

**CREDIT RISK MANAGEMENT PRACTICES ON LOAN  
PORTFOLIO OF BARCLAYS BANK OF KENYA**

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THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION  
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## **DECLARATION**

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

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**MBA PROGRAMME**

## **SUPERVISOR'S APPROVAL**

The research project has been presented for examination with my approval as the university supervisor.

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## **DEDICATION**

I dedicate my work to my mum Margaret, my dad Ben, My brothers and sister Tony, Charles Frederick and Millicent for standing by me throughout my course work. A special thanks to my brother Charles and my very good friend Majwa for chipping in financially. God bless you all abundantly.

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## **ABSTRACT**

Since banks core business is lending, they are viewed as business with huge risk appetite with lending activities being one of the key sources of credit risk. Among the risks that banks face, credit risk is of great concern to most bank authorities and banking regulators since it easily and most likely prompts bank failure. Credit risks faced by commercial banks are not only a threat to its financial performance but also to the financial market. The main aim of the current research study was to evaluate the extent to which credit risk management policies influenced the loan book in terms of quality at Barclays bank of Kenya. The researcher adopted the case study research design as it places more emphasis on full contextual analysis of fewer events or conditions and the interventions. The study used primary data that was obtained with the help of personal interview steered by the use of interview guide. Once the data was collected, content analysis was used to conduct an analysis on a text, after the text was coded, into manageable concepts which were quantified and tarried using the basis method of content analysis, the conceptual analysis. From the findings, it is clear that loan portfolio at Barclays Bank of Kenya was influenced by credit risk management policies. The conclusion was that lenders need to levy their customer's reasonable interest rates. In this regard, loan portfolio performance tends to get better thus enhanced lender returns. Subsequently, reduced interest rates attract new customers thereby improving income levels to the bank. This research explained fifty seven percent variance of NPA's in banks. Further research needs to be done to include the additional determinants hence reveal the remaining NPA variance.

# CHAPTER ONE

## INTRODUCTION

### **1.1 Background of the study**

Profitable bank lending is based not on making loans but on minimizing the risk in collecting them. In this respect then, the major business of the bank therefore is the administration of risk in a profitable ways. The continued and profitable operation of banks is dependent is how it presently manages its credit risk. The bank crunches in USA and other areas around the globe are as a result of poor loan quality (Hempel & Simonson, 1999). Banking institutions carries risk associated with private sector lending more so when some of the loanees don't honor their payments obligations. Whatever the degree of risk is taken; loan losses can be minimized by organizing and managing the lending function in a highly professional manner that is credit risk management. Critical to growth and survival of financial institutions is adequate risk management by banks. To the financial institutions, credit risks awake inordinate apprehension due to high risk profile of some of the banks customers.

Credit creation in the main income earning activity undertaken by banking institutions (Tefera, 2011). In that respect then clients not meeting their repayments requirement in accordance to the agreement on due date or anytime thereafter greatly expose the proper running of the functions of the bank's business. At the same time, a bank whose credit risk is high risks a higher rate of insolvency thus putting clients' money at risk. Of all the risks faced by the banking institutions risks inherent in credit is a major headache to banks management and policy makers as it may course bank failure. Since banks core business is lending, they are viewed as business with huge risk appetite with lending activities being one of the key sources of credit risk (Rose

& Hudgins, 2010). This study is two anchored on two theories, the Resource-Based theory and the Survival Based Theory. The advocates of Resource-Based or competence-based theories argue that it provide better analytical tool to organizational change within the firm (Hodgson, 1998). Survival based theory is closely linked to the evolutionary theory which zeros on the need for a business to at all times ensure it is in synch with the competition to ensure its survival (Raduan, Jegak, Haslinda, & Alimin, 2009). The Resource Based View holds it that it is the resources internal to the business and not the position in surrounding environment gives the organization the competitive-edge required. The resource-based view of the firm predicts that certain types of resources owned and controlled by firms have the potential and promise to generate competitive advantage and eventually superior financial performance (Raduan, Jegak, Haslinda, & Alimin, 2009). The two theories helped explain the influence of credit risk management policies on loan portfolio quality of Barclays Bank of Kenya.

Weakening in bank loan quality may possibly dwindle the profits of the banking institution as huge amounts non-performing assets in its books of account threatening them to become insolvent. As a result, banks may be reluctant to extend new credit thus impeding on the economy's progression, and in some instances may push to situations where private sector lending is curtailed (Basel Committee on Banking Supervision, 2006). Accordingly, to guard against problem loans, banks customarily provided for non performing assets and charge the amounts to the income statements (Rose & Hudgins, 2010). In banking institutions, policies of managing credit risk essentially comprises of its policies of managing and diminishing the risk exposure and occurrence (Dam, 2010). As issuance of loans is a core business of banking

institutions products and services, managing risk is crucial to profit generation of financial institutions.

Barclays Bank of Kenya was founded in 1916 and plays a significant role in the development of Kenya's financial and economic landscapes. The banking industry in Kenya was negatively impacted by the closure of two banks in 2015. This brought the issues surrounding sound business practices within financial institutions to the fore. In addition, increased inflation has had the effect of limiting consumer spending. Further, the regulator's adjustment of the Central Bank Rate to 11.5% so as to address a weakening currency has impacted on the sector negatively due to liquidity environment. Despite all these challenges of market volatility and the short termism of the financial markets, the underlying quality of the Barclays brand and performance of the Bank have not been obscured. In 2015, the bank's gross interest income grew by 10% to Shs 25 Billion compared to 2014 while the loan portfolio increased by 16% to Shs 145 Billion compared to Shs 126 Billion in 2014 while customer deposits stood at Shs 165 Billion. It is not clear whether banks impressive performance was influenced by the credit risk management practices. This study seeks to evaluate how loan-quality is influenced by credit management practices at Barclays Bank of Kenya (BBK).

### **1.1.1 Credit Risk Management practices**

Credit risk management practices are the apperception, evaluation, auditing and management of risk arising from the likelihood of loan non repayment. Management of credit risk is at the heart of survival of most financial institutions. Credit risk management is at the core of survival for the big majority of commercial banks.

Kithinji (2010) defined credit risk management has been defined as implementation of policies to limit insider lending and large exposures to related parties this is in addition to controlling risks stemming out of chances that a client may not repay the loan. Inadequate credit risk management practices and absence of care to variations in economy can be named as causes for poor financial performance by banking institutions (Tefera, 2011). The objective of credit risk management in banks is to achieve maximum risk-adjusted rate of return by retaining credit risk exposure within satisfactory limits (Wang, 2013). Indicatively credit risk management may be spell out methodical appliance of management strategies, processes and practices to the tasks of pinpointing, evaluating, gauging, treating and monitoring risk. Earnings due to banks will be exposed to risks of variations in returns and hence fluctuate if the financial institutions are not aware of the percentage of loans that will become delinquent. Loans extended to bank's clients might have risks associated with non-repayment in circumstances the bank assumes that the loanees will faithfully pay back amounts borrowed. A few of the clients ordinarily don't make the repayments resulting to decreased profits due to the need for provisioning and writing of the loans (Karugu & Ntoiti, 2015). Essentially, the credit risk of a bank is the likelihood of cost arising from non-repayment of interest and the initial loaned amount, or both, or failure to sell of securities pledged on the loan (Kithinji, 2010).

Credit risks faced by commercial banks are not only a threat to its financial performance but also to the financial market (Eder, Fecht, & Pausch, 2014). Basel Committee on Banking Supervision, (2006) encouraged the use of "know your customer" principal as a strategy to minimizing credit risk. Nonobjective decisions made by banks executives may result to insider leading or lending to personal friends,

persons without superior financial knowledge or to meet personal agenda (Kithinji, 2010). An answer to the problem would be the usage of verified loaning systems and chiefly the measurable ones which are more objective (Karugu & Ntoiti, 2015). Changes in credit risks may mirror changes in the health of a bank's loan portfolio which may in turn affect the bank's performance (Weersainghe & Perera, 2013). Weersainghe & Perera, (2013) were of the view that varying profitability levels could be traced back to variations in credit risk as increased exposure to the risk is associated with declining organization profitability. According to Karugu & Ntoiti, (2015) empirical evidence supported the view of the presence of an inverse connection existing between credit risk and performance of financial institutions suggesting that the more these institutions are exposed to high risk loans, the higher the poor performing assets the poor the performance.

### **1.1.2 Loan Portfolio Quality**

Loan portfolio relates to the sum total of monies loaned out through various lending products to different borrowers (Kurui & Kalio, 2014). Loan portfolio encompasses salary loans, group bonded loans, individual loans and company loans (Murugu, 2010). Loan portfolio refers to number of bank customers with loans and the total amount loaned out (Crabb & Keller, 2006). According to Kurui & Kalio (2014), continued existence of most financial institutions depends entirely on successful lending program that revolves on funds and loan repayments made to them by the clients. This means a restrictive credit control policy should be adopted to act as a deterrent to unnecessary lending and in the process improve on profitability of the financial institutions (Kipchumba, 2015). Credit management is the managerial

responsibility through which customer's credit ratings are determined as part of the credit control function.

Non-performing loans are used as a measure of the quality of loan portfolio. The portfolio is said to be of good quality if there are minimal or no non-performing assets (Onuko, Muganda, & Musiega, 2015). According to Onuko et al (2015), should a loan remain unpaid for a period of time exceeding ninety days, then it is classified as non-performing loans and have limited chances of being serviced either partially or fully. Onuko et al (2015) suggests that unhealthy loan portfolio rather poor operating efficiency is the clearest sign of failed banks. A fall in loan portfolio quality impends on banks liquidity and hence its daily processes. Onuko(2015) posit that a healthy loan portfolio is very critical to the performance of the individual bank and also entire country's financial sector. The study concluded that poor loan portfolio tend to reflect on the total net worth of a bank.

### **1.1.3 Barclays Bank of Kenya**

In Kenya banks and other financial institutions are licensed by the Central Bank in accordance to the laws of Kenya. Banks are main players in the Kenya's economy and close attention is paid to ensure they comply with laws and regulations. Presently 42 commercial banks and one mortgage have been licensed and are operating in Kenya. Of the 42 establishments, 38 commercial banks and the mortgage institution are privately. Kenya government holds controlling interest in the other three banks. Kenyans hold a controlling interest in twenty five of the thirty nine banks and the mortgage institutions. The rest are owned by foreigners.

Barclays Bank of Kenya is a subsidiary of Barclays Africa limited and it one of the leading banks in Kenya. The bank has an asset base of Kenya Shillings 226 Billion and a loan portfolio of Kenya shillings 126 Billion. This has resulted to the bank being classified as tier one bank by the regulatory authority. The bank has operated in Kenya for over 100 years with different profit centres such as individual retail, business banking, treasury and credit card unit supporting local big to emerging business. Barclays financial strength coupled with extensive local and international resources have positioned Barclays as the top provider of financial services in the market for the past several years. Barclays has had consistent financial performance has built confidence as a leading retail and corporate bank in Kenya (Barclays Bank of Kenya, 2013).

## **1.2 Research problem**

Banks are useful to economic development by through the provision on financial services and intermediation of lenders with savings to borrowers who need the money (Kolapo, Ayeni, &Oke, 2012). Sound financial performance, well-organized and effective banking sector over time is an important barometer to any country's financial stability. The pace of a country's economic growth and long term sustainability is accelerated by the extent to which banks extend credit to the general public. Credit creation, being the main income generating activity of the banking institutions, exposes them to credit risk. Credit risk plays a significant part on banks' financial performance and hence profitability as a huge proportion of banks revenue is derived from loan interest. These risks have a huge influence on the bank's financial performance hence calling for prudent credit risk management practices (Kolapo, Ayeni, & Oke, 2012).

The Kenya's banking sector was liberalized in 1992 but brought with it cut throat competition in the industry, leading to some banks extending credit with an aim of increasing profitability (Kithinji, 2010). According to Kithinji (2010), little regard was however given to credit risk assessment as the loans were extended either to attain political capital or to insiders. Each of the institutions adopted its own credit risk management policies which were largely determined by; banks ownership, credit policies adopted by individual banks among others. Weaknesses in credit policy by the Kenya's financial sector lead to several of the banking institutions collapsing over what was termed as poor management of credit risks which resulted to increased amounts of loans that are not being serviced. The poor managements of threats associated with credit extension exposed the banks to non-performing loans which were eventually written off thus reducing the bank's profitability (Kithinji, 2010). The same scenario was to be repeated in the period August 2015 to April 2016 when three banks were placed under statutory management by the Kenya's banks regulator, the Central bank of Kenya. The ill-fated banks that were placed under receivership were Chase Bank, Imperial Bank Limited and Dubai Bank limited due to inadequate capital and liquidity ratios. Dubai bank was eventually wound up and closed.

The recent crisis in the Kenya's banking sector thus brings sharp focus on credit risk management practices and their effects on loan portfolio quality. Several foreign and local studies have been done in respect to credit risk management practices and loan portfolio quality of financial institutions for example Dam (2010) carried a study that evaluated policies and practices adopted to manage credit risk by Joint Stock banks in Vietnam and concluded that the institution had adopted a standard credit risk management framework. The study however did not examine the influence of the

CRM policies of the loan portfolio quality of the bank. Weersainghe & Perera (2013) sought to establish factors that determined performance of commercial banks in Sri Lanka. Empirical results from the study indicated that banks large banks recorded higher profits compared to those with higher regulatory adequacy capital ratios. It was not clear whether the findings are portable to Barclays Bank of Kenya. Kolapo, Ayeni, & Oke, (2012) used a panel model approach to investigate the effects of credit risk policies on financial performance of commercial banks in Nigeria and found out that credit risk did not influence banks performance as measured by Returns of Assets of the bank. The study however used one measure of financial performance and ignored the Capital Adequacy Ratios which are the barometers recommended by the regulatory authorities world over.

In another study, Kaggwa (2013) looked the influence that interest rates had on asset quality performance of Ugandan commercial banks. The study findings indicated even though credit procedures and regulations were being followed there was still some loan repayments defaults that affected credit risk and hence profitability. The study however adopted one policy of credit risk management practices and ignored the rest. Karugu & Ntoiti (2015) carried out a study that study sought to analyze the influence of credit risk management practices on profitability of listed commercial banks at Nairobi Security Exchange in Kenya. The study findings were that credit appraisal, debt collection and credit risk management had a major direct influence on returns. The study however did not address the issue of loan portfolio quality and if it was affected by credit risk management practices. Kipchumba (2015), evaluated the influence of assessment of credit on repayments of loans in Kenya's micro-finance institutions. The study found out that credit assessment to a large extent influenced

loan repayment and hence the institutions profitability. It was not clear however if the findings were applicable to commercial banks and in particular Barclays bank of Kenya. Kithinji (2010) assessed credit risk management and profitability of commercial banks in Kenya. The study found out that most of the profits made by banking financial institutions were not swayed by loans extended or by the delinquent loans and suggested that other factors could have impacted on profits. The study by Kithinji was on all commercial banks and there are likelihood of smoothening out effects and hence the need to concentrate one commercial bank.

From the foregoing, none of the studies reviewed have specifically focused on definite risk administration policies influencing loan-portfolio of Kenyan banking institutions. Some of the studies have revolved on the entire banking sector while not giving attention to individual banking institutions. This creates gaps in literature that the current study seeks to fill. The current study thus seeks to answer the question, what is the effect of credit risk management practices on loan portfolio quality of Barclays Bank of Kenya?

### **1.3 Objectives of the Study**

The Current study was to the influence of credit risk management practices on financial performance of Barclays Bank of Kenya.

Specifically, the study sought to:

- i. Determine the extent to which credit-risk administration practices influence loan- portfolio of Barclays Bank of Kenya.
- ii. Establish the influence of credit-risk administration policies on market growth of Barclays Bank of Kenya.

## **1.4 Value of the Study**

It is hoped that this study will be significant to the management of Barclays Bank of Kenya as they will be able to uncover the effects of credits risk management practices on loan portfolio quality and adopt appropriate credit risk management practices in reducing level of nonperforming loans and enhance banks performance.

The study will provide an insight on the best credit risk management approaches banking institutions should adopt in order to effectively manage and enhance portfolio quality. Managers in banking industry will find this study significant as it will provide an insight on the best credit risk management practices that should be taken to lower the credit risk and hence improve on the firm's performance.

It is expected that the current study will contribute to the government in so far as coming up with policies that deals with the loan requirements and also for the supervision of banking institution. The policy makers will obtain knowledge on the best mechanisms that should be adopted to improve loan portfolio quality. This study will therefore act as a guide in adopting effective credit risk management practices by banks in improving performance in banking institutions.

This study will contribute to academia by showing how credit risk management (CRM) practices can affect the loan portfolio quality of banking Institutions. It will add to the body of literature on CRM practices that has shown the effects of CRM on the management of the loan portfolio quality of banking institutions. The study will also be significant to research who may find this study valuable to form a foundation to identify research gap and carry further research.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Introduction**

This chapter presents theoretical, conceptual and empirical literature along the key constructs of the study. First, the theoretical underpinnings of the study are presented and discussed.

#### **2.2 Theoretical Perspectives**

This study has two concepts, Credit Risk management and Financial Performance. The concepts are anchored on the survival based and The Resource-Based theories. Survival based theories which could be seen as a sub group of a larger group of theories, termed as competences, resources based or capabilities theories, whose proponents argue that it provide better analytical tool to organizational change within the firm (Hodgson, 1998). Survival based theory is closely linked to the evolutionary theory which zeros on the need for a business to at all times ensure it is in synch with the competition to ensure its survival (Raduan, Jegak, Haslinda, & Alimin, 2009). The Resource Based View holds it that it is the resources internal to the business and not the position in surrounding environment gives the organization the competitive-edge required. The resource based theory of the firm states that the possessions and in control of the business the ability for generation of strategic- competitive advantages and eventually better financial performance (Raduan, Jegak, Haslinda, & Alimin, 2009).

### **2.2.1 The Survival Based View**

The Survival Based View advances that for any business to survive, it should always be adjusting to deal with its business rivals. This Survival Based idea was initially developed by Herbert Spencer guided by firms' necessity to adjust to its surroundings for continued existence. The concept analyses in what way businesses prosper besides competing with other firms doing similar business. In addition it helps to explain economic changes. The theory assumes that cooperation and competition are closely linked to each other and eventually the competitive forces pushes businesses to cooperate (Mohammad & Abdullah, 2010). The survival-based theory emphasizes on the expectations that for businesses to survive, strategies focusing on efficient operations need to be put in place to react quickly towards the shifting business environment that is competitive (Mohammad & Abdullah, 2010).

Survival based theories are of the opinion that businesses have to at all times keep in synch with competition in its area of operations to ensure its survival (Raduan, Jegak, Haslinda, & Alimin, 2009). However, even if businesses under no circumstances actually endeavoured to get the most out of earnings, radical procedures of assortment and simulated earnings ensures that most profitable enterprises continue in existence (Hodgson, 1998). Survival-based theory argues that firms not adjusting towards the fast changing environment and become efficient in it. Firms not adopting will simply not survive but will die (Mohammad & Abdullah, 2010). The focus is if specific characters exist in business that is suitable for specific setting. The evolutionary view point looks at the structure, existence and boundaries of the business can be expounded in some way by the coexistence of individuals and teams within the framework of the organization that maintains and fosters them (Hobson, 1998).

The theory however is not without critics due to the inability of the theory to elucidate reasons establishments act in a one way and not the other even though it shows how the organization adopted. The theory holds that for an organization to be said to be successfully then it must have adapted well to its environment and operates efficiently. However, some of the advocates of the theory posit that it were better for the firm to try out several policies at the same time and let the environment select the best rather than opt for a single strategy.

### **2.2.2 The Resource-Based Theory**

The Resource-Based framework centers on the basis that the foundation of a firm's competitive advantage comes from its internally generated resources rather than from the external environment. This view forecasts that definite types of resources possessed and controlled by organizations have the stimulus to generate competitive advantage and superior firm performance. The theory emphasizes the role of resources and capabilities in forming the basis of strategy implementation (Mutunga, Minja, & Gachanja, 2014). The resource-based theory views firms with above average systems and structures as being profitable not because they engage in strategic projects that may discourage entry and increase prices above long run costs, but because they have markedly lower costs, and high quality product performance is offered (Mutunga, Minja, & Gachanja, 2014).

The Resource Based framework has become one of the most powerful and cited theories in the history of strategic management theories (Mutunga, Minja, & Gachanja, 2014). The theory clarifies that for the organization to attain Sustained Competitive Advantage it must acquire and control prized, infrequent, unique, and

non-substitutable resources and capabilities, in addition organizations must plan on how to use them. Capability and resources must have value, uncommon, matchless, and with no close substitutes to generate sustainability of competitive advantage. The theory appraises and categorizes a firm's strategic advantages centered on examining its individual mixture of assets, skills, capabilities, and intangibles of an organization (Mutunga, Minja, & Gachanja, 2014) The fundamental premise of the theory is that organizations differ in a big way because each holds a distinctive package of resources- tangible and intangible assets and organizational capabilities to make use of those assets. Each organization develops proficiencies from these resources, and when advanced especially well, this becomes the source of the firm's competitive advantages and through intervening effect of innovation, the resources influence implementation.

### **2.3 Credit Risk Management Practices**

The danger that financial cost may occur when customers, clients or market counterparties fail to fulfill their contractual obligations to the bank is referred to as credit risk. Barclays Bank of Kenya actively seeks to originate and manage credit risk in such a way as to achieve sustainable asset growth and risk-adjusted returns in line with board approved risk appetite (Barclays Bank of Kenya, 2013). Credit risk management practices have been defined as the identification, measurement, monitoring and control of risk arising from the possibility of non-payment of loans advanced to various clients (Kithinji, 2010). Loans extended to bank's clients might have risks associated with non-repayment in circumstances the bank assumes that the loanees will faithfully pay back amounts borrowed; some borrowers usually don't repay resulting to decreases performance due to non-performing loans provisioning

(Wang, 2013). Earnings vary as the commercial banks don't have an indication of the proportion of defaulters thus exposing the banks to additional risks (Kithinji, 2010). Every commercial bank experiences a certain amount of uncertainty in instances where it loans funds to individual and corporate customers. In such scenarios, the financial institution may end up with lending losses should some of the borrowers fail to clear loans as per agreements (Karugu & Ntoiti, 2015). Primarily, credit-risk of a banking institution are the chances that a loss resulting from default of interests and the principal, or the two of them, or in ability of the bank to sell the securities held against the loan (Kithinji, 2010). As a threat facing the soundness of commercial banks, credit risks faced by banking institutions portend crunches not only to the financial institutions but also to the financial market as a whole (Kithinji, 2010).

Banks are required to use the "Know Your Customer" principle as a strategy aimed at minimizing and/or eliminating credit risk (Basel Committee on Banking Supervision, 2006). Biased decisions made by banks management might result to insider lending or to individuals associated with the banker or individuals with poor financial background or to fulfill personal motives, which may include trying to befriend persons with higher status in the society. One of the solutions suggested is the use of well-known lending methods and especially quantitative ones as they filter out biasness (Abdifatah, 2010). Clear credit philosophy is a prerequisite for proper management of credit risk as it would result clear credit risk management priority (Barclays Bank of Kenya, 2013). According to the report the credit policies includes stressing on the importance on steady returns on loan portfolio which must be top notch and grounded on standards of high quality in respect to under-writing and insistent on growth in loan portfolio that is above average. The report summarizes the

BBK's lending philosophy in written and formal loan policy, principles and procedures. The important elements of managing credit risk have been summarized as loan policy and procedures, credit culture, and loan product diversification.

### **2.3.1 Loan Policy and Procedures Formulation**

Loan policy is the chief means by which banks provide guidance and focus to its lending activities of a banking institution (Barclays Bank of Kenya, 2013). In addition to subscribing standards loan policy also states the bare minimum required of a bank's credit policy to ensure a structure of ensuring loan-quality and profitability goals in such a way it conforms with the institution's policy goals (Kaggwa, 2013). Loan policy sets principles for portfolio structure, individual credit decisions, fair lending, and compliance management (Abdifatah, 2010). The quality and composition of banks' loans should reflect their loan policies which on the other hand checks on the institution's policies on lending, its cultures, areas that require to be prioritized on, stipulating processes and ensuring loan granting is monitored. In addition to ensuring the policy and procedures are communicated, the loan policy should be documented. Policies in this context mean written documents issued by the lender to guide credit risk management. The major requirement for an effective policy of management of risk inherent in credit is an unambiguous and well-thought out policy of granting loans specifying how loans are planned, ratified, managed and collected (Dam, 2010). The loan policy consists of a generalized statement on policies broadly specifying the goal of the institution's lending function and the expected loan-portfolio quality. Such policy elements are: Introduction, Objectives, Strategies, Lending authorities and approvals, and Credit standards

### **2.3.2 Culture of Credit**

For the culture of credit to be effective, the real behaviour of each person in the banking institution should reflect on the areas that bank gives precedent (Kumar & Moin, 2016). The culture adopted by banks on credit should be seen in the organizations credit structures and processes and implementation key result areas aimed at reducing the losses associated with improper loaning choices. The credit culture of a bank is its unique combination of policies, practices, experiences and attitude of the management that defines the lending environment and determines the lending behavior acceptable to the financial institution (Soke & Nurul, 2009). In additional lending culture can be seen as a system of activities, values, opinions, idea, manifestation and way of doing things in so far as credit management function is concerned. Credit culture is seen as policies that act as guidelines to credit risk management. Alternatively, to credit ethics leading to a practice that checks and protects assets and credit criteria (Mukonda, 2011). For culture on credit to be effective it must have, targeted yearly rates of growth, achieving the returns that were budgeted, achieving satisfactory and quantifiable risk coverage levels on different types of loans classified according to liquidity and time structures, composition of the loan portfolio, expected loan growth, targeted profitability, risk appetite and approval limits (Dam, 2010).

### **2.3.3 Credit Criteria**

The use of certain factors to determine credit worthiness of a borrower and his capability of repaying monies lent is referred to as credit culture. Credit criteria are the factors employed to determine borrower's credit worthiness and ability to service the loan. Some of the areas taken into consideration by the bankers are; the income of the client, existing loans and credit score. Overly aggressive lending practices, which refer to giving credit with terms exceeding the charged assets life, is though common is unwelcome risk. In addition to that, extending credit to customers who are already overloaded with debt or possess unfavorable credit history can expose banks to non-repayment and credit risk. To mitigate against credit risk, financial institutions should have a culture of paying close attention to some common customers' details such as the ratio of debt to income, historical record showing the performance of the business overtime including history of credit. Banks should consider customers length of service in an organization, place and duration of stay when evaluating individual customers (Soke & Nurul, 2009).

### **2.3.4 Loan Product Diversification**

Diversification in the financial sector takes the form of offering a wide range of loans but not limited to corporate, individual, motor vehicle and training loans. Diversified products include the mortgage market as well as credit card business (Mukonda, 2011). Diversification serves to reduce credit risk and allows for more consistent performance under a wide range of economic conditions. Diversification has its benefits which also observe that credit risk management practices could extend to objective audit of credit functions to confirm if proper procedures have been followed and check on the how risk has been rated and point out danger areas in addition to

recommending on correction action needed aimed at improvement on quality of credit. Management of credit risk stems from the fact that gains that comes with a wide array of credit portfolio needs to be guarded with an aim of reducing their exposure to risks associated with rates of returns charged. Thus the need for continuous and speedy review of systems aimed at identifying areas of weakness well before they occur. (Mukonda, 2011).

## **2.4 Credit Risk Management Practices and Loan Portfolio**

The major sources of Credit risk to a bank are its business dealings with individual customers, business and other financial institutions including state corporations. Such trade which is mainly in advancing loans to banks clients comes with some obvious risks. Loans being the major and most apparent source of credit risk to most banks means that credit management techniques needs to be applied (Abdifatah, 2010). Credit risk has been defined as the potential that a bank debtor and other counterparties will not meet their responsibilities occasioning to depressed earnings. Exposure to financial risk, in addition to direct financial loss should also be taken into consideration when it comes to credit risk. As it does not always happen in isolation, credit risk also exposes banks to other risks for instance liquidity risk with both affecting loan portfolio quality. The aim of credit risk management practices is to maximize banks risk adjusted rate of return by retaining credit risk exposure within acceptable levels (Hempel & Simonson, 1999).It is imperative for banks to ensure credit risk attached to loan portfolio is well managed in addition to that of individual client's credit transaction (Soke & Nurul, 2009). The financial institutions must also put in mind the connection revolving among interest rates, credit and liquidity risk well-organized credit risk management is vital to the entire risk management structure and is vital to each financial institution profitability and eventually its own survival

and growth in the long run (Karugu & Ntoiti, 2015). Comprehensive review risks involved lending decisions is of great significance and goes a long way in mitigating losses that would be occasioned should the loan book turn out to be bad. On the flip side, banks loan portfolio quality is directly related to the amounts of credits granted and hence strict credit management practices need to be put in place to lower the credit risk and hence prevent financial loss. Banks must consider and stabilize the two options in order to improve on profitability (Wang, 2013).

## **CHAPTER THREE**

### **RESEARCH DESIGN AND METHODOLOGY**

#### **3.1 Introduction**

This section sets out the research design to be used in the study, the justification of the design, the data collection method, the analysis and reporting of data has also been explained.

#### **3.2 Research design**

Orodho (2003) defines research design as a structure needed to generate solutions to research questions. It is a presentation of the structure or strategy of investigations which seeks to answer various research questions (Legase, 2009). The researcher adopted the case study research design as it places more emphasis on full contextual analysis of fewer events or conditions and the interventions. Case study is flexible and permits the scholar to preserve the complete individualities of actual proceedings though examining experimental proceedings (Yin, 2013). A case study has been defined as an experiential examination that examines a present-day occurrence inside its realistic background (Yin, 2013).

#### **3.3 Data Collection**

The research made use of both primary and secondary data in the current research. A personal interview steered by an interview guide was used in the collection of primary data. Secondary data which consisted of Capital Adequacy and profitability ratios, collected through a data collection form, was obtained from published financial statements of Barclays Bank of Kenya. Primary data was collected using both open

and closed ended questions in the context of the research topic. Each variable had its related questions and the interview guide was divided into five sections. Section A was on the profile of respondents section while Section B is on the respondents understanding of credit risk management practices. Section C is on loan product diversification while Section D collects data on loan approval process. Data on credit control functions section is gathered in section E. The interviewees will be the two vice presidents, three senior manager, seven line managers and five team leaders as they are considered key to CRM.

### **3.4 Data Analysis**

Content analysis was applied to the collected data whereby analysis was done on text, after the text was coded, into manageable concepts which were quantified and tarried using the basis method of content analysis, the conceptual analysis. The results obtained were then used to make inferences about the messages within the text. Content analysis draws its advantage from the fact that it permits the researcher to recover and examine the behaviour, perception and trends in organizations. It acts as a key link between strictly quantitative and strictly qualitative research techniques. Content analysis permits scholars to examine concepts that are challenging to study through quantitative approaches. In addition, it permits researchers to use big samples that may be challenging to use in strictly qualitative research. It is appropriate since it offers flexibility and allows for objective, systematic description of the content under study. The researcher collated data obtained from interviews into tables and as percentages to be able to come up with tables to aid in analysis.

## CHAPTER FOUR

### DATA ANALYSIS, RESULTS AND DISCUSSION

#### 4.1 Introduction

This chapter presents the analysis of data collected and discusses the findings of the study whose overall objective was to determine the influence on loan portfolio quality by credit risk management practices of the Barclays Bank in Kenya. Descriptive statistics were used to analyse the demographic data and was presented in frequency tables and charts, mean and standard deviation generated by Microsoft office excel.

#### 4.2 Response rate

The population of the study comprised of 17 senior credit managers of Barclays Bank of Kenya, however, 14 managers were interviewed and responses recorded which 82 percent was. This was an acceptable response rate as it compared well to similar studies conducted locally. Kipchumba (2015) had a response rate of 79.5 percent Karugu & Ntoiti (2015) undertook a study on listed commercial banks whose responses were placed 72 percent. Mugenda & Mugenda (2009) states that a response rate of above 70 per cent is good and hence a response rate of 82% was considered adequate.

**Table 4.1 Response Rate**

Categories	Frequency	Percentage (%)
Responded	14	82
Did not Respond	3	18
<b>Total</b>	<b>17</b>	<b>100</b>

Source: Filed data 2016

Table 4.1 presents a response rate of 82 percent (n=14) and non-response is 18 percent (n=3).

### 4.3 Respondents profile

**Table 4.2 Length of service**

<b>Category</b>	<b>Frequency</b>	<b>Percentage</b>
Below 2 years	2	14
2-5 years	3	21
6-10 years	8	58
Above 11 years	1	7
<b>Total</b>	<b>14</b>	<b>100</b>

**Source: Field data 2016**

Table 4.2 presents majority of the respondents (58%, n=8) as having worked in the credit department for between 6 to 10 years while the rest of the respondents had experience of above 11 years accounting for 7% (n=1), 2 – 5 years 21 percent (n=3) and below 2 years 14 percent (n =2). The results indicate that majority of the respondents have worked in the credit department for a longer duration of time and thus they it is considered that the respondents are adequately experienced and they understood the questionnaire and so their responses can be relied upon.

**Table 4.3 Current Designation of the Respondents in the Bank**

<b>Parameter</b>	<b>Frequency</b>	<b>Percentage</b>
Senior Managers	3	21
Credit Risk managers	7	50
Team Leaders	4	29
<b>Total</b>	<b>14</b>	<b>100</b>

**Source: Field data 2016**

Table 4.3 presents a research study which revealed that 50% of respondents were credit risk managers, senior managers were 21. %, while 29% were Team leaders. Considering that the topic of study centred on credit risk management, the respondents were drawn from the relevant departments and are therefore considered to be adequately informed on the topic of study and are therefore capable of giving reliable responses.

**Table 4.4 Level of Education**

<b>Category</b>	<b>Frequency</b>	<b>Percentage</b>
Diploma	2	14
Degree	12	86
<b>Total</b>	<b>14</b>	<b>100</b>

**Source: Author, (2016)**

Table 4.4 presents most of the respondents (86%, n=12) as having attained a university education either acquiring undergraduate degree or the post graduate degree and only 14% (n=2) of the respondents have diploma education.

#### **4.4 Credit Risk Management Practices**

The respondents were asked to evaluate the extent to credit risk management practices lead to the achievement of good asset quality in banking. A Likert scale was used to capture responses on the extent. In the scale, 1 represented “not at all” 2, “little extent”, 3 “moderate extent”, 4 represented “great extent” while 5 was for “very great extent”. The table 4.5 summarizes these findings.

**Table 4.5 Credit Risk Management practices and the Extent they lead to the achievement of good asset quality.**

<b>Extent</b>	<b>Frequency</b>	<b>Percentage</b>
Not at all	0	0
Moderate	6	43
Great Extent	8	57
Total	14	100

**Source: Field data 2016**

Table 4.5 presents 57 per cent of the interviewees having thought that management of credit risk, to a great extent, lead to the achievement of good asset quality. 43 percent of the respondents felt that the effect was moderate.

#### **4.5 Loan Product Diversification**

Loan product diversification across different sectors and products has beneficial effects on the banks profitability. This study sought to establish variety of loan products offered to the clients of Barclays Bank in Kenya. The study also sought to

find out which was sector the dominant sector in bank’s loan book. In addition the researcher sought the respondents view on the influence of credit diversification on loan portfolio quality. The results were highlighted in Table 4.6

**Table 4.6 Loan products offered by Barclays Bank of Kenya.**

<b>Loan product</b>	<b>Percentage of Total Loan Book</b>
Barclayloan	9
Scheme loans	22
Expatriate loans	6
Secured loans	19
Mortgages	5
Business Mortgage Loans	17
Business Loans	22
Total	100

**Source: Field data 2016**

Table 4.6 presents loan product portfolio of Barclays Bank of Kenya as being made of business loans at 22 percent, Scheme loans at 22 percent, Secured loans stood at 19 percent, Business mortgages 17 percent, Barclayloan proportion was 9 percent, expatriate loans was at 6 percent while personal mortgages were at 5 percent. The finding show that the loan book of Barclays Bank of Kenya was well diversified in terms of loans types.

The study also sought to find out which was sector the dominant sector in bank’s loan book. The findings were as presented in table 4.7.

**Table 4.7 Dominant sectors in bank’s loan book.**

<b>Sector</b>	<b>Percentage of Total Loan Book</b>
Personal and Households	26
Trade	34
Real Estate, Building and Construction	18
Manufacturing Sector	12
Others	10
Total	100

**Source: Field data 2016**

Table 4.7 presents the dominant sectors where loans were channelled through included Personal and House holds, Trade, Real Estate, Building and construction and Manufacturing Sectors. In total, these four economic sectors accounted for 90 per cent of total loan book. 34 percent of the gross credit was extended to the trade sector while personal and household sector received 26 percent of the gross loans. Real Estate, Building and construction sectors received 18 percent while manufacturing received 12percent of the total loans advanced.From the findings loan portfolio diversification had a strong association with credit risk management among commercial banks in Kenya.The respondents believe that loan product diversification influence loan portfolio quality of Barclays Bank of Kenya, in addition, the respondent stated the areas that required improvement we also noted.

The researcher sought the respondents view on the extent to which credit diversification influence loan portfolio quality. The findings were as presented in table 4.8

**Table 4.8 Extent to which credit diversification influenced loan portfolio quality.**

Extent	Frequency	Percentage
Little Extent	1	14
Moderate	3	21
Great Extent	9	65
Total	14	100

**Source: Field data 2016**

Table 4.8 presents majority of the respondents (65 percent) having indicated that credit diversification influenced to a great extent the loan portfolio quality 21 percent indicated that the influence was moderate while 14 percent felt it was to a little extent.

#### **4.6 Credit Criteria**

Financial institutions employ credit criteria practices to determine the ability of the borrowers to service the debt and hence his credit worthiness. The study sought from the respondents the credit criteria practices that were employed to determine the ability of the borrowers to service the debt and hence his credit worthiness. Table 4.9 below records the respondents' view of the credit criteria used by Barclays Bank of Kenya. The main credit criteria in this research study were eight and included Credit history, reputation and character; experienced business executives; profitable organization; future cash-inflows; repayment capability; sufficient equity; ability to sustain successful operations and the influence on associated companies and subsidiaries.

**Table 4.9 Credit Criteria**

<b>Credit Criteria</b>	<b>Percentage</b>
Reputation and character	14
Experienced business executives	13
Profitable organization	13
Future cash-inflows	13
repayment capability	12
Sufficient Equity	10
Potential for Long Term success	11
Effects of Business Affiliates	14
Total	100

**Source: Field data 2016**

Table 4.9 presents customers' character reputation and credit history and effects of business affiliates were of great concern when evaluation loan applications as both were rated at 14 percent. According to the respondents other credit criteria's employed by the bank were; Strength of the business at 13 percent; past and projected cash flows 13 per cent; Ability to repay at 13 percent while sufficient equity was pooled at 10 percent with potential for long term success placed at 11 percent. The study also sought to find out how the bank rated credit worthiness. The findings are presented in Table 4.10.

**Table 4.10 Rating of worthiness of credit**

<b>Credit Worthiness Rating</b>	<b>Percentage</b>
Overdue repayments	20
delinquent payments	14
insolvencies	19
Accrued repayments	14
Length of Credit History	10
Fresh applicants	11
Various uses of credit	12
Total	100

**Source: Field data 2016**

Table 4.10 presents that the bank would rate credit worthiness of clients by inspecting overdue repayments, delinquent payments, insolvencies, Accrued repayments, and history of credit, fresh applicants, and various uses of credit types of credit in use. The key guideline used to rate worthiness of credit was overdue payments and insolvencies.

The interviewees were also required to specify the extent to which they felt credit criteria influenced loan portfolio quality. The findings are presented in Table 4.11

**Table 4.11 Extent to which credit criteria influenced loan portfolio quality**

<b>Extent</b>	<b>Frequency</b>	<b>Percentage</b>
Moderate	2	24
Great Extent	4	29
Very Great Extent	8	57
Total	14	100

**Source: Field data 2016**

The researcher also sought knowledge from the interviewees as to the extent to which credit criteria influenced loan portfolio quality. Table 4.11 presents revelations that the credit criteria influenced to a very great extent (57 percent) loan portfolio quality. The respondents who thought it was to a great extent were 29 percent, while 14 % indicated that credit criteria influenced loan portfolio quality to a moderate extent.

#### **4.7 Credit Culture**

A lending organization’s credit risk management framework is designed under an umbrella guideline called credit culture. The study required the respondents to indicate the extent to which various credit frameworks were applied in the previous six months. The findings are as tabulated in Table 4.12.

**Table 4.12 Credit culture**

<b>Strategies used</b>	<b>YES</b>	<b>NO</b>	<b>COUNT</b>
	Frequency/(percentage)	Frequency/(percentage)	
Credit Reminder	6 (43)	6 (57)	14
Loan Guideline	10 (71)	6 (29)	14
Credit Ration	4 (29)	10 (71)	14
Risk mitigation	14 (100)	0 (0)	14

**Source: Field data 2016**

The researcher sought to find whether the main components credit culture that is risk management systems strategies were used in the last six months. The findings revealed that the key components that were during loan applications were risk mitigation and loan guidelines. Table 4.12 presents these findings.

## **CHAPTER FIVE**

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

#### **5.1 Introduction**

The broad purpose of this study was to establish the influence of credit risk management practices on the loan-portfolio of Barclays Bank of Kenya. This is the last chapter and gives the highlights of findings, conclusions and recommendations of the research drawn from the findings. They were arrived after recognizing the background, statement of the problem and the objectives in chapter one. Chapter two dealt with literature review, while chapter three laid out the methodology and data collection methods. Data was analysed in chapter four with the last chapter presenting recommendation for additional studies.

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

The research initially determined the respondent characteristics. It was established that a majority of respondents had worked for the bank for periods ranging between five to ten years. This was important for the study because length of service indicated institutional memory. Majority of employees had a bachelor's and master's degree which indicated a highly learned work force that was in a better position to give the required information.

The outcomes indicate that, managing credit risk impacts the magnitude of NPA's hence drives loan portfolio performance and in turn determining the success of financial institutions. Loan pricing was found to positively influence the size of NPA's thereby affecting the credit portfolio of lending institutions. Continued

existence of every lender is pegged on interest income earnings. This is dependent on management of credit risk. These findings relate to those of (Idowu Abiola, 2011), who established that high interest rate compromises entrepreneurs access to loans. The few who can access the facilities at times struggle with the loan repayments due to very high cost of credit. This phenomenon tends to create 'loan-losses high-interest cycle'

A key driver of NPA's is cost of credit amongst other determinants. Lenders need to levy their customer's reasonable interest rates. In this regard, loan portfolio performance tends to get better thus enhanced lender returns. Subsequently, reduced interest rates attract new customers thereby improving income levels to the bank. This research explained fifty seven percent variance of NPA's in banks. Further research needs to be done to include the additional determinants hence reveal the remaining NPA variance.

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# APPENDICES

## Appendix I: Data collection authorization letter



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SCHOOL OF BUSINESS

Telephone: 020-2059162  
Telegrams: "Varsity", Nairobi  
Telex: 22095 Varsity

P.O. Box 30197  
Nairobi, Kenya

DATE 10/10/2016

### TO WHOM IT MAY CONCERN

The bearer of this letter JACKLINE JACKITA AKOPH OTENO

Registration No. DG1/70875/2014

is a bona fide continuing student in the Master of Business Administration (MBA) degree program in this University.

He/she is required to submit as part of his/her coursework assessment a research project report on a management problem. We would like the students to do their projects on real problems affecting firms in Kenya. We would, therefore, appreciate your assistance to enable him/her collect data in your organization.

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

Thank you.



PATRICK MWABUTO  
SENIOR ADMINISTRATIVE ASSISTANT  
SCHOOL OF BUSINESS

## **Appendix II: Introductory letter**

Dear Sir/Madam,

RE: COLLECTION OF RESEARCH DATA

My name is Jackline Jacinta Akoth Otieno and a Masters student in Business Administration – Strategic Management option at the University of Nairobi. Currently, I am carrying out a research on the “ Credit Risk Management Practices on Loan Portfolio of Barclays Bank of Kenya” I am in the process of gathering relevant data for this study. You have been identified as one of the respondents in this study and kindly request for your assistance towards making this study a success.

I therefore kindly request you to take some time to respond to the attached interview guide. I wish to assure you that your responses will be treated with confidentiality and will be used solely for the purpose of this study. I thank you in advance for your time and responses.

Yours Sincerely,

Jackline J.A Otieno

## **Appendix III: Interview guide**

### **SECTION A: Profile of Respondents**

1. Name (optional).....
2. Please state your current position.....
3. What is your experience in the credit field?
4. What is your highest level of education?

### **SECTION B: Your understanding of Credit Risk Management Practices**

1. How do you evaluate your understanding of credit risk management practices towards the achievement of good asset quality in banking?
2. What do you think of the importance of credit risk management practices in your bank?

### **SECTION C: LOAN PRODUCT DIVERSIFICATION**

1. What are some of the loan products offered by Barclays Bank of Kenya?
2. Which is sector the dominant sector in bank's loan book?
3. To what extent does credit diversification influence loan portfolio quality?

### **SECTION D: CREDIT CRITERIA**

1. What are the credit criteria practices employed to determine the ability of the borrowers to service the debt and hence his credit worthiness?
2. How do you rate credit worthiness of a client?
3. To what extent do credit criteria influence loan portfolio quality?

**SECTION E: CREDIT CULTURE**

1. Have you used any of the following credit culture practices in the last six months? (indicate YES or NO)

- Credit reminder [ ]
- Guideline for loan [ ]
- Credit recipe ration loan and agreement [ ]
- Risk mitigation [ ]

2. Kindly rate the effectiveness of the following credit cultural practices and their effectiveness on the loan portfolio quality using 5 as very effective, 4 as more effective, 3 as effective, 2 as less effective and 1 as not effective.

	5	4	3	2	1
Risk identification					
Risk Analysis and assessment					
Risk monitoring					
Risk mitigation					

**THANK YOU FOR TAKING YOUR TIME!**