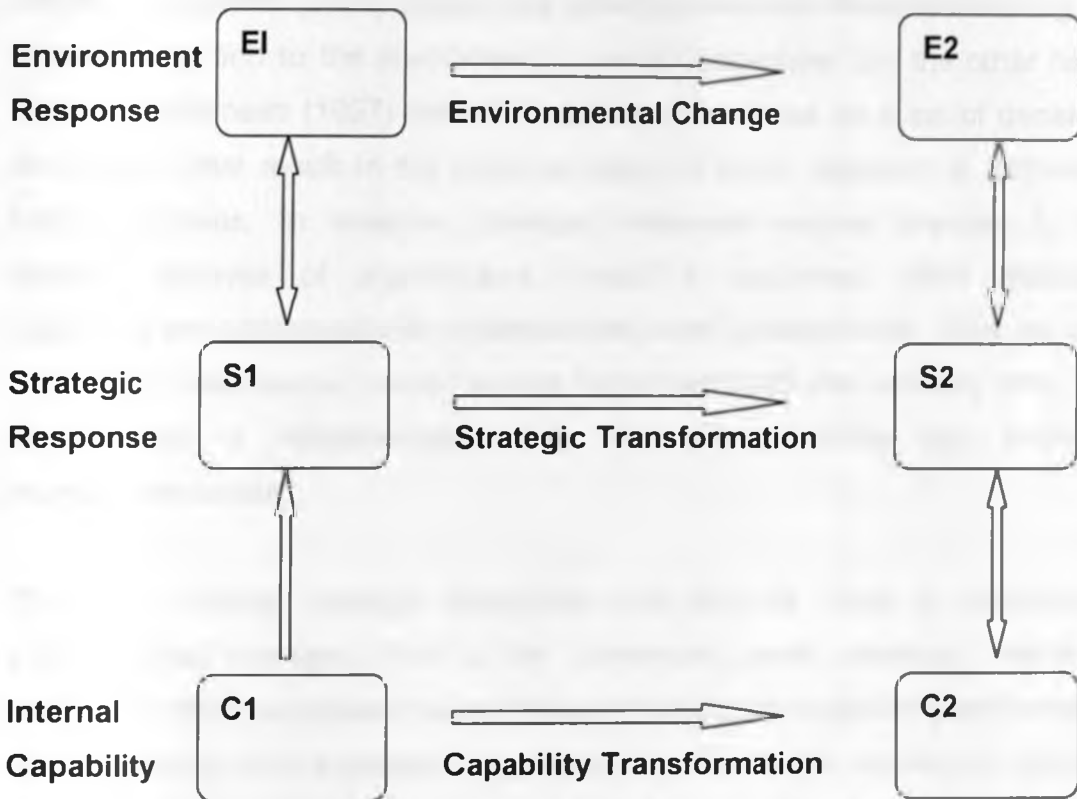
how. However, organizational capability is seen as being more than just the sum of its parts. It possesses systematic properties, which include: the manner in which the tasks are divided, the way the tasks are related to one another, the organizational culture within the function, the power structure within and among the functions.

The success of an organization occurs when there is a match between not only its strategy and the environment, but between the strategy and internal capability as well (Howe 1986). A successful strategy is consistent with the organization's goals and objectives, the resources and capabilities and the external environment.

Thompson (1994) argued that strategic responses are adaptations that firms make to their strategies, which should be aligned to the resources and capability of the firm. Firms that fail to respond to environmental changes are likely to suffer and become irrelevant to the needs of the market and their consumers. In other words, firms have to adapt their internal operations and strategies to reflect the changing external realities.

According to Ansoff (1979), the role of general management is crucial in responding to the environment. He saw three factors as underlying the strategic response of organizations. These include the right climate or the will to respond, the competence or capability and the capacity to respond. The diagram overleaf illustrates the inter-relationships between the environment, the strategy and organizational capability.

Figure 1 – Managing A Firm's Adaptation to Environment



Source: Ansoff & McDonnell (1990, p.40) Implanting Strategic Management Hertfordshire, UK: Prentice Hall International (U.K)

The diagram illustrates the environmental dependency of firms. When there is an environmental shift from E1 to E2, then it follows that an organization should shift its strategy from S1 to S2, and it's capability from C1 to C2 in order to adapt to the environment. Failure to shift either the strategy or capability as indicated above results in a strategy or capability gap respectively. An organization with a strategic or capability gap will be unable to adapt to the environment. It is therefore imperative that organizations continuously monitor their environments in order to identity any shifts that necessitate change of strategy or capability.

2.4 Strategic Responses

Johnson & Scholes (2002) argued that strategic response involves matching the activities of a firm to the environment in which it operates. On the other hand, Pearce & Robinson (1997) described strategic responses as a set of decisions and actions that result in the implementation of plans designed to achieve a firm's objectives. In essence, strategic responses involve changes to the strategic behavior of organizations (Ansoff & McDonnel 1990). Strategic responses are concerned with organizational wide transformation. They are said to be broad, ambiguous, usually involve high investments and are long term. The responsibility of implementation lies with the corporate and business management levels.

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

The second response is retrenchment. This is a crucial element in a turnaround strategy, though many firms use retrenchment as a short-term response. Pearce & Robinson (1997) advised that the goal of retrenchment is to reverse the current negative trends like declining profitability and inability to retain a market share. Thompson (1994) noted that in order to improve efficiency, three aspects of the organization are involved either individually or in combination. They include cost reduction i.e. decrease of work force and reducing expenditure, asset reduction (selling anything which is not essential) and revenue generation.

Restructuring is crucial in a turn-around strategy, but may be used as a short-term response. 'Here the business is in some degree of trouble; with a call for both re-defining what the organization should be doing and re-aligning to do it' (Lorange, 1998, pg. 22). Ansoff & McDonnell (1990) described restructuring as the divestiture of some businesses or part of a business that are of little value to the company or are loss making, while at the same time acquiring others which will bring financial synergy to the existing business/businesses. The goal of restructuring is to carve away under performing businesses. Restructuring is based on the premise that some businesses within a businesses value chain are more critical to the success of the strategy than others (Pearce & Robinson, 1997).

Another strategic response utilized by firms is culture change. Harris (1999) described organizational culture as the personality of the organization, comprising assumptions, values, norms and tangible signs or artifacts of organization members. Thompson (1994) observed that culture change may be necessary if the existing one does not fit well with the needs of the environment or with the organizational resources. Additionally, change may become necessary if the organization is not performing well and needs major strategic changes.

'It would appear that for strategic planning to begin, certain cultural values need to be absent and it would seem inherently logical that other values would have to be present. This implies that the instigation of a planning effort is culturally dependent and that managements initiating planning should be aware not only of complexities of planning but also conversant with the intricacies of the organization culture' (Harris, 1999, pg. 124)

Adoption of new technology is yet another response utilized by firms in responding to environmental challenges. Ansoff & McDonnell (1990, p.167) observed that ' failure to recognize in time an impending technology substitution

can result in a major loss of market share or indeed, cause the firm to leave an industry in which it has enjoyed profitable existence'. Technological changes affect firms both positively and negatively. Positive effects include ease of communication and enhanced operational efficiency, which may provide firms with a competitive advantage. On the other hand, technology is very expensive and requires substantial investment that deters firms from acquiring or modernizing their technology.

Change of leadership may be used by firms as a strategic response. Leadership is the art or process of influencing people so that they will strive willingly and enthusiastically towards the achievement of group goals (Kouzes & Posner, 1997). A leader influences people and takes them through a process that creates desired change, by setting a direction or agenda, rallying people into the agenda and galvanizing and inspiring them to accomplish their goals.

When a firm's performance is poor, change of leadership is considered as a way of establishing confidence and looking at the problem through a new perspective. (Thompson et al, 2007). A new leader may chart a new direction to overcome the threats facing a firm. To do so, the leader requires a new vision and strategies to accomplish the vision. Most importantly, they require to align their people into the vision, letting the people own the vision and carry it forward.

2.4.1 Local Studies on Strategic Responses

Various studies have been conducted on the strategic responses of firms to change in the environment. Mwanthi (2003) & Mokaya (2003) in a study of the strategic responses of British American Tobacco (BAT) and Inter Urban Bus Companies respectively found that both companies utilized restructure of their organizations and cost leadership strategies to adapt to the environment. This enabled them to lower costs of production and therefore ensure that their products and services remained affordable to their consumers.

Migunde (2003) found that the environmental challenges at Kenya Broadcasting Corporation increased after liberalization with entry of new players in the market, forcing the organization to undertake technological advancement. Ohaga – Okoko (2004) in study of the strategic responses of commercial banks in Kenya found that banks that were negatively affected by changes in the environment had no tangible strategic management processes, whilst those that benefited were those that constantly evaluated their strategies by aligning them to the changing environment. In a case study of Kenya Commercial Bank, Kiptugen (2003) found that it responded to the environmental challenges by restructuring, marketing, information technology and culture change.

However, not all environmental changes posed challenges to the firms. Muraah (2003) in a survey of strategic responses by Kenyan Pharmaceutical Firms to the challenge of HIV/AID's pandemic found that firms had benefited from the pandemic through increased sales. That notwithstanding, it is clear from all the above studies that firms respond differently to changes in the environment depending on the magnitude of challenges they face.

2.4.2 Local Studies on NPLs.

Kabiru (2002) found that the government owned banks had asset quality ratio of 30% above the industry average of 28%. This was attributed to the high level of NPLs. By contrast, three of the major foreign owned banks had an asset quality of less than 10%. Ultimately, he concluded that banks that use qualitative credit assessments methods had higher incidences of NPLs as compared to those that used quantitative methods.

Kalani (2004) argued that some bank factors that related to risk management structures put in place by banks were to blame for NPLs. These bank factors include lax procedures used in credit risk assessment, negligence in monitoring

NPLs, insider loans, lack of trained personnel and aggressive credit collection methods.

Kanyiri (2005) found that some banks faced the challenge of declining profitability as a result of provisioning of bad debts. Consequently, they responded by strict monitoring of new lending to identify weaknesses early for corrective measures and a thorough review of financial information submitted by borrowers before lending.

CHAPTER 3 – METHODOLOGY

3.1 Research Design

The research adapted a case study approach, aimed at conducting an in depth research of NBK to establish the responses of the bank to the challenge of non-performing debts. Bell (1999) explained that the case study approach is very appropriate for individual researchers because it gives them an opportunity to research in-depth one particular aspect of a problem, even with limitations of time.

The merit of using a case study over the other methods such as surveys is that a case study allows an in-depth understanding of the behavior pattern of the concerned unit. This facilitates intensive study of concerned unit, which is not possible with different other methods (Musa, 2005). Additionally, a case study allows the researcher to use one or more of the several research methods depending on the circumstances. Such methods include in-depth interviews, questionnaires, document and report study.

3.2 Data Collection

Data was collected through a semi-structured questionnaire used as an interview guide for 10 respondents. Nine of the respondents were to have been selected from Head-Office. They comprised the Managing Director, two Executive Directors, four General Managers and two senior managers of the bank. Additionally, the researcher was to interview one respondent from Central Bank of Kenya Inspection Unit. However, due to limitations of time, only six were eventually interviewed who include: two general managers, two retired general managers and two senior managers. The change in the composition of the respondents original profile was made because the two retired staff had been part of the respondents' profile, but had retired in September 2007.

Data was collected face to face in a personal interview in order to ensure in-depth responses from the respondents. Secondary data was used to augment data collection from the existing records of the bank such as the strategy papers, marketing efforts, and internal circulars. Additionally, Central Bank publications were used.

A semi-structured questionnaire comprising of open ended and closed questions was used. It was divided into three sections. Section A collected information on the major causes of NPLs, Section B on challenges facing NBK as a result of NPL's, Section C the responses of the bank to the challenge of NPLs and the last section covered the strategic fit to establish whether the respondents deemed the responses as adequate.

3.3 Data Analysis

The research utilized content analysis to analyze the responses of NBK to the challenge of non-performing debts. Kothari (2004) described content analysis as a method of analyzing contents of documentary materials such as books, journals, magazines, newspapers and most importantly contents of verbal material whether spoken or written.

The information gathered was analyzed and divided into logically groupings using qualitative analysis to facilitate interpretations. Mugenda & Mugenda (1999) observed that this method is very appropriate for case studies because the researcher provides a systematic description of the composition of the objects or material of the study. This involves detailed description of objects that comprise the study.

CHAPTER 4 – Findings and Discussions

4.1 The Respondents' Profiles

The respondents comprised the top management of National Bank of Kenya, some of who were instrumental in formulation of strategic responses of the bank to the challenge of NPLs. Initially; the intention was to interview ten respondents, nine of who were to be from the bank. The nine were to comprise the managing director, two Executive directors, four general managers and two senior managers of the bank. Additionally, one respondent was to have been interviewed from Central Bank of Kenya Inspection Unit. However, due to limitations of time and unavailability of some respondents, only six were eventually interviewed who include two general managers, two retired general managers and two senior managers.

The change in the composition of the respondents' profile was made because the two retired staff had been part of the initial respondents' profile, but had been retired in September 2007, before data collection was started. The contribution of the two was crucial to this study, as they had been working for the bank since the 1980's. Consequently, it was assumed that they had a broad and extensive contribution, particularly on the causes of NPLs. In view of the above, it became necessary to alter the description of the respondents.

4.2 The Causes of Non-Performing Loans

This section had two questions, which sought to establish the causes of NPLs, categorized into external environmental factors and internal causes. The respondents identified six external factors as having been the major cause of NPLs. These include economic downturn that prevailed for the better part of the 1990's, government interference on lending and debt collection, inflationary tendencies, limited supervision by the Central Bank of Kenya, poor and inadequate government monetary policies and an unsupportive and slow judicial system. The internal factors

include poor management, poor credit risk management practices and use of qualitative methods of loan appraisal, lack of adequate credit policy guidelines, poor monitoring and evaluation systems, reckless lending, and lack of a diversified loan portfolio.

4.2.1 – External Causes of NPLs

The respondents identified the economic downturn that persisted for the better part of the 1990 as a major cause of NPLs. Customers who had borrowed funds from the bank suddenly found their businesses adversely affected by the general poor economic performance prevailing in Kenya. Additionally, the interest rates rose sharply from 1991, which further affected the borrowers' capacity to repay the debts. While interest rates rose, business turnover stagnated making it difficult for borrowers to repay their loans.

Further, the respondents identified another major factor that contributed to the NPLs as the government interference in lending to unviable parastatals, government related bodies and politically correct individuals. The run up to the 1992 multi-party elections created the biggest number of bad debtors, whose loans had been granted on the influence of government officials. Printing of money to fund the first multi-party elections and use of NBK as one of the state banks to roll out such moneys left the bank very vulnerable.

Additionally, political interference in debt collection delayed and frustrated faster recovery of debts. Most respondents stated that it was not uncommon for the bank to receive calls from politicians requesting them to halt or suspend legal action such as auction of properties without concrete repayment proposals from debtors. Subsequent attempts at auctioning the properties helped to escalate recovery costs to the detriment of NPLs. Such debts that would have been fully recoverable thus became unmanageable. All these external factors were seen as having been contributing factors to the problem of NPLs.

Inflationary tendencies in the period immediately following the 1992 multi-party elections were also seen as a major cause of NPLs. The Treasury bill rates are said to have gone over the 70% mark as government sought to mope excess liquidity, that came as a result of the money printed to fund the 1992 elections. Consequently, interest on lending generally rose in excess of 40% per annum, as they were pegged to TB's. Given that some customers had borrowed at lower interest rates of not more than 30% per annum, they could hardly keep up with the subsequent high interest repayments, as their businesses could not generate such high returns.

Like other government institutions, CBK's operations were interfered with by the government leading to minimal supervision of banks up to the early 1990's. This lead to some banks perpetrating financial irregularities and reckless lending. There is some indication that NBK continued to categorize NPLs as performing loans, thus recognizing interest paid on the NPLs as interest income. The reason behind this action was a desire by the previous management to continue to post profits and to minimize bad publicity regarding the extent of NPLs. Consequently, the NPLs continued to grow unchecked to levels that made it difficult for the borrowers to ever repay fully.

The inadequate government monetary policy in the 1990's was also seen as another cause of NPLs. Faced with a weak budgetary deficit the government had from the late 1980's resorted to borrowing funds locally from the banks and the public through sale of Treasury Bills to cover the deficit. Money supply growth was uncontrolled to fund the government budget deficit leading to run away inflationary pressures. This gave rise to the high interest rate regime and high inflation that prevailed in the 1990's. CBK then had limited powers to drive the monetary policy until the Central bank Amendment Act in 1996 and this inadequacy in the monetary policy was seen as a precursor to NPLs.

Lastly, inadequate and slow legal judiciary system was responsible for the slow execution of recovery cases that had been filed in court. Most respondents lamented

how cases filed in court under certificate of urgency by debtors seeking to stop sale of their properties took as long as five years to be determined. This delay made it difficult to diligently execute debt collection and security realization. This is because parties to a suit are restrained from acting on the matter before the court until the cases are determined.

Additionally, cases filed by the bank seeking judgment against bad debtors for attachment of private property took as long as ten years to determine. More revealing was the fact that some influential debtors were purported to have had a way of influencing the court to delay judgment. These delays in quick determination of cases were seen as a cause of NPLs. This is because some loans that could have been repaid early before they escalated to unmanageable levels were delayed, until the security for the loan far outstripped the NPLs.

4.2.2 Internal Bank Specific Causes

The respondents noted that poor management was one of the major internal causes of NPLs. The government appointment of the top management was seen as the primary cause of poor management of the bank. The appointees were chosen without regard to qualifications and prior experience. The respondents noted that most of the appointees prior to the last appointment of the current managing director had little or no qualifications in banking or finance. Consequently, they had limited lending capability and thus were unable to guide the bank towards prudence in lending. These coupled with inadequate and weak internal controls compromised the banks leading and credit decisions.

Poor credit risk management practices and use of qualitative methods of debt collection was another internal cause of NPLs. Qualitative methods entail analysis of such factors as the character and reputation of borrower. Other qualitative aspects considered include over reliance on the collateral granted for the loan, long association of the borrower with the bank, and the historical financial capability,

which mostly comprised account turnover. In contrast, prudent credit appraisal and credit management emphasizes borrowers projected cash flows, analysis of the audited financial books, income statement and the balance sheet. Qualitative methods of credit appraisal therefore jeopardized the assessment of the borrower from a past and future perspective.

The respondents further identified poor monitoring and evaluation systems as another cause of the NPLs. The Central Bank guidelines advise that a loan should be downgraded to a NPL, after repayment arrears fall in excess of three months. That notwithstanding, the bank did not adhere to these grading guidelines. Consequently, lack of proper grading of NPLs delayed debt recovery, as the bank continued to consider the NPLs as performing loans. More adversely, the NPLs continued to escalate due to interest application and other bank charges.

Lack of management's accountability for bad debts was also a cause of worsening NPLs. No management employee had been held accountable for bad debts until 2002, when management changed hands. This Lack of accountability tended to perpetuate reckless lending. The respondents identified two branches Nakuru and Kisumu as having generated over 30% of NPLs in the bank because of reckless lending. Despite having an internal audit and supervision team, recommendations arising from these audits carried little weight with the management at the time.

Lack of adequate credit policy guidelines by the bank also increased the level of NPLs. For the better part of the 1990's the bank utilized an old credit policy that had not been updated for almost fifteen years. Despite the old credit policy guidelines, the environment had continued to change. The policy, which had been formulated in the early 1980's, did not give credence to economic decline. As such, the bank failed to mitigate the risk of further decline of the economy and lower purchasing power of the borrowers.

Lack of portfolio diversification worsened the portfolio of NPLs. The bank had concentrated on lending mostly to start ups, small trading businesses and the agricultural sector. All these are particularly vulnerable during economic downturns. It is noteworthy that the macro-economy experiences periods of growth and then sustains periods of contraction, which form the alternating time periods of the business cycle. Business cycles can have far reaching effects on business. Business cyclicality is the degree to which firms follow the trend of the business cycle. Some ventures grow and contract as the economy does. i.e. banks. Others run against the business cycle. i.e. the mitumba business. Still other ventures are unaffected by the business cycles. By carefully diversifying the bank's loan portfolio, the bank would have been able to mitigate and absorb the risks associated with economic decline.

4.3 The Challenges Posed by NPLs.

Five major challenges were identified which include liquidity problems, low profitability, bad public image, and problems with debt collection.

The high level of NPLs adversely affected the banks liquidity position. It is instructive that banks lend depositors money, which they hope to be repaid back with interest. While the borrowers may fail to repay their debts, the banks still retain the obligation to the depositors to pay back their deposits together with interest thereon upon demand or at a specified future time. The huge NPL portfolio at NBK therefore posed a liquidity problem resulting in the bank facing a run on two separate occasions in the 1990's.

Another challenge was low and declining profitability. This was due to frequent provisioning of the bad debts that adversely affected the bank's profitability. Consequently, the bank made losses for three consecutive years from 1999 to 2000. Ultimately, shareholders have had to go without dividend payments since 1999.

Poor public image of the bank was another challenge the bank faced as a result of the non-performing loans. The publicity generated by the NPLs created a negative image of the bank that has persisted since 1999. This in turn affected the business of the bank, with many customers moving to other competitors due to lack of confidence in the bank.

High and rising NPLs were a costly affair to the bank. Debt collection entails use of external service providers like lawyers, auctioneers, valuers, investigators and court appointed process servers. These service providers charge substantial fees towards recovery of debts. Additionally, most respondents described debt collection as a tedious exercise particularly when it involves court matters. The legal system in Kenya is clogged with many unheard cases and it takes over four years on average for a matter not filed under certificate of urgency to be determined. This delay in determination of cases further escalates the cost of debt recovery. Legally, these costs should be borne by the debtors. However, given that some debts cannot be fully recovered leaves the bank to bear the same.

Finally, there were difficulties encountered in executing judgment. When a debt is classified as a NPL, the first action is for the bank to issue statutory notices demanding payment of the debt. Should the letters elicit no response, the bank is at liberty to exercise its statutory power of sale of security properties. Most often the sale proceeds are inadequate to liquidate the NPLs fully and a residue debt ensues. Consequently, unless the bank has investigated the debtor and found his financial capability to be poor, the last recovery action is for the bank to pursue a debtor by filing a civil suit for recovery of the residue debt.

The study found that it is very difficult to collect debts even where judgment had been delivered against a bad debtor and in favour of the bank. The limitation is that the bank can only execute judgment by way of attachment of a debtor's tangible assets or by arrest. This recovery process presents difficulties as most debtors do not have enough unencumbered assets to ensure full recovery. To compound

matters respondents advised that until recently, some debtors had proved very evasive when it came to arrest, as the legal system was prone to corruption. All these challenges needed to be responded to if the bank was to make a comeback.

4.4 Sources of Pressure to Respond to the Challenge of NPLs.

The pressure to respond emanated from both the internal and external environment. Liquidity problem was the only internal force identified by the respondents. The real impetus seems to have emanated from external sources. These forces include pressure from shareholders, Central Bank of Kenya, competitors, the stock exchange, bad publicity and economic recession.

The major internal pressure to respond was the bank's liquidity problem. The respondents advised that due to liquidity problems, the bank had been paying heavy interest penalties up to year 2000, arising from its overdrawn account at CBK. Between the year 1998 and 1999, the bank was charged in excess of Kshs.1.6 billion in interest penalties. The government as a major shareholder intervened by injecting substantial capital in 1993 and further in 1998. However, these were short term measures while long term measures were being sought. The heart of the problem was the fact that the bank was saddled by non-performing debts, and the provisioning of the debts had grave consequences on the liquidity of the bank.

The most significant force pressuring the bank to respond to the problem of NPLs came from the external environment namely the shareholders. The bank's dismal performance as a result of the NPLs was a cause of concern for the shareholders. As a result the government and National Social Security Fund (NSSF) as the major shareholders, appointed a seasoned banker as the managing director of the bank in 1999. The respondents saw this move as a way to restore confidence, improve the image of the bank and internal practices, provide leadership and turn around the bank. Since then, the shareholders have constantly created pressure to collect the

debts and ensure that new lending is thoroughly appraised so as to minimize future incidences of NPLs.

Financial sector reforms to restore confidence in the whole banking industry enhanced CBK inspection and also created an impetus to respond to the NPLs. Until the 1996 amendment of Central Bank Act, the bank was criticized as having been ineffective in its chief role of regulation and inspection of banks. This had lead to the collapse of a number of local banks due to mismanagement. After the amendment of its Act, Central Bank has been instrumental to the bank in providing pressure for adequate provisioning and grading of NPLs.

Another pressure to respond emanated from the stock exchange. The National Bank of Kenya shares hit a record low of less than Kshs. 3.00 in 2002. This was due to the negative publicity of the bank. It was clear that the low listing price was as a result of the liquidity problems evident in the bank's balance sheet. The solution was to increase deposits through marketing initiatives to mobilize deposits and reduce the NPLs by making concerted efforts to provision and collect the same.

Additionally, intense competition also created an impetus to respond. Since 2002 the yields on government securities such as Treasury Bills and Bonds went so low, forcing banks to reduce further investment therein. Consequently, most banks suddenly found themselves with excess liquidity, for which they required to establish other areas to invest in. The corporate lending could hardly absorb the excess liquidity and thus the banks started lending to individuals through personal unsecured loans.

The market suddenly became very dynamic, and customers less loyal to banks as they were poached from one bank to another. NBK lost many customers to other banks as a result. Despite the freeze on lending from 1999 to 2002 as it concentrated on debt collection, the bank had to resume lending in order to maintain

UNIVERSITY OF NAIROBI
LOWER KABETE LIBRARY

its market share. Crucial to this was the need to collect NPLs, in order to re-invest the funds in personal loans, besides other deposit mobilization initiatives.

The economic recession and subsequent recovery also created pressure to respond. The economic recession tended to actuate the problem of NPLs, as the problem would have been less severe had the customer's purchasing power not been adversely affected. Additionally, economic decline reduced the business opportunities for the bank and its ability to overcome the challenge. The recovery that came with change in government in 2002 created resurgence in demand for credit thereby allowing the bank to grow its lending book. These combined factors imbued the bank to respond to the underlying problem of NPLs.

4.5 Responses of the Bank to the Challenge of Non-Performing Loans

The respondents identified six main responses of the bank to the challenge of NPLs. The first response was change of leadership. When company performance dwindles to alarming levels, change of leadership may be a way to induce confidence and strategic direction. The respondents felt that the appointment of a seasoned banker as the managing director in 1999 created an impetus to turnaround the bank. For NBK to make a turn-around, all staff needed to focus their effort in the same direction. The incoming CEO created a unity of purpose by providing leadership, motivation and inspiration. This has been instrumental in aligning NBK's culture to its strategies.

Most importantly, through change of leadership, the bank was able to disclose the full extent of the NPLs. Consequently; the bank started provisioning for the NPLs in 1999 resulting with a loss after taxation in excess of Kshs. 2.6 billion and Kshs. 2.2 billion in 2000. The heavy provisioning and subsequent allocation of resources for debt collection, sent signals that indicated the top management's commitment to responding to the problem of NPLs. Further, the change of the organizational structure of the bank to the good and bad bank, besides the creation of the legal

department, was seen as a platform to support successful implementation of strategies to minimize the challenge of NPLs.

Another response was the turn-around strategy, which involved both retrenchment and restructuring of the bank. Among the activities undertaken in the retrenchment exercise were asset rationalization, cost reduction and establishing new sources of revenue generation. The bank sold off some non-core bank assets like houses it had acquired for its managers all over the country to generate revenue and cut down maintenance costs. Additionally, the bank commenced an aggressive debt collection exercise by selling off securities held to secure NPLs and filing suit for the residue debt.

More importantly, cost cutting measures were undertaken of staff rationalization in two phases. The first phase was the special early retirement of 97 employees of all cadres in 2000.Together with those who had left that year under normal attrition; the bank establishment was reduced by 12% to 1203 with no plans for replacement. Phase two involved retrenchment of staff in 2001, which reduced employees further to 980. But despite the retrenchment of staff, the bank proceeded to employ professionals like lawyer, auditors and accountants, as there existed a gap in professional cadre at the bank.

Further cost cutting measures involved the adoption of the open office plan as opposed to formal closed-door offices that resulted in more efficient space utilization. In essence managers were removed from offices and brought to sit in the open with their staff and at the easy access of customers. Only very senior cadre managers retained offices, but these were redone with glass sides to signify an open door policy. The impact of this was the release of three un-utilized floors that were previously occupied by the bank Head Quarters at the National Bank Building. Consequently, the bank was able to lease the floors to outsiders to generate revenue.

More specifically on debt collection, the bank established a legal department in 1999 to guide the bank in debt collection, and assist the bank to minimize the costs of debt recovery. The unit was instrumental in advising the bank the debts that could be successfully followed through the judicial system. This subsequently enabled the bank to hire external service providers only where chances of success in recovery of the debts were high. This not only reduced recovery costs paid to external service providers, but has also ensured that the bank was able to screen accounts to establish the suitability of filing suit, which saved time. The combined actions generated revenue and also cut down costs. In 2000, the operating expenses were down from 2.2 bilion to 1.8 billion.

The restructuring of the bank involved closure or merger of loss making subsidiary and branches, thereby allowing allocation of resources to their most efficient use. The merger of Kenyac a merchant bank subsidiary of the bank in 1999, was occasioned by many years of negative profitability with a substantial portfolio of bad debts. The restructure further led to the closure and merger of some branches that contributed minimally to the overall profitability of the bank. The branches that were closed in 1999 – 2002 included Valley Road, Kericho, Nyamira, Muhoroni, and Mugotio Agency. In addition, two branches which were operational in Kisii, (the Bank having previously acquired another branch that had been disposed by Standard Chartered Bank) were merged, as the volume of business being handled in that town did not warrant two separate branches. More recently in June 2002, the Bank closed its Moi Avenue branch, which was a loss maker with a large NPL portfolio.

The restructuring culminated in the classification of the bank assets into the good and bad bank in 2002. The good bank comprises the operations of the bank and the performing debts, while the bad bank comprises bad debts. But the bank had not completed the provisioning of NPLs, and as such the division was virtual. However, the exercise was completed by June 2007 and all NPLs were fully provided for and subsequently written off. Consequently, the bank effectively curved the bad bank from the banks books and established a division to conclude recovery of the NPLs,

given that most of the written off debts still have court cases pending. The main purpose of curving out the bad bank was to give the bank an opportunity to clean its books, by creating a leaner healthier good bank. Moreover, this helped remove debt follow up from branch managers thereby enabling them to concentrate their efforts on growing the business.

The combined turn-around strategies was instrumental in reducing expenditure, generating revenue and curving out non-performing branches or businesses that had little value to the profitability of the bank. This measures left the bank more agile and able to handle the challenge of NPLs and the competitive banking environment that has persisted since 2002.

Culture Change was another response of the bank to the challenge of NPLs. The culture of the bank required to be compatible with the strategies being implemented. The new management of the bank was instrumental in culture change to induce a performance driven culture to enable the bank to compete in a competitive market.

On debt collection, the respondents stated that until 1999 the organization culture did not support performance management. Staff appraisals were subjective and the rewards did not reflect performance. In order to encourage collection of NPLs, the bank set annual targets for branches that were linked to individual targets. Any deviations from the set targets required an explanation. To achieve this, the bank employed a senior manager on contractual basis, whose primary task was to collect the NPLs. Renewal of the contract was pegged to performance of set targets. The senior manager is credited as with having induced a performance culture in debt collection.

Culture change further affected credit appraisals making them quantitative in nature, which was achieved through training. To further support this, the bank introduced committee lending with at least three officers of differing ranks required to appraise a credit together so as to minimize reckless lending. This initiative served as

empowerment of staff and reduced the extent of centralization in decision-making that previously rested in the hands of managers. All these required change of mindset of the staff and the bank had to manage resistance to change through training.

The re-capitalization of the bank by the majority shareholders was another response to the challenge of non-performing debts. Following several years of loss making, and heavy provisioning for NPLs, the bank's capital base had been eroded. This was compounded by the fact that the bank's balance sheet reflected shareholders loans aggregating over Kshs 5 billion, since 1998 that was creating a heavy burden of repayment by the bank. Additionally, this greatly compromised the bank's ability to lend to its customer's. The new management therefore put in a strong case urging the shareholders to re-capitalization the bank, to give the turn-around impetus.

Consequently, in 2003, loans advanced to the bank by the government amounting to Kshs. 4 billion were converted into preferential shares of Kshs. 5 each. Similarly, deposit liabilities for National Social Security Fund (NSSF) amounting to Kshs. 1.1 billion, which had been converted into a loan in 1998, were also converted to preferential shares. These conversions helped the bank meet capital adequacy standards and also enhance public confidence. Further, the respondents indicated that the government had repaid the Kshs. 20.4 billion, representing government initiated advances that were non-performing. This was by way of issuing long-term non-negotiable bonds as at June 2007 with various tenors. This gave the bank a constant stream of income from interest to be paid on the bonds until maturity.

Technological enhancement was another response to the challenge of NPLs. In order to respond to a competitive environment, the bank embarked on centralization and networking of branches in 2000 at a cost of US$ 10 million, by acquiring the Bank-master software and Automated Teller Machines. The project was completed by December 2004 and all branches are now interlinked creating a branchless bank. Other technological enhancement included the intra-net, automation of the clearing

system, an international payment system known as Society for Worldwide Inter-bank Financial Transfer (SWIFT) and the Internet banking.

Regarding debt collection, the interconnectivity allowed centralization, monitoring and reporting of debt collection. Moreover, the computerization gave debt collection an impetus to speed up the exchange of crucial reports and returns on debt recovery through the intra-net. Most crucial to debt collection, the bank is in the process of acquiring software, which will enhance debt recovery by prompting automation of debt monitoring and recovery. This will assist reduce the workload by providing an automated follow-up diary as well as automatically generating demand letters. The system will allow for more enhanced supervision through the computer monitor and help cut costs. The system will not only be useful for debt recovery but also for monitoring performing loans.

Lastly, the bank commenced an aggressive marketing initiative to mobilize deposits so as to reduce the negative effects of NPLs such as liquidity problems. The most successful initiative was collection of payments for government parastatals like Kenya Revenue Authority and Customs department. The large amounts of collections on daily basis helped to reduce liquidity problems as the collections are remitted periodically to the principals. Another successful initiative was salary payments for customers. One of the largest payrolls in the country being handled by a single bank is the Teacher Service Commission payroll, which is being handled by the bank among others. Because of these combined marketing initiatives, large amounts are transacted through the bank that helped to reduce the liquidity problem.

Arising from the combined effect of all the above strategic responses, the bank had by June 2007 provided for all NPLs in line with the Central Bank of Kenya guidelines. These debts were subsequently written off.

4.6 Strategic Fit

Most of the respondents did not consider the strategic responses made by the bank as being adequate given that the bank's performance was still poor, as compared to competitors. The responses of the bank were more reactive than proactive and there is an inherent danger that future incidences of NPLs may not be eliminated. The study established that after the successful write-off of NPLs, the task of debt collection and follow up was removed from the branches. In essence that left a gap in as far as debt follow up and monitoring of any future bad debts is concerned.

Despite the credit risk management in place, bad debts still remain a challenge in the banking industry. Respondents therefore felt that a special unit charged with monitoring NPLs should have been created at branch level. Account managers dealing with performing loans are given targets to enhance lending so as to increase the bank's loan book. Naturally, they concentrate on their core task to the detriment of monitoring debts in their portfolios. Respondents felt that this may create a new generation of NPLs, particularly because these staff have little training or experience in debt collection and monitoring.

The respondents further observed that staff involvement and participation in the strategic responses was minimal. As a result, some strategies presented problems at implementation, which reduced the impact of the responses. For example, the decision to curve out NPLs through write off had failed to involve staff charged with debt collection. Consequently, implementation of the response presented challenges to both staff and also customers. The staff having been involved only at the implementation stage therefore had to deal with customer complains arising from closure without notice of the written off accounts. The customers who were servicing their NPLs periodically, had to contend with queuing at the bank only to be advised by cashiers that their accounts had been closed. These operational problems during implementation could have been eliminated through staff involvement and participation.

CHAPTER 5 - Summary, Recommendations and Conclusion

5.1 Summary

5.1.1 Causes of NPLs.

The research established that the causes of NPLs were both external as well as internal. The external factors contributing to NPLs were economic downturn, government interference in lending, inflationary tendencies in the 1990's, limited supervision by the Central Bank of Kenya during the same period, inadequate government monetary policies and a slow and inadequate judicial system.

The internal or bank specific causes responsible for NPLs were political appointment of the top management, use of qualitative methods of debt appraisals which ignored analysis of the financial performance of the debtors, poor debt follow-up, lack of management accountability for NPLs, inadequate credit policy guidelines, imprudent and reckless lending and lack of portfolio diversification. We can therefore conclude that both the internal and external environment had an impact on the genesis of NPLs.

5.1.2 Challenges Posed on NPLs.

Five major challenges posed by NPLs were identified. These include liquidity problems, low profitability. bad public image, high cost of recovery and problems associated with debt collection. All these challenges had a root cause in the problem of NPls, and served to give the bank impetus to solve the underlying problem of NPLs. Given the magnitude of these challenges, the bank had to respond or risk becoming irrelevant to the needs of the customers or eventual liquidation.

5.1.3 Responses of the Bank to the Challenge of NPLs

The study found that NBK had responded to the challenge of NPLs in a number of ways. These include change of the bank management in 1999, retrenchment to cut down costs, reduce idle assets and generate revenue, restructuring of the bank by closing branches and a subsidiary which were loss making, culture change, technological update and re-capitalization. Central to these responses was the need to turn-around the bank through collection, provisioning and subsequent write-off of the NPLs. The objective was for the bank to present a healthy balance sheet and improve its public image before it can commence growth strategies.

The respondents however indicated that the responses were not completely adequate as there were problems during implementation of some these strategies. They have however observed that the bank had the necessary capability to match the environmental changes.

5.2 Recommendations

The respondents felt that the bank had adequately responded to the challenge of NPLs. They noted that the bank's approach to strategy making was more reactive than proactive. This study therefore recommends that the bank considers a more proactive approach in the strategy making process.

Additionally, the bank should ensure staff participation and involvement of staff in the strategy making process. Most often when staff involvement and participation is lacking, it is difficult for staff to own the strategy. Consequently, I recommend that the bank should ensure adequate staff participation and involvement so as to let staff own the implementation process.

Respondents noted that the bank had not explored reconciliatory approaches towards recovery of NPLs. Negotiations with bad debtors may provide a way to restructure NPLs to enable customers to repay. it was evident from the study that the bank had allowed NPLs to escalate to levels that debtors found difficult to service. It is therefore my recommendation that the bank may consider waiving off a reasonable percent of NPLs for bad debtors who may be willing to pay a reduced amount as a full and final payment. This would not only serve to reduce recovery costs but also create goodwill between debtors and the bank.

Finally, now that the NPLs have been effectively curved out of the banks books, the study recommends that the shareholders consider identifying a strategic investor to jumpstart further growth of the bank.

5.3 Limitations of the study

First, as a case study the research has limitations of the extent to which the findings can be generalized to the entire banking industry. Secondly, data collection was limited due to time constraints and unavailability of respondents. Lastly, many other strategic responses were implemented in the bank. However, only those that pertain to debt collection were mostly high lighted in this study.

5.4 Suggestions for Further Research

To my knowledge, there has not been any survey conducted on state owned banks to establish the causes of NPLs. The study therefore, recommends a survey of public sector banks such as NBK, Consolidated bank and Co-operative Bank. Additionally, a survey on the multi-national banks to establish how they managed to minimize NPLs in the 1990's despite the economic decline may be significant to future occurrences of NPLs.

REFERENCES

Ansoff, I. (1979) Strategic Management. London, U.K: Macmillan Press Ltd.

Ansoff, I. & McDonnell, E. (1990) Implanting Strategic Management Hertfordshire, U.K: Prentice Hall International (U.K) Ltd. 2nd E.D

Aosa, E. (1992) An Empirical Investigation of Aspects of Strategy Formulation and Implementation Within Large Private Manufacturing Companies in Kenya. Unpublished PhD Thesis University of Strathclyde, U.K.

Bani , P.B.(1999) Corporate Strategies New York, USA: Oxford University Press

Bell, J. (1999) Doing Your Research Project- A Guide For First-Time Researchers In Education And Social Sciences Buckingham: Open University Press. 3rd E.D

Bennet, R. (1999) Corporate Strategy Essex, England: Pearson Education Ltd. 2nd E.D.

Bourgeios, L.J., Duhaime, I.M. & Stimpert, J.L. (1999). Strategic Management – A Managerial Perspective Texas, USA; The Drypan Press Harcourt Brace College Publishers.

Bowman, C. & Asch, D. (1987) Strategic Management London: Macmillan Press Ltd.

Byrars, L.L. (1991) Strategic Management Formulation and implementation, Concepts and Cases. New York , USA: Hyper Collins Publishers Inc. 3rd E.D.

Byrars, L.L., Rue, L.W. & Zahra, S.A. (1996) Strategic Management Boston, USA: Times Mirror Higher Education Group.

CBK (1997) A Guide To Wise Management Of Loans From The Banking Institutions Nairobi, Kenya: Central bank of Kenya
Paper
CBK(2000) The Practice of Monetary Policy In Kenya Nairobi, Kenya: Central Bank Of Kenya.

CBK (2002) Bank Supervision Annual Report Nairobi, Kenya: Central bank of Kenya.

CBK(2006) Annual Report [Online] Available http://www.Centralbank.go.ke/downloads/publications/annual/annual_2006L.pdf

CBK(July, 2007) The Monthly Economic Review Monthly Report [Online] Available http://www.centralbank.go.ke/downloads/publications/Monthly Report-2007 L.pdf

Chandler, A. (1962) Strategy and Structure : Chapter in the History of Industrial Press. In Howe, S.W (1986) Corporate strategy. Hong Kong: The Macmillan Press Ltd.

Courtney, H., Kirkland, J. & Viguerie, P.(1999) Managing Uncertainty. Harvard Business Review. Boston, USA: A Harvard Business Review Paperback.

Gruening, H. V. & Bratanovic, S. B. (2000) Analyzing Banking Risk - A Framework for Assessing Corporate Government and Financial Risk Management. Washington, D.C: The World Bank.

Gupta, A. (1998) Is Kenya on the Brink of a Banking Crisis. In Market Intelligence The Business and Finance Journal: Kenya's Top Banks a Comprehensive Survey.

Harris, L.C. (1999) Initiating Planning: The Problem Of Entrenched Cultural Values. International Journal Of Strategic Management : Long Range Planning Vol. 32 No. 1. February

Hitt, M.A., Ireland, R.D. & Hoskisson, R.E. (2000) Strategic Management Competitiveness & Globalization St. Paul, USA: West Publishing Company

Hofer, C. W. & Schendel, D.(1978) Strategy Formulation: Analytical Concepts London : West Publishing Company.

Holden, T. (1991). Japan's Bankers Pulling in their Necks. In Business Week, December pp. 48-49.

Houlden, B. (1996) Understanding Company's Strategy – An Introduction to Analysis and Implementation Oxford: Blackwell Publishers Ltd 2nd E.D.

Howe, A. J., Mason, R., Dickel, K.E., Mann, R.B. & Mockler, R.J.(1994) Corporate strategy USA: Addison- Wesley Publishing Company Inc.

Howe, S.W.(1986) Corporate strategy Hong Kong: The Macmillian Press Ltd.

Johnson, G. & Scholes, K.(2002) Exploring Corporate Strategy Salisbury, U.K: Prentice Hall Europe.

Judson, A.S. (1996) Making strategy Happen. Transforming Plans into Reality Oxford, U.K: Blackwell Publishers Inc. 2nd E.D

Kabiru, J.M.G. (2002) The Study on the Relationship Between Credit Risk Assessment Practice and the Level of NPLs in Kenya. Unpublished MBA Project, School Of Business, University of Nairobi.

Kalani, V.M. (2004) The Causes of Non-Performing Loans – A Survey of Commercial Banks in Kenya.Unpublished MIBA Project , School of Business-U.S.I.U – Africa.

Kanyiri, R.W.(2005) Strategic Responses of Commercial Banks in Kenya to the Challenge of Non-Performing Debts. Unpublished MBA Project School of Business, University of Nairobi.

Keiichiro, O. (March, 2002) Corporate Finance Restructuring is the Key to Thailand's Economic Recovery The Japanese Research institute Ltd (2002) [online] Available http://www.jri.co.jp/research/pacific/monthly-2002/200203/ Ame200203thailand.html

Kiarie, R. (2006) E-Banking Elevated or Exacerbated Banking. Kenyan Banker: A Publication of the Kenya Institute of Bankers Issue No. 16.

Kiptugen, E.J. (2003) Strategic Responses to a Changing Competitive Environment: A Case Study of Kenya Commercial Bank. Unpublished MBA Project. School of Business, University of Nairobi.

Kothari, C.R.(2004) Research Methodology – Methods & Techniques New Delhi, India: New Age International (P) Limited. 2nd E.D

Kouzes, J.M. & Posner, D.L. (1997) The Leadership challenge San Francisco, USA: Jossey-Bass publishers.

KPMG (2003) Budget Brief 2004- An Overview of the Three Budget Speeches From the Region. KPMG- Kenya P.10

Levicki, C.(1999) The Interactive Strategy Work-out – Analyze and Develop the Fitness of your Business Strategy London: Pearson Education Ltd.

Lorange, P.(1998) Strategy Implementation: The New Realities. In the International Journal Of Strategic Management: Long Range Planning Vol 31 Issue No. 1. Feb

Migunde, F. A. (2003) Strategic Responses by Kenya Broadcasting Corporation to Increased Competition. Unpublished MBA Project School of Business, University of Nairobi.

Mintzberg, H. (1987) Crafting Strategy. in Harvard Business Review July – August Issue No. 4.

Minstzberg, H., Lampel,J., Quinn, J.B. & Ghoshal, S. (2003) The Strategy Process. Concepts. Contexts and Cases New Jersey, USA: Pearson education.

Mintzberg, H. & Quinn, J.B. (1996) The strategy Process. Concepts. and Context Cases New Jersey, USA: Prentice Hall. 3rd E.D

Mokaya, B.R. (2003) Responses of Inter-Urban Bus Companies In Kenya to Environmental Changes. Unpublished MBA Project School of Business, University of Nairobi.

Mugenda, M.O. & Mugenda, A. (1999) Research Methods: Quantitative and Qualitative Approaches. Nairobi, Kenya: African Center For Technology.

Muraah, P. (2003) A Survey of Strategic Responses by Kenyan Pharmaceutical Firms to the Challenge of HIV/AIDs Pandemic. Unpublished MBA Project School of Business, University of Nairobi.

Musa, A.H.(2005) Responses by Commercial Banks Operating in Kenya to Changes in the Environment: A Case Study of National Bank of Kenya Limited. Unpublished MBA Project School of Business, University of Nairobi.

Mwanthi, J.W.(2003) Strategic Responses of British America Tobacco Kenya Ltd to Current Environmental Challenges. Unpublished MBA Project School of Business, University of Nairobi.

NBK(2006) Annual Report & Financial Statements Nairobi, Kenya: Auditors Deloitte & Touche.

Njuguna, S. N. & Ngugi, R.W.(2000) Banking Sector Interest Rate Spread in Kenya. In Kenya Institute For Public Policy Research and Analysis (KIPPRA) Discussion Paper No. 5- March

Ohaga-Okoko, C. (2004) A Study of Responses Of Commercial Banks in Kenya to changes in their Environment. Unpublished MBA Project School of Business, University of Nairobi.

Oloo, O. (2000) Kenya's Top Banks: In Market Intelligence -The Business and Finance Journal: Banking Survey 2000, Annual Special Edition 2000.

Oloo, O. (2001) A Comprehensive Analysis and Ranking of Kenyan Banks: In Market Intelligence – The Business and Finance Journal: Annual Special Edition

Oloo, O. (2003) Challenges facing Kenya's banking sector: In Market Intelligence

-The Business and Finance Journal: Banking Survey 2003, Annual Special Edition (p.8)

Pandey, I.M. (1997) Financial Management. New Delhi, India: Vikas Publishing House, PVT Ltd. 5th E.D.

Pearce, J.A. & Robinson, R.R. (1997) Strategic Management Formulation. Implementation & Control. USA: The McGraw – Hill Companies, Inc. 6th E.D.

Porter, M.E. (1985) Competitive Advantage – Creating and Sustaining Superior Performance. New York: The Free Press.

Scott, R.W.(2002) Organizations: Rational. Natural and Open Systems New Jersey, USA: Prentice Hall. 5th E.D

Thompson, A.A., Strictland, A.J. & Gamble, J. (2007) Crafting and Executing Strategy. Text and Readings New York, USA: McGraw – Hill Companies Inc. 15th E.D.

Thompson, J.L. (1994) Strategic Management Awareness and Change London, U.K: Chapman & Hall. 2nd E.D.

Vanzi, S.J. (2003) Government Selling P14-Billion Non-Performing Housing Loans [online] Available http://www.newsflash.org/staff/solvanzi.htm.

Wen, J. (1999) China Gets Tough on Debt [online] Available (http:// www.cbw.com/busbj/ issue 38 / 24-27 html.

Wernerfelt, B. (1984), The Resource-Based View of the Firm. In the Strategic Management Journal; 5, (2), pp. 171-180.

Letter of Introduction

October 2007

Dear Respondent

RE: MBA RESEARCH PROJECT – THE RESPONSES OF NBK TO THE CHALLENGE OF NON-PERFORMING LOANS

I am a student at the University of Nairobi School of Business pursuing a Master of Business Administration (MBA) degree course.

I am undertaking the above research project in partial fulfillment of the degree program. Kindly assist me towards collecting data for the research project by answering the following questions in an interview section to be arranged at your convenience. The information gathered shall be used purely for academic purposes and will be treated with outmost confidentiality.

Yours faithfully,

Mathara Kellen
MBA Student

Prof E. Aosa
Supervisor

RESEARCH QUESTIONAIRE

Responses of National Bank of Kenya to the Challenge Of Non-performing Loans (NPLs).

Instructions:

Kindly answer the following questions. Information given will be analyzed for a research project to be submitted in partial fulfillment of an MBA degree course and will be treated with the highest degree of confidence. The questionnaire covers the last 15 years, when the problem of NPLs became prevalent at NBK and other banks.

SECTION A: Causes Of Non-Performing Loans

1. What are the major external causes of NPLs?

2.What are the internal causes of NPLs?

SECTION B: Challenges Posed By Non-Performing Loans

1. What are the challenges posed by NPLs to the bank?

SECTION C: Sources of Pressure to Respond to the Challenge of NPLs.

2. What do you consider to have been the forces bearing pressure on the bank to respond to the problem of NPLs?

SECTION D: RESPONSES OF NBK TO THE CHALLENGE OF NON-PERFORMING DEBTS

1. In your opinion, has NBK responded to the challenge of non-performing debts?

- ❑ No
- ❑ Yes

2. Describe the responses of the bank to the challenge of NPLs? --------------------------------

----

SECTION D: STRATEGIC FIT

1. Do you consider the strategic responses of the bank as adequate--------------------------------

----

----

2. If the answer to the preceding question is no, what recommendations would give to enhance the responses of the bank to the challenge of NPLs-------------------------------
----

Appendix 3

Kellen W. Mathara
P.O. Box 51427-00200
Nairobi.
Cell-phone No: 0722555553
Office No:2828000 Ext 8711
30th October 2007.

The Director,
Bank Inspection Unit,
Central Bank of Kenya,
Nairobi

Dear Sir/Madam,

RE: MBA RESEARCH PROJECT: THE RESPONSES OF NATIONAL BANK OF KENYA TO THE CHALLENGE OF NON-PERFORMING LOANS

I am a student at the University of Nairobi School of Business, pursuing an MBA degree course. I am required to submit a management research project in partial fulfillment of the degree, and towards this end I am researching the responses of NBK to the challenge of non-performing debts.

I intend to interview several senior managers from National Bank of Kenya. Additionally, I would be grateful for your authority to interview at least one of your inspectors, particularly someone who has been working with the unit since the 1990's. This would provide a broad and extensive contribution to my research.

Yours Sincerely

Mathara Kellen

UNIVERSITY OF NAIROBI
LOWER KABETE LIBRARY