THE RELATIONSHIP BETWEEN QUALITATIVE CREDIT ASSESSMENT AND DEFAULT RATES IN CREDIT CARD BUSINESS IN KENYA

BY:

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DECLARATION

This research project is my original work and has not been presented for a degree at any University.

Signed.....Date.....05/11/2011.....

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This research project has been submitted for examination with my approval as University of Nairobi supervisor.

Signed.....Date.....7/11/2011.....

MR. MIRIE MWANGI

UNIVERSITY OF NAIROBI

DEDICATION

This project is dedicated to my mother and dad, Mbeke Maundu and Maundu Muia, Brothers and sisters especially Stephen Kilonzo for support.

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ABSTRACT

The study delved to research on the relationship between qualitative credit assessment and default rates in credit card business in Kenya. The study was done on seven credit card issuing commercial banks in Kenya.

Questionnaires were sent to the respondents in respective banks. Out of the seven commercial banks which issue credit cards, 5 responded which translates to 71.43%. The data so received was analyzed. There was found to be a strong relationship between qualitative attributes of a customer and default rates in credit card business in Kenya. The relationship was rated to 90% relationship.

Banks have special attention to the customers' attributes. Most of this information is based on the information provided in the application form. This captures from basic personal information to financial information, to academic background. This gives Commercial banks in Kenya the information important in deciding who should get credit card or not.

The relationship between default rates and qualitative assessment is a key pointer to the success in credit card business among credit card issuing commercial banks. CRB Africa also plays a key role in the provision of customers' financial history. In Kenya, there has been little research on credit cards especially default rates. This provides a formidable challenge in in-depth research on the topic.

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LIST OF ABBREVIATIONS

BBK -	Barclays Bank of Kenya
FI-	Financial Intermediaries
KCB-	Kenya Commercial Bank
SCBK-	Standard Chartered Bank

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CHAPTER ONE

INTRODUCTION

1.1 Background of the study

The research paper aims to evaluate the relationship between qualitative credit assessment and default rates in credit card business in Kenya. It will focus on the 5 Cs approach and evaluate their importance in the checking of default risk in credit card and possible recommendations in their usage and application.

1.1.1 Credit card History

A credit card is an automatic way of offering credit to a consumer Bellis, (2011). A credit card is a promise by a bank to lend the cardholder money with which to make purchases. When a customer does a purchase, the store owner's account receives payment immediately, but the money that is used for payment does not belong to the buyer. Instead the bank that issued the credit card makes the payment; creating a loan the cardholder must pay (Cecchetti, 2008).

The modern credit card was the successor of a variety of merchant credit schemes. It was first used in the 1920s, in the United States, specifically to sell fuel to a growing number of automobile owners.aq In 1938 several companies started to accept each other's cards. Western Union had begun issuing charge cards to its frequent customers in 1921. Some charge cards were printed on paper card stock, but were easily counterfeited.

The Charga-Plate, developed in 1928, was an early predecessor to the credit card and used in the U.S. from the 1930s to the late 1950s. In recording a purchase, the plate was laid into a recess in the imprinter, with a paper "charge slip" positioned on top of it. The record of the transaction

included an impression of the embossed information, made by the imprinter pressing an inked ribbon against the charge slip. Charga-Plate was a trademark of Farrington Manufacturing Co. Charga-Plates was issued by large-scale merchants to their regular customers, much like department store credit cards of today. In some cases, the plates were kept in the issuing store rather than held by customers. When an authorized user made a purchase, a clerk retrieved the plate from the store's files and then processed the purchase. Charga-Plates speeded back-office bookkeeping that was done manually in paper ledgers in each store, before computers (Timberlake, 1987).

Nationwide cards were not established until after World War II, when the Diners Club developed one were used in restaurants all over the country (and abroad). Similar credit cards programs were started by America Express and Carte Blanche, but because of the high cost of operating these programs, cards were issued only to selected persons and businesses that could afford expensive purchases

Based on the success story by the Diners Club, American Express and Carte Blanche, bankers wanted to share in the profitable credit card business. Several commercial banks attempted to expand the credit card business to a wider market in the 1950s but the cost per transaction of running these programs was so high that their earlier attempts failed. In the late 1960s, improved computer technology, which lowered the transactional cost of providing credit card programs, would be profitable. The banks tried to enter this business again and this time their efforts led to creation of two successful bank credit card programs: BankAmericard (originally started by Bank of America but now independent organization called Visa) and Master Charge (now MasterCard, run by the Interbank Card Association). These programs have become phenomenally successful; more than 200 million cards are in use. Indeed bank credit cards have

been so profitable that non-financial institutions e.g. Sears (which launched Discovery Card) General motors and AT&T have also entered credit card business. Consumers have also benefited because credit cards are more widely accepted than cheques to pay for purchases (particularly abroad) and consumers to take loans more easily (Keith, 2010).

The design of the credit card itself has become a major selling point in recent years. The value of the card to the issuer is often related to the customer's usage of the card, or to the customer's financial worth. This has led to the rise of Co-Brand and Affinity cards - where the cards design is related to the "affinity" (a university or professional society, for example) leading to higher card usage. In most cases a percentage of the value of the card is returned to the affinity group (Rose, 1993).

1.1.2 Situation of Plastic Money in Kenyan

In Kenya the first credit card was issued by Diners Club Africaltd in 1967. In 1984 the Southern Credit introduced The Senator credit card, Barclays bank introduced the Barclaycard in 1990. Kenya Commercial Bank introduced their credit card in 1995 while Commercial Bank of Africa in 1997. Other credit card issuers in Kenya include the Cooperative bank, NIC Bank, Fidelity Bank, Prime Bank, National Bank, CFC bank and Imperial Bank. ...Commercial banks and petroleum companies (Muchiru, 2008).

Kenya is the fastest growing market in Africa besides South Africa, with $452 million processed through the Visa credit card and Electron debit cards in 2003. John Mwanyela the CEO of Kenya Bankers Association says the number of credit cards issued in Kenya is slightly above 200,000 (Business Daily, 2009). Since 2000, Barclaycard has seen its credit card holders increase, doubling the number in 2004. There has been dramatic increase I credit card use and electronic

payment since the turn of the century, despite a large proportion of Kenyan population being not formally banked (Muchiru, 2008).

1.1.3 Default Rates in credit cards

According to Cecchetti& Stephen (2008), in the recent years there has been a sharp increase in the default rate on credit card debt. Default risk is the risk that the borrower is unable to fulfill the terms promised under the loan contract (Saunders& Cornet, 2008). The likelihood of default is the central component and forms the foundation of potential rationales for conducting risk management. Its most obvious manifestation are the expected cost of financial distress that they are key in a bank particularly when viewed from cost benefit perspective, but also influences almost all other components of business. Therefore the value gains are seen were profound when a bank tries to avoid costs of financial distress via risk management (Schroeck, 2002)

The major cause of serious banking problems was noted in, 1999 to continue were directly related to lax credit standards for borrowers and counterparties, poor portfolio, risk management or lack of attention to changes in economic or other circumstances that can lead to deterioration in the credit standing for the banks counterparties.

Credit risk arises because some bank borrowers may not be able to repay their loans. Moreover, many of these loans are made to borrowers whose risk is difficult to assess and whose performance is difficult to monitor. That is they are characterized by asymmetric information of adverse selection and moral hazard. Success in making these loans depends on banks' ability to produce information about these borrowers and structure their loans appropriately. (Ritter, Et al 1996)

The size of credit risk is the amount that could be lost if the risk were realized, and non-repayment or late payment occurred. The maximum potential loss is the full amount of debt in the event of non-repayment by the customer....A default on a loan would create a loss of the unpaid debt, principal plus any overdue and unpaid interest (Coyle, 2002)

Barclays is among banks that went big on unsecured lending, offering up to Sh2 million with monthly repayments of between one and three years. The second bank to release its financial results, Barclays has a loan book of Sh108.08 billion; compared to Equity's Sh40.8 billion, implying that it faces the highest default risk based on its size and previous huge lending appetite, but is not only in unsecured loans portfolio that a high default rate could be seen. While secured loans are unlikely were posing a challenge to banks, it is the large volumes of unsecured loans that is causing jitters among lenders,."What commercial banks are likely to do in these hard times is to renegotiate new proposals with those having their loans," said Mr. Reuben Marambii, National Bank managing director, Business Daily, 30th March 2009. These new loan agreements were include a loan repayment rescheduling plan which varies from the older loan agreement, taking into account the borrower's difficult circumstances. He also discounts fears that the anticipated economic slowdown could lead to a rise in bank loan defaulters. (Mutie, 2002)

1.1.4 Credit Evaluation

Credit scoring system is a mathematical model that uses observed loan (and credit card) applicant's characteristics to a calculated score that represents the applicant's. Since exposure to credit risk continues were a major issue in the contemporary financial management, credit managers need to adopt appropriate mitigation measures to curb the risk. Most of credit problems reveal a basic weakness in credit granting and the monitoring process. These problems

can be avoided by formation of an internal credit process. (Brealy and Myers, 1998) Qualitative models more generally include 5Cs of credit (Saunders& Cornet, 2008). Abedi, 2002 increased the number to 6Cs after he introduced common sense to the 5cs. A variety of factors influence a customer's credit worthiness. This makes credit investigation a difficult task....the firm based on past experience or empirical study, may identify both financial and non-financial attributes that measure credit standing of a customer. (Pandey, 1995)

The safe extension of credit depends on complete and accurate information regarding every detail of the borrower's credit standing. A lending policy should define the financial statements and individuals at various borrowing levels and should include appropriate guidelines for audited, interim, cash flows and other statements. (Kabiru, 2002)

The primary benefit from credit scoring is that credit lenders can more accurately predict a borrower's performance without having to use more resources. With commercial loan credit scoring an 85% accuracy rate on average, according to credit scoring experts, using these models means fewer defaults and write-offs for commercial lenders....Quality of credit scoring models has improved providing positive impact on controlling write-offs and default (Saunders& Cornet, 2008).

1.1.5 Statement of the Problem

Research on credit cards have zeroed in on market trends. There has been no study on the impact of qualitative credit assessment and credit card default rates. The lack of detailed credit card default has limited the understanding of consumer behavior and motivational factors in the use of credit card and subsequently understanding default (Muchiru, 2008).

Ngare (2008) did a survey of credit risk management practices by commercial banks in kenya. He found that commercial banks in Kenya employ different risk management practices to check credit risk.

Mutwiri (2003) studied on the use of 6Cs credit risk appraisal model and its relationship with the level of non- performing loans of commercial banks in Kenya. He found out that the 6cs model used by banks informed the banks on the critical information on the probability of default

Risks are warranted when they are understandable, measurable, controllable and within a financial institution's capacity to readily withstand adverse results. Sound risk management systems enable managers of financial institutions to take risks knowingly, reduce risks appropriate and strive to prepare for a future that cannot be predicted with absolute certainty. Risk management is a discipline at the core of every financial institution and encompasses all activities that affect its risk profile. The management of financial instructions should attach considerable importance to improve the ability to identify measure, monitor and control the overall levels of risks undertaken. (Central Bank of Kenya, 2010)

These large banks provide a variety of services to their customers, but often rely on factual financial information, computer models, and centralized decision making as the basis for conducting business. Small banks focus more on relationship banking, often basing decisions on personal knowledge of customers' credit worthiness and understanding of business conditions in the community they serve (Saunders& Cornet, 2008)

Risk taking is inherent element of banking and indeed, profits are in part the reward for successful risk taking in business. On the other hand, excessive, poorly managed risk can lead to

losses and thus endanger the safety of banks' deposits. (Risk Management Guidelines, Central Bank of Kenya, 2010)

For most financial banking lending represents the heart of the industry. Loans are dominant assets at most banks; they generate largest share of operating income and represent the banks greatest risk exposure. Poor lending policies have led to fiascos resulting into collapse of a number of banks due to bad loans. Banks need to identify, measure and monitor, control default risk and determine how capital against these risks. (Edwards, 1997)

Vivek Tawadey, head of credit research at BNP Paribas noted that there is a very strong connection between increases in unemployment and defaults in credit cards and auto loans. (Calem, 2009)

1.2 Objective of the Study

The objective of the study is to investigate the relationship between qualitative credit assessment and default rates in credit card business in Kenya.

1.3 Research gap

Past studies have dealt with the relationship between lenders' decisions and characteristics of consumers rather than the relationship between consumer credit credits and characteristics of the clients

1.4 Importance of the Study

The paper seeks to evaluate the extent to which qualitative credit assessment contribute to default rates on credit cardholders. The paper will illuminate on the trends on credit card default rates.

To Commercial Banks

The study were provide customer perspective to credit assessment which were bridge the information gap between credit card issuing banks and their consumers. This were provide the banks with clarity on the relationship between qualitative credit assessment and default credit card default.

To Credit Card Holders

To the credit cardholders and potential card holders, the paper were provide insights on the 'side-effects' of defaulting. Also information which might prove invaluable to cardholders were be on how to check credit card defaulting even when economic environment change.

To Scholars

To scholars, the study aims at providing a balanced approach to trends, evaluation and critique on the credit evaluation procedures and their 'viability' in mitigating credit risk among credit card issuing banks.

CHAPTER TWO
LITERATURE REVIEW

2.1 Introduction

This chapter reviews both theoretical and empirical literature. The chapter starts by defining default/ credit risk as provided by different authors. A review of theories that guide the study were present the research with a firm theoretical base. The empirical studies done on this research topic were be looked at which make it easier to understand the research.

2.2 Default risk/ Credit Risk

The event in which companies or individuals were be unable to make the required payments on their debt obligations. Lenders and investors are exposed to default risk in virtually all forms of credit extensions. To mitigate the impact of default risk, lenders often charge rates of return that correspond the debtor's level of default risk. The higher the risk, the higher the required return, and vice versa (www.investopedia.com/terms/d/defaultrisk.asp, 2011)

Credit risk affects virtually every financial contract. Therefore the measurement, pricing and management of credit risk has received much attention from practitioners, who have a strong interest in accurately pricing and managing this kind of risk, financial economists, who have much to learn from the way such risk is priced in the market, and bank supervisors, who need to design minimum capital requirements that correctly reflect the credit risk of banks' loan portfolios (Basel Consultative paper, No. 113 2002)

Banks are financial intermediaries. Financial Intermediaries are firms that borrow from savers and lend to companies or individuals that need resources for investments. (Gorton, Et al, 2002) it is therefore incumbent on financial institutions to estimate the expected default risk on loans held

as assets and demand risk premiums on these loans commensurate with that risk exposure. The return distribution of credit risk suggests that financial institutions need to both monitor and collect information about firms whose assets are in their portfolios. Thus, managerial efficiency and credit risk management strategy affect the shape of the loan distribution. (Gorton et al, 2002)

After a lull in credit card defaults in the early 1990's, default and personal bankruptcy began to increase sharply after 1995; and this phenomenon has become a serious issue for banks and policy makers (Domowitz, 1993). Work by Ausubel (1997) and Domow and Sartain (1999) both find a strong positive correlation between credit card debt and personal bankruptcy filings. The potentially serious impact of credit card default on the general state other economy has prompted a number of researchers to explore the default issue. Calem and Mester (1995) test the argument of Ausubel's 1991 paper that irrational consumer behavior and adverse selection problems account for the failure of competition in the credit card market. They also examine default in this market and find that cardholders with higher balances have a higher probability of default. Laderman (1996) concludes that although cyclical factors in the economy affect charge-offs by banks, the aggressive marketing of card issuers since the mid-1980's has deteriorated the quality of the cardholders' pool and contributed to the high rate of charge-offs seen in the 1990's. Morgan and Toll (1997), using a permanent income/life-cycle approach, and (Black and Morgan, 1998) also attribute rising default to socioeconomic and demographic characteristics of cardholders.

2.3 Credit Card And Traditional Loans

The largest class of loans is the non-revolving consumer loans which include new and used and used automobile loans, mobile home loans and fixed-term consumer loans such as 24-month personal loans. The other major class of consumer loans is revolving loans such as credit card debt. With a revolving loan, the borrower has a credit line on which to draw as well as to repay up to maximum over the life of the credit line contract. In recent years, banks have faced charge-off rates between 4 and 8% on their credit cards loans outstanding. (Saunders& Cornet, 2008)

Much of the early work on consumer debt focused on traditional loans which are unlike credit card loans in several key respects. Whereas traditional loans involve predetermined loan amounts and fixed payment schedules, with credit card loans, the actual borrowing decision is at the consumer's discretion after receiving a fixed line of credit. Debt repayment on credit cards is flexible, with the minimum monthly repayment being a fixed percentage of the total balance. Finally, unlike many traditional loans, credit card borrowing does not require consumers to post collateral which may place a greater risk on the lender. (Dunn &Kim, 1999)

Commercial banks, finance companies, retailers, saving institutions, credit unions and oil companies provide loans through credit card, such as Visa, MasterCard and proprietary credit cards…credit card transaction typically must be authorized by the cardholders' bank. Thus verification of satisfactory credit quality occurs with each transaction. During the transaction process, fixed fees are charged to merchant, the merchant's bank and the card issuer. The fees charged to the merchant, the merchant's bank and the card issuer. The fees cover the data processing and technology services necessary to ensure that the revolving credit transaction process is accomplished. (Saunders & Cornet, 2008)

It is well accepted that borrowing limits on collaterized loans are primarily determined by the amounts of collateral pledged by the borrower. However, for non-collaterized loans such as credit cards, the information about the borrowers' repayment abilities plays a crucial role in determining the credit on their credit card borrowing limits on credit cards. Asymmetric information between borrowers and lenders and the lack of collateral to mitigate the informational asymmetry are mainly responsible for the existence of credit rationing in some credit markets. (Subhasis, 2005)

2.4 Default Control Policy

Over the last decades, both the banking industry and regulatory bodies have devoted massive resources to the management of market and credit risk. Models have been developed to assess both risk types based on which regulators set out transparent rules on capital requirements, supervisory review process, and market discipline to prevent banking crises. Those principles form the three pillars of Basel Committee on Banking Supervision (BCBS) in (Basel Paper, 2001).

Risk Management is a discipline at the core of every financial institution and encompasses all the activities that affect its risk profile. It involves identification, measurement, monitoring and controlling risks to ensure that...acceptance and management of financial risk is inherent to the business of banking and banks' roles as financial intermediaries. Risk management as commonly perceived does not mean minimizing risk; rather the goal of risk management is to optimize risk -reward trade -off. Notwithstanding the fact that banks are in the business of taking risk, it should be recognized that an institution need not engage in business in a manner that unnecessarily imposes risk upon it: nor it should absorb risk that can be transferred to other participants. Rather

it should accept those risks that are uniquely part of the array of bank's services. (State Bank of Pakistan, 2010)

Activity aimed at serving the dual purpose of; increasing sales revenue by extending credit to customers who are deemed a good credit risk and, minimizing risk of loss from bad debts by restricting or denying credit to customers who are not a good credit risk. (Business dictionary.com, 2011)

2.5 Qualitative Default Risk Models

Quality of credit scoring models has improved providing positive impact on controlling write-offs and default.(www.mhhe.com/saunders6e,03/09/2011). Economists, analysts and FI managers have employed many different models to assess default risk on loans and bonds. These vary from relatively qualitative to highly quantitative. The models are not mutually exclusive an FI manager may use more than one to reach a credit pricing or loan quantity rationing decision. (Saunders & Cornet, 2008)

In the absence of publicly available information on the quality of borrowers, the FI manager has to assemble information from private sources such as credit and deposit files and or purchase such information from external sources such as credit rating agencies. The information assembled varies with the size of the potential debt exposure and the cost of collection. However a number of decisions enter into the credit decision. These include; the borrower-specific factors, which are idiosyncratic to the individual borrower and the market specific factors which have an impact on all borrowers at the time of credit decision. The FI manager then weighs these factors subjectively to come to an overall cedi decision. Because of the reliance of subjective judgment of the FI manager, these models are often expert systems (Saunders & Cornet, 2008). As always

investors face considerable cost in acquiring the information necessary for assessment of the risk they face (Howells, 2008).

It is now widely acknowledged that utilization of better risk measures not only provides insights into risks, leading risk mitigation, but also leads to enhanced risk-return decisions, which improves capital deployment. Consequently, the Central Bank of Kenya expects that the adoption of these elements of sound risk management were translate to effective identification, measurement, control and monitoring of all risks affecting institutions. This process was further support institutions in computing and allocating their economic capital. Economic capital is the capital that a bank holds and allocates internally as a result of its own assessment of risk. Economic capital methods seek to translate quantitative risk assessment of multiple types into a single common metric-economic capital, which can be used as an indicator of risks and returns for each business activity, as a way to determine risk pricing and/or to allocate capital among banking activities and modify allocations over time. (Central Bank of Kenya, 2010)

2.5.1 Borrower Specific Factors

These are factors which are borrower defining. They expose the qualities of the borrower. They include:

2.5.2 Reputation

The borrower's reputation involves the borrowing-lending history of the credit applicant. If over time the borrower has established a reputation for prompt and timely repayment, this enhances the applicant's attractiveness to the FI. A long-term customer relationship between borrower and lender forms and implicit contract regarding borrowing and repayment that extends beyond the

formal explicit legal contract on which borrower-lender relationships are based. The importance of reputation, which can only be established over time through repayment and observed behavior, works to the disadvantage of small and newer borrowers (Saunders& Cornet, 2008)

In Credit card business in Kenya, borrowers are first weighed against the Credit Bureau Africa through Credit data sharing program initiated by the Central Bank of Kenya. The Central Bank of Kenya, (2010) notes that effective and comprehensive procedures and information system need were developed to monitor the condition of the credit portfolio in terms of individual borrowings. The monitoring system will ensure the likelihood that the credit was is repaid and the classification of the loan is adequate.

2.5.3 Leverage

A borrower's leverage is the ratio of debt to equity which affects the probability of its default because large amounts of debt, such as claims on the cash flow. Relatively low debt equity ratio may significantly impact the probability of debt repayment. Yet beyond some point the risk of bankruptcy increases, as does the probability of some loss of interest and the principal for the lender (Saunders& Cornet, 2008). However, Grossman and Hart (2009) argue that the high debt may be a signal of managerial (personal) efficiency and may in fact lower bankruptcy risk. (The Economics of Information and Uncertainty, Chicago University, 1982)

2.5.4 Volatility of Earnings

As with leverage, a highly volatile earnings stream increases the probability that the borrower cannot meet fixed interest and principal charges.

2.5.5 Collateral

A key feature in any lending and loan pricing decision is the degree of collateral or assets backing security of the loan

2.5.6 The Cs of credit

The Cs of credit is common reference to the major elements of a financial institution analysis. When considering a request for a loan, the 5Cs of credit are; Character is the general impression you make on the prospective lender or investor. It is the unwilingfulness to repay debt, the lender were form a subjective opinion as to whether or not you are sufficiently trustworthy to repay the loan or generate a return on funds invested in your company. Your educational background and experience in business and in your industry were be considered. The quality of your references and the background and experience levels of your employees were also be reviewed (Sparks, 1979)

Capacity to repay is the most critical of the five factors; it is the primary source of repayment - cash. The prospective lender needs to know exactly how you intend to repay the loan. The lender ought to consider the cash flow from the business, the timing of the repayment, and the probability of successful repayment of the loan. Payment history on existing credit relationships - personal or commercial- is considered an indicator of future payment performance. Potential lenders also should know about other possible sources of repayment.

Capital is the money you personally have invested in the business and is an indication of how much you have at risk should the business fail. Interested lenders and investors were expect you to have contributed from your own assets and to have undertaken personal financial risk to establish the business before asking them to commit any funding.

Collateral, or guarantees, are additional forms of security you can provide the lender. Giving a lender collateral means that you pledge an asset you own, such as your home, to the lender with the agreement that it were be the repayment source in case you can't repay the loan. A guarantee, on the other hand, is just that - someone else signs a guarantee document promising to repay the loan if you can't. Some lenders may require such a guarantee in addition to collateral as security for a loan.

Conditions describe the intended purpose of the loan. Were the money be used for working capital, additional equipment or inventory? The lenders also do consider local economic conditions and the overall climate, both within your industry and in other industries that could affect your business (www.mhhe.com/saunders6e). Common sense is the natural ability to make good judgment and behave sensibly (Abedi, 2002)

2.6 Credit Card Default Rates

Evidence from many countries in recent years suggests that collateral values and recovery rates on corporate defaults can be volatile and, moreover, that they tend to go down just when the number of defaults goes up in economic downturns. This link between recovery rates and default rates has traditionally been neglected by credit risk models, as most of them focused on default risk and adopted static loss assumptions, treating the recovery rate either as a constant parameter or as a stochastic variable independent from the probability of default. This traditional focus on default analysis has been partly reversed by the recent significant increase in the number of studies dedicated to the subject of recovery rate estimation and the relationship between default and recovery rates. The recovery rate and more specifically, its relationship with the probability

of default of has gotten new impetus. Recent empirical evidence concerning this issue is also presented and discussed. (Altman, Resti and Sironi, 2003)

"Cardholder agreements," the contract meant to give both the bank and the consumer equal standing in the relationship, have increasingly become biased towards the credit card issuers. Nowadays, banks can unilaterally change the terms of these documents and do so, often, up to 2-3 times per year. In consequence, these contracts can, in an ordinary language sense, hardly be termed "agreements" and should more accurately be called terms of use. Furthermore, issuers routinely include a mandatory arbitration clause into the agreement, under which the consumer gives up his/her right to participate in class action lawsuits, as well as private right of action against the issuer. The private right of action is a critical legal protection that affords individuals or their representatives the option of seeking enforcement of federal regulations through the court system. Recently, credit card issuers have extended their marketing to target nonprime groups, including the economically disadvantaged and young people with poorly established credit. College students have become particularly attractive to banks: credit card representatives are present in large numbers on campuses each fall, soliciting unestablished borrowers with offers of free t-shirts and other gifts. Coupled with rising tuition rates, the result is a generation of young people burdened with consumer debt even before entering the job market (Westrich and Bush, 2007).

2.7 Causes Of Credit Card Defaults

The rising level of credit card debt is often cited as one of the factors in the rising personal bankruptcy rate worldwide. Numerous theories have been advanced to explain the increases, including aggressive marketing by credit card issuers and a lack of discipline on the part of consumers. Legislations ushered in deregulation of usury ceilings on consumer interest rates by allowing lenders in a state with liberal usury ceilings to export those rates to consumers residing in states with more restrictive usury ceilings. The result was a substantial expansion in credit card availability, a reduction in average credit quality, and a secular increase in personal bankruptcies. The Canadian experience with bankruptcies supports this argument. Ellis, (1998) continue to contend that a tightly regulated world, marked by restricted access to consumer credit and a low level of personal bankruptcies was exchanged for a deregulated world, marked by expanded access to consumer credit and a higher level of personal bankruptcies. This argument implies that a return to the bankruptcy rates and charge-off levels that prevailed in the early 1980s or before may be unlikely

The U.S. personal bankruptcy rate has risen to a historically high level, from less than one per thousand populations annually in the early 1970s to almost five per thousand population for the year ending September 30, 1997. An increase in outstanding consumer debt, particularly credit card debt, has been cited as a significant contributor to the increased rate of filing. One financial planner was recently quoted as saying, "I've never seen anyone come in with a financial problem that wasn't related to credit cards (Ellis, 1998).

Westrich &Malcolm, (2005) Attributed aggressive marketing by credit card lenders or lack of discipline on the part of consumers to often blame for the increase in credit card debt outstanding. These explanations in essence argue that behavior has changed: that lenders have

become more aggressive or borrowers less prudent. Whatever the merit of these explanations, they leave unanswered questions as to when and why behavior changed.

Some industry experts have attributed the increases in credit card debt outstanding and personal bankruptcies to changes in marketplace rules rather than changes in lender or borrower behavior. One type of change to the marketplace rules occurred in both 1978 and 1994 when federal bankruptcy law was modified, in part, to increase the level of assets that could be protected in a bankruptcy filing. (Westrich &Malcolm, 2005)

These legal changes, which made bankruptcy a more attractive option for debtors, sometimes, are cited as reasons for the rising level of personal bankruptcies. Despite the intuitive appeal of this argument, there is some evidence that changes in bankruptcy laws may not be a primary driver of increases in personal bankruptcy rates. For example, Ellis (1998) provides evidence on the lack of correlation between state homestead exemption rates and state personal bankruptcy rates. Zandi (1997) points out that a similar increase in personal bankruptcies has occurred in Canada without any significant recent changes in the bankruptcy law.

Another significant change to the marketplace rules occurred in the late 1970s with deregulation of consumer interest rates. Both Ausubel (1997) and Rougeau (1996) focus on interest rate deregulation as the event that set the United States on a course of rising credit card volumes. The dramatic rise in personal bankruptcies did indeed begin shortly after the Supreme Court's Marquette decision, which initiated interest rate deregulation. The evidence alone is not sufficient to establish causal relationship, Ellis (1998), argue that such a relationship exists.

The importance of interest rate deregulation as a driver of expanded credit availability and higher personal bankruptcy rates, Ausubel and Rougeau. Ausubel (1997) maintains that borrowers

underestimate their use of credit cards and, therefore, the importance of credit card interest rates, which enables lenders to earn an extra normal profit on every good customer. He argues that the extraordinary profits made by credit card lenders have caused them to relax their standards and make credit available to poorer credit risks. Rougeau (1996) suggests that the absence of interest rate regulation allows credit card lenders to pursue unlimited profits by taking advantage of borrowers' weakness and desire to consume, which often reaches an irrational.

There is vast complexity of the pricing of credit card products. This complexity is most likely to have a highly deceptive effect on consumer perceptions of the cost of credit. But the credit union data described above demonstrate that credit card lending can be done without exorbitant fees and without confusing terms. Banks do not explain the huge differences in fees structures between the two types of financial institutions or the huge difference in the complexity of terms. Westrich& Malcolm, (2007) continue to argue that, while bankers often respond to such criticism by calls for more financial literacy training, the complexity of credit card terms and the frequent changes in those terms are likely to confuse all but the most careful consumer. Rather, consumers need a simple statement of the costs of doing business with a credit card company. Consumer groups see the complexity as part of a larger and deliberate trend by consumer service providers such as cable providers, and cellular phone providers to hide the true costs of their services. Price-shopping among this group of providers is next to impossible. There is an academic term for such practices, "shrouding", whereby "optimizing firms" exploit "myopic" consumers through marketing schemes that "shroud "the true price of the product.

2.8 Strategic Moves To Check Defaults

Harvard Business School Professors Moon and McGovern, (2007) argued that firms that consciously and cynically exploit their customers that they may profit in the short term but were

ultimately pay dearly. If Congress doesn't punish them, customers and competitors were. While Moon and McGovern (2002) focused on some of the more famous customer abusers--banks, cell-phone service providers, and the health club industry--their cautionary advice applies to any company that builds exploitation into its model.

They advised executives to ask themselves four questions about their business:

1. Are our most profitable customers those who have the most reason were dissatisfied with us?
2. Do we have rules we want customers to break because doing so generates profits?
3. Do we make it difficult for customers to understand or abide by our rules, and do we actually help customers break them?
4. Do we depend on contracts to prevent customers from defecting?

In this economic environment, no company can afford to abuse customers. To paraphrase the authors, great CEOs recognize and seize opportunities; they also identify and eliminate vulnerabilities. (Gardiner, 2009) Also imposing penalties for late payment used were virtually unenforceable. Now it is provided for in law. All businesses can claim interest on late payments, and in many. The phone is an effective debt-collection tool. If payments are overdue, chase them on the phone. Be consistent and firm but not hostile. Telephone any late payers after a week to ask the reason for the delay.

2.9 Empirical Studies

Muchiru, 2008 said that the lack of detailed credit card default has limited the understanding of consumer behavior and motivational factors in the use of credit card and subsequently inadequate understanding default customers.

Ngare (2008) did a survey of credit risk management practices by commercial banks in Kenya. He found that commercial banks in Kenya employ different risk management practices to check credit risk.

Mutwiri (2003) studied on the use of 6Cs credit risk appraisal model and its relationship with the level of non- performing loans of commercial banks in Kenya. He found out that the 6cs model used by banks informed the banks on the critical information on the probability of default.

A central issue in the context of household debt is default. Compared to the large literature on determinants of household portfolios, relatively little is known about what drives households' choices of debt levels and their decision of whether and when to default. Industry models for predicting default emphasize past borrowing and repayment behavior. For example, in the calculation of an individual's FICO score (a commonly used measure of credit risk in the (U.S.), 35% weight is given to on time payment of past debt, 30% to the current amount of debt of various types, how many accounts the individual has, and how large the debt is relative to the total available credit, 15% to the length of time of credit history, 10% to the number of new accounts and recent requests for credit, while 10% is given to the mix of credit (credit cards, installment loans, finance company loans, and mortgages) used in the past (Isaac, 2005).

In the context of mortgage delinquencies the perspective of understanding the underlying economic drivers of debt and default, predicting default based on past repayment behavior is not informative. Furthermore, models predicting default tend to have a modest statistical fit. Predicting credit card delinquency can be done using time effects, account age, measures of account risk (including credit scores), and local economic conditions as explanatory variables (Keys et al, 2010).

However, with the growth of credit card debt in the world economy in the last decade, researchers have increasingly turned their attention to various aspects of this unique credit instrument. Ausubel (1991), who was one of the first to carry out an empirical study of this market, found that abnormally high profits and high and sticky interest rates exist in the industry in spite of its seemingly competitive structure with over 6,000 card issuers.2 He speculated that search/switching costs and a type of irrational consumer behavior might be involved in these paradoxical market outcomes. Responding to Ausubel' argument, Brito and Hartley (1995) introduced the aspect of the liquidity service of credit cards which saves consumers the opportunity cost of holding money for payment. Therefore they argue that it is rational for consumers to hold positive credit card balances even in the face of the high interest rates. Mester (1994) also pointed that high and sticky interest rates could exist without irrationality on the part of consumers because of information problems for the credit card banks. Morgan (1997) explains the situation by referring to the open-ended nature of the credit card loan and the high risk involved with this for banks; while Stavins (1996) found that defaulters had higher interest elasticities, and this could induce banks to keep their interest rates high.

Empirical models, too, tend to indicate a rise in risk during correlation of default probabilities and loss in the event of default and the business cycle. These authors argue that models that

assume independence of default probabilities and loss-given-default were tend to underestimate the probability of severe losses during economic downturns. A study by Bangia et al (2002) documents the empirical significance of the procyclicality of credit quality changes by showing that estimated credit losses are much higher in a contraction relative to an expansion. (Jeffery and Furfine 2005)

2.10 Theoretical Review

Many studies have been done about credit risk. These include several on qualitative models and more on quantitative credit models. Quantitative credit models are mathematical and include; linear probability and logit model which use past data such as financial ratios as inputs into a model to explain repayment experiences of old loans. Linear discriminant models on the other hand divide borrowers into high and low default risk classes contingent on their observed characteristics. This depends on values of various financial ratios of the borrower and weighted importance of these ratios based on the past observed experiences of defaulting versus non-defaulting. Newer models of credit risk management include Mortality Rate Deviation of Credit Risk which focuses on FI manager may analyze the historic or past risk experiences. Raroc (Risk Adjusted Return on Capital) Models has increased popularity based on market data to evaluate credit risk. This is informed by evaluation of actual or contractually promised annual ROA on a loan (Saunders& Cornet, 2008)

There are a number of problems using quantitative analysis to make credit risk evaluations. Discriminant analysis model usually discriminate only between two extreme cases of borrower default and non-default. This does not take to account delayed payment. The Mortality Rate Deviation of Credit Risk model has a number of conceptual and applicability problems. It

produces historic or backward looking measures. RAROC experiences the hardship in estimating loan risk. These weaknesses in quantitative credit risk assessment FIs need to rely also on more practical and qualitative models. Qualitative Models rely on information on the borrower or the market. This means the information is more predictive rather than historical information from which quantitative models employ

2.11 Summary

This chapter has delved into literature review of the study. it has sought acknowledge from other studies. it was found that with the growth of credit card debt in the world economy in the last decade, researchers have increasingly turned their attention to various aspects of this unique credit instrument. finally, unlike many traditional loans, credit card borrowing does not require consumers to post collateral which may place a greater risk on the lender. Jaffee and Russell (1976) and Stiglitz and Weiss (1981), as well as others, studied the tradition loan market theoretically using the tools of asymmetric information and adverse selection.

CHAPTER THREE
RESEARCH METHODOLOGY

3.1 Introduction

This chapter describes the research methodology by indicating the research design, target population, data collection method/techniques and data analysis were utilized in illustrating the relationship between qualitative credit assessment and default rates in credit card business in Kenya. Mugenda (2003), says this chapter includes Research design, population and sample, data collection procedures data analysis procedure. The chapter is divided into two sessions: one presents research designs, and, discussion of the data collection procedure and data analysis.

3.2 Research Design

The study employed causal design. Causal research aims to suggest linkages between variables by observing existing phenomena and then searching back through availed data to identify plausible causal relationship(s). It is concerned with determining cause and effect relationship (Ross, 2005). This research aimed to explore possible relationship between qualitative credit assessment and default rates in credit business in Kenya.

3.3 Populations

Population as a group of objects which provides the sample that is studied. The objects usually have similar characteristics. It is critical for researcher to find out as much as possible about the targeted population. The study targeted seven banks credit card issuing banks in Kenya.

3.4 Census Survey

A census survey was undertaken from the seven credit card issuing banks in Kenya as per the attached appendix 1.

3.5 Data Collection Instruments

Questionnaires were used in the collection of data and information. These are instruments where a list of questions in a prescribed sequence that are administered to the correspondents (Mutai, 2000). Questionnaire was be administered to credit departments heads in the various banks.

Pilot testing using sample credit card holders was carried prior to questionnaire being used. Participants in the study were asked to comment on any perceived ambiguities, omissions and/errors concerning the draft questionnaire. Noted cases were corrected to guarantee the highest degree of clarity before the questionnaire is used for the intended study

3.6 Variables

The study is based on several variables. These include

This include the 5cs, the number of times the credit card user has reached their credit limit, number of Credit cards, and default rates

3.7 Data analysis and reporting

Gay (1992) observed that data analysis involves organizing, accounting fr and explaining the data, that is making sense of data in terms of respondents definition of the situation noting patterns, themes, categories and regularities.

The data were be analyzed by use of MS Excel. Graphs and charts were be used to depict the relationship(s). Further analysis were done by the use of Spearman's rank correlation coefficient or Spearman's rho, named after Charles Spearman and often denoted by the Greek letter ρ (rho) or as r_s, is a non-parametric measure of statistical dependence between two variables. This assesses how well the relationship between two variables can be described using a monotonic function. If there are no repeated data values, a perfect Spearman correlation of +1 or −1 occurs when each of the variables is a perfect monotone function of the other.

The Spearman correlation coefficient is defined as the Pearson correlation coefficient between the ranked variables. The n raw scores X_i, Y_i are converted to ranks x_i, y_i, and ρ is computed from these:

$$\rho = \frac{\sum_i (x_i - \bar{x})(y_i - \bar{y})}{\sqrt{\sum_i (x_i - \bar{x})^2 \sum_i (y_i - \bar{y})^2}}.$$

Tied values are assigned a rank equal to the average of their positions in the ascending order of the values. In applications where ties are known to be absent, a simpler procedure can be used to calculate ρ. Differences $d_i = x_i - y_i$ between the ranks of each observation on the two variables are calculated, and ρ is given by:

$$\rho = 1 - \frac{6 \sum d_i^2}{n(n^2 - 1)}.$$

The researcher presents results in form of graphs showing pictorial presentations of the findings.

3.8 Ethical Considerations

The information so provided must be accorded the highest degree of confidence to safeguard the informants from unfair benefit from competition.

CHAPTER FOUR

DATA ANALYSIS, FINDINGS AND INTERPRETATION

4.1 Introduction

This chapter presents the data analysis and findings in line with the research objective. The objective of the study was to investigate the relationship between qualitative credit assessment and default rates in credit card business in Kenya. Questionnaire was sent to four out of the seven banks. The Data collected was analyzed. Discriminant analysis was employed to determine the potential relationship between the variables.

4.2 Level of involvement

It was established that Board of Directors had the most say on the changes on policy affecting credit card business. This informed the requirements for one to qualify were potential Credit card customer. In this they participated to the level of 92.86%. Senior management was involvement in 87.14% in deciding the qualities needed for one to qualify for a credit card.

Table 1: Source: Research Data

level of Involvement	
Level of Involvement	%age Score
board of directors	92.86%
Senior Management	87.14%
Other Employees	55.71%
Third party	48.57%

This showed the seriousness with which credit card business is accorded. This can be further be graphically by the following graph. In the graph it can be deduced that the bank accords least involvement in the qualities required for a customer, third parties.

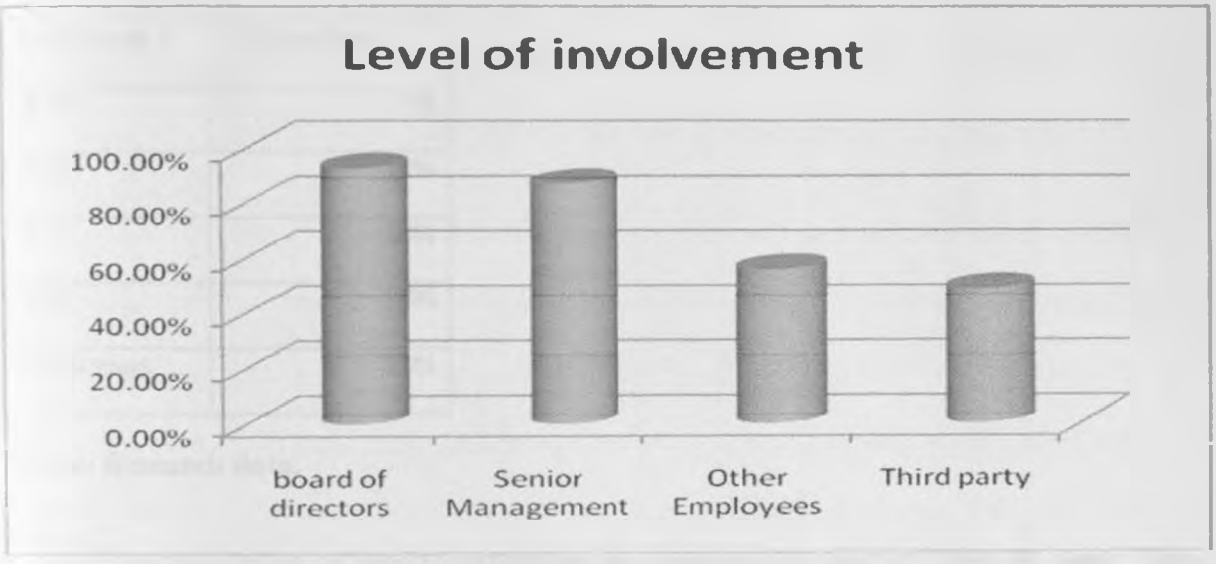

Figure 1 Source: Research Data

Credit card loans are not determined by the bank. This calls for Customer Due Diligence especially in the awarding of credit limits after the qualification for the credit card process. Customer qualities are monitored and weighed. This information is usually filled in the application form. Character, capital and capacity are highly regarded customer traits. The ability to pay is evidenced by the pay slip. This gives information to the limit were accorded to the credit card. In the study, capital had a score of 98%.

4.3 Customer age

Table 2

Customer age	
Age in years	% age of total
18-30	7%
31-40	33%
41-50	30%
51-60	18%
Over 61years	12%

Source: Research data.

It was found that most of credit cardholders are between the ages of 31to 40 years. This comprises of 33% followed by the ages 40-50 years who carry an average of 30%. This can be attributed to the productive ages.

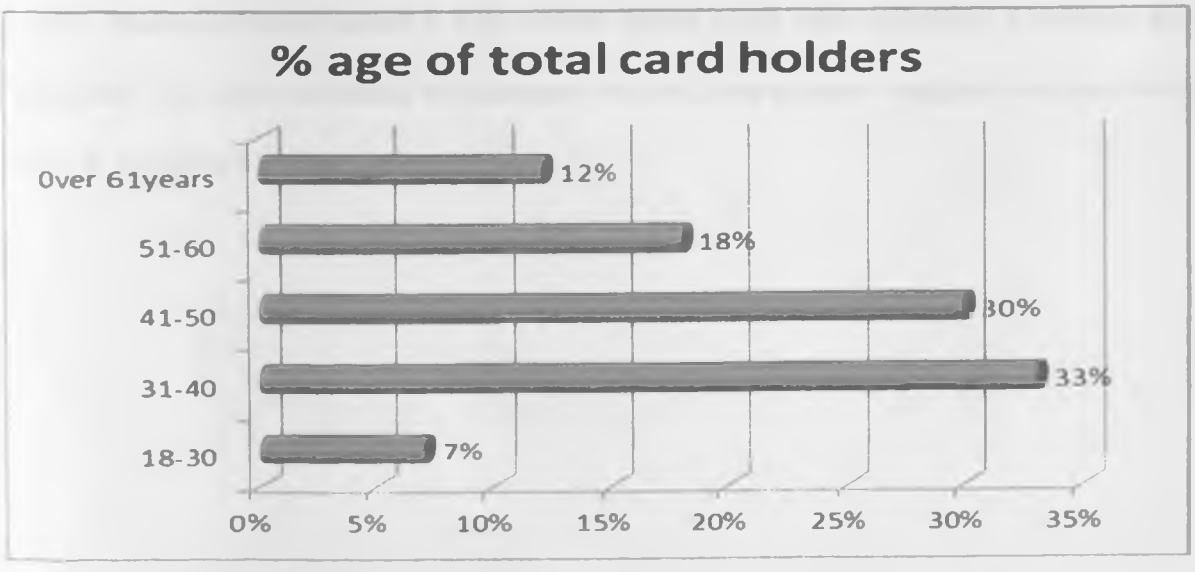

Figure 2: Source Research data

At these ages, most people are trying to find their economic feet thus are the most potential credit card customers. However, above 60 years, the number of credit cardholders is as low as 12%. Most people have already retired at this age. Most of these credit cardholders are an overflow from those who held credit cards before retirement. Banks consider a given salary bracket for one to qualify for a credit card. In Kenya unemployment especially in the 18-30years impacts on their ability were awarded credit cards and thus the dismal 7% of all credit cardholders.

Customer characteristics were evaluated. This compared the weight each is accorded during the credit card application process. This weights were a mirror of the ipmortance of these qualities in default rates. The character of a customer ranked highly with a weight of 99%. This was alsothe case for the capacity to pay. These two factors were key in credit worthiness measurement of a potential customer. The salary the customer earned was of second importance. This was captured by the capital which scored an avarage of 98% weight. Collateralin credit card business was not ranked highly. This was because, the collateral application is majorly to business people and they have to put some ammount in fixed account for them to qualify for the card. This was practiced in most Banks.Collateral carried a 93% weight during credit card apllication. Condition was ranked last. The macro-economic environment was not given as much weight as compared with others. It weighted a palltry 89%.

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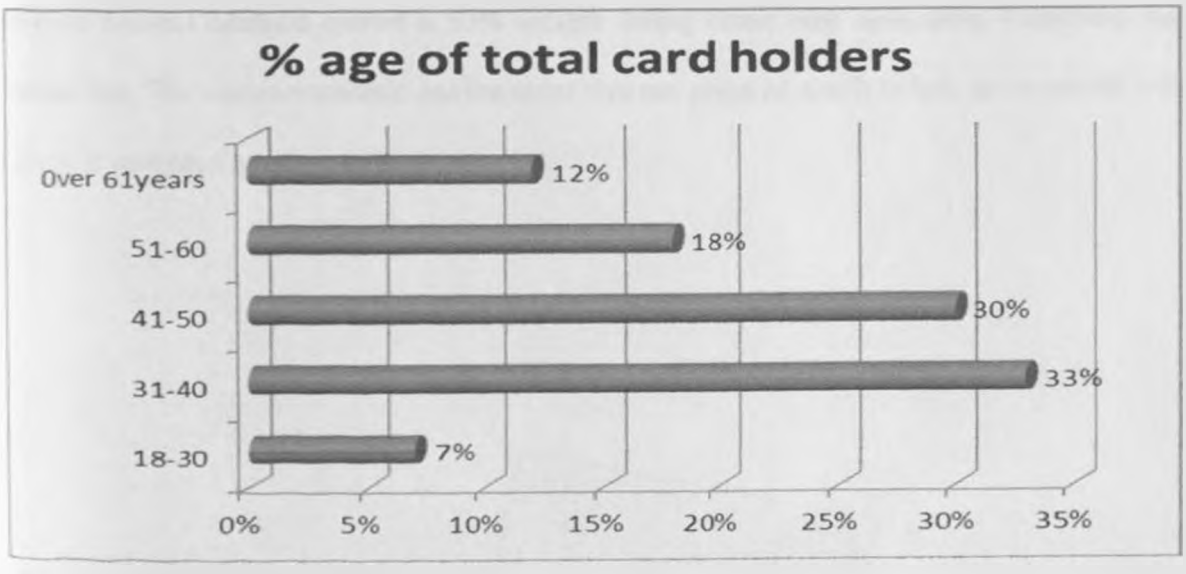

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4.4 Customer Characteristic

Table 3: Source; Research Data

Customer Characteristic	Weight	Max Score Possible	Weighted %age
Character	79	80	99%
Capital	78	80	98%
Capacity to pay	79	80	99%
Condition	71	80	89%
Collateral	74	80	93%

In the following graphical analysis, it can be deduced that, cusomer's characteristic is an imperative measure during the credit card business. This was majorly conveyed by the reqiurements; payslip and a minimum salary for qualifiation for a credit card.

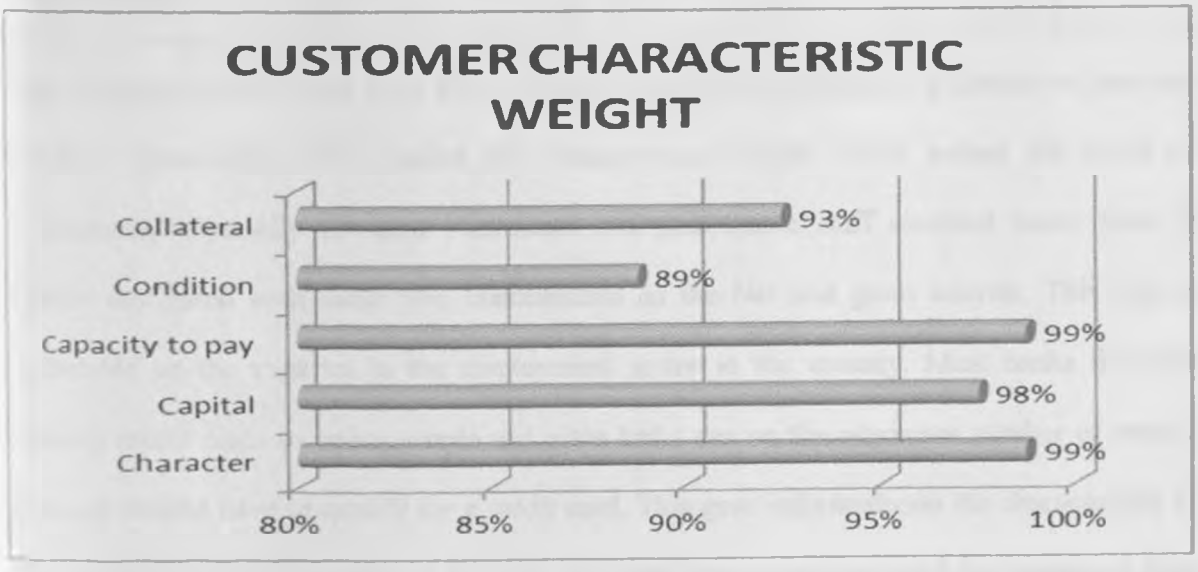


Figure 3 Research Data

In credit card business, there are several requirements which need were met before one qualifies for a credit card. Different banks accord different weights to requirements, while others pointed at different requirements as the underpinnigs of different attributes.

Table 4

Requirement Customer Characteristic	Character of the Customer	Capital	Capacity to pay	Condition	Collateral
Term of Employment	X		x		
Gross Salary	X	x	x		
Net Salary	X	x	x		x
Age	X		x		
Employer	X		x		
Credit History	X	x	x	x	x
Other (Specify)					

From the above matrix table, it can be noted that, most of the requirements pointed to at least one customer charactristic. This played into default rates. Banks which valued the terms of employment, especially favoured Permanent and pensionable staff recorded lesser rates of defaults compared with those who concentrated on the Net and gross salaries. This can be attributable to the vagaries in the employment sector in the country. Most banks favoured allowing credit cards to young people and often had a cap on the maximum number of years a customer should have to qualify for a credit card. This gave informationon the characteristic of the customer, ie high, moderate or low risk customer. Some banks selected the employers from whom employees could get credit cards. This employer reputation resonatedon the terms of employment of the employees and the stability of the employer. Those employers facing

imminent staff reduction were not favoured by credit card issuing banks. Albeit the list was revised from time to time, this was noted as a key indicater towards default rates increase or decrease.

4.5 Credit Card Usage

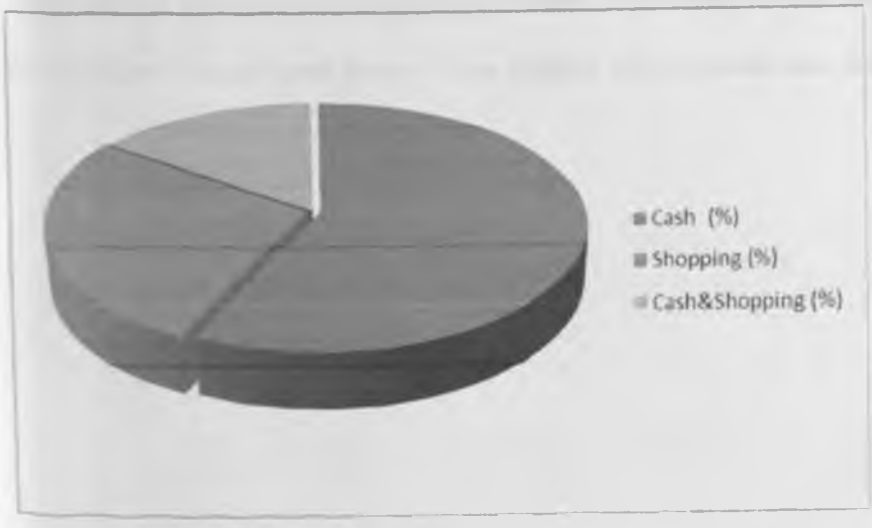
Credit cards used for cash withdrawals showed increased activity as compared with ones for shopping. Those used for cash withdrawal had 67% usage as compared with 37% with 33%

Table 5: source, Research Data

CREDIT CARD USAGE	
Cash (%)	67
Shopping (%)	33

The graphical represenattion below paints the picture of the usage ofcredit cards

Figure 4 Credit card usage



The number of cash withdrawals was analysed. It was found that the number of withdrawls per month was below 10 times. 42% of customers who withdrew cash using their credit cards did in less than 5 times a month. Only 6% customers withdrew more than 10 times, this was majorly on high limits credit card holders.

Table 6

Number of Cash withdrawals	
Number of Cash withdrawals	%age of total
Nil	29%
1-5	42%
6-9	23%
Above 10	6%
Total	100%

Graphically, the peculiar way of using credit cards in Kenya is captured. Basically, a credit card is a shopping tool. Banks have known this and most Kenyan Banks have opened avenues that customers can convert some percentage of their credit limits to cash withdrawal. This is based on the customer's repayment history. Low default risk cutomers are selected for these exercises.

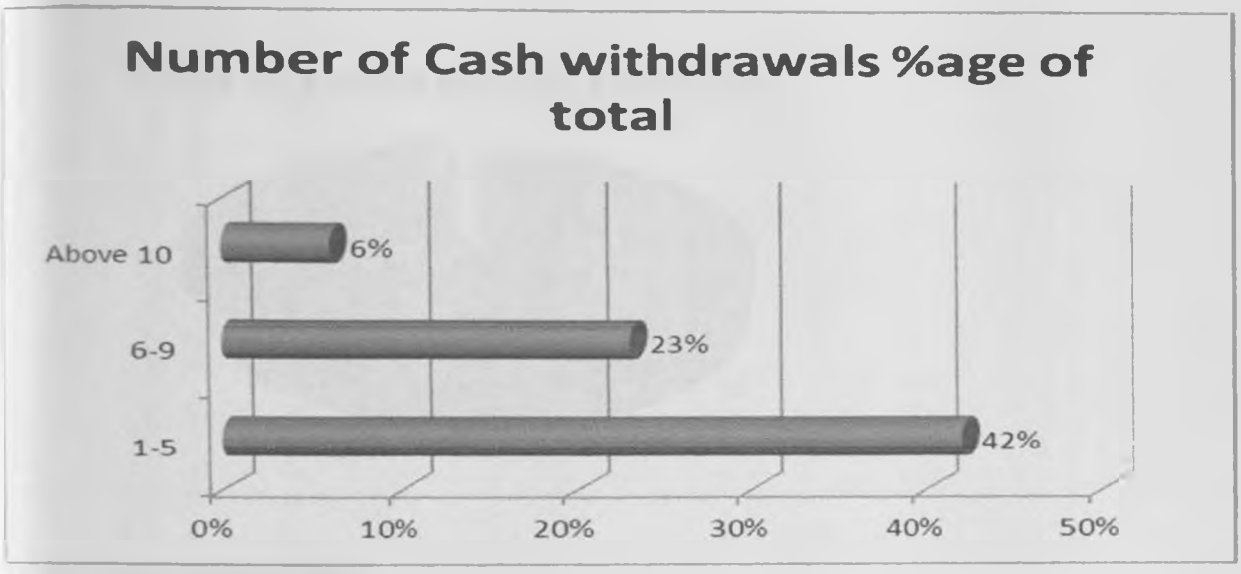


Figure 5 Source: Research Data.

Credit card use was tested if it has a contribution to default. Cash withdraw being the major activity pointer in credit card business was given priority. The table below tries to find the relativeness of cash from credit card use to default rates.

Table 7: Source; Research Data

CASH WITHDRAWAL VERSUS DEFAULTS	
YES	73
NO	27

Its evident that most banks encourage their customers to access cash using their credit cards. However, most customers who use their credit cards for cash withdrawal more often than not default on their payment. It was found that 73% of customers who access cash using their credit cards default on payment. This may not necessarily translate to 'harsh' defaults.

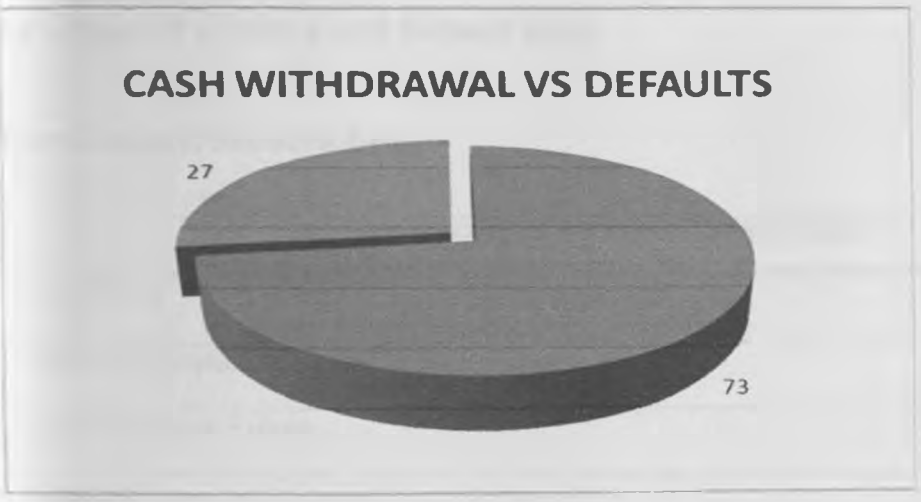


Figure 6: Source, Research Data

There however other factor which influence default apart from card usage related factors. These include; System failure, terminology ineptitude, business failure among others. Banks seem to have embraced technology in credit card business in Kenya. System failure in the study referred to internal failures in the banks. This encompasses late statement dispatch to the cusomers, wrong data capture, double and multiple charges on credit cards among others. This however was only to a level of only 6% of other causes of default. When customers fail to get their bills on time, they may not pay on the due date, or when multiple billings, they tend to shy away from payments for sometime.

4.6 Causes of Credit Card Default Risk

Table 8: Source; Research Data

OTHER CAUSES OF CREDIT CARD DEFAULT RISK	
system failure	6%
Terminology Ineptitude	23%
Customer Business Failure	17%
Retirement	26%
Loss of Employment	28%

Loss of employment was established were the biggest contributor to default risk. As noted erstwhile, of the total credit cardholders, those in the 30-40years bracket led by 33%. This group showed high level of job loss and consequent default. Retirement was also cited as a contributor to default risk. It did contribute to 26% of average default cases. Although the customers pay their dues in this bracket, delayed retirement package payment was cited as a key cause to default on credit card. Majorly, credit card business in Kenya was aimed at the employed. This was evidenced by the requirement of a recent pay slip across the surveyed banks. However, some card holders withdrew cash to start businesses hoping to repay when the business were pick-up and may fail. Especially after losing employment, the credit card comes in handy, when the business fails, default is evident. Terminology ineptitude is a state of card holders not understanding the jargon used by credit card issuing banks. Customers may be not in the know of their Due Date, Grace Period, and Anniversary Date among others. This terminology ineptitude made customers default only because they did not understand the credit card operation, to a level of 23% contribution to default rates.

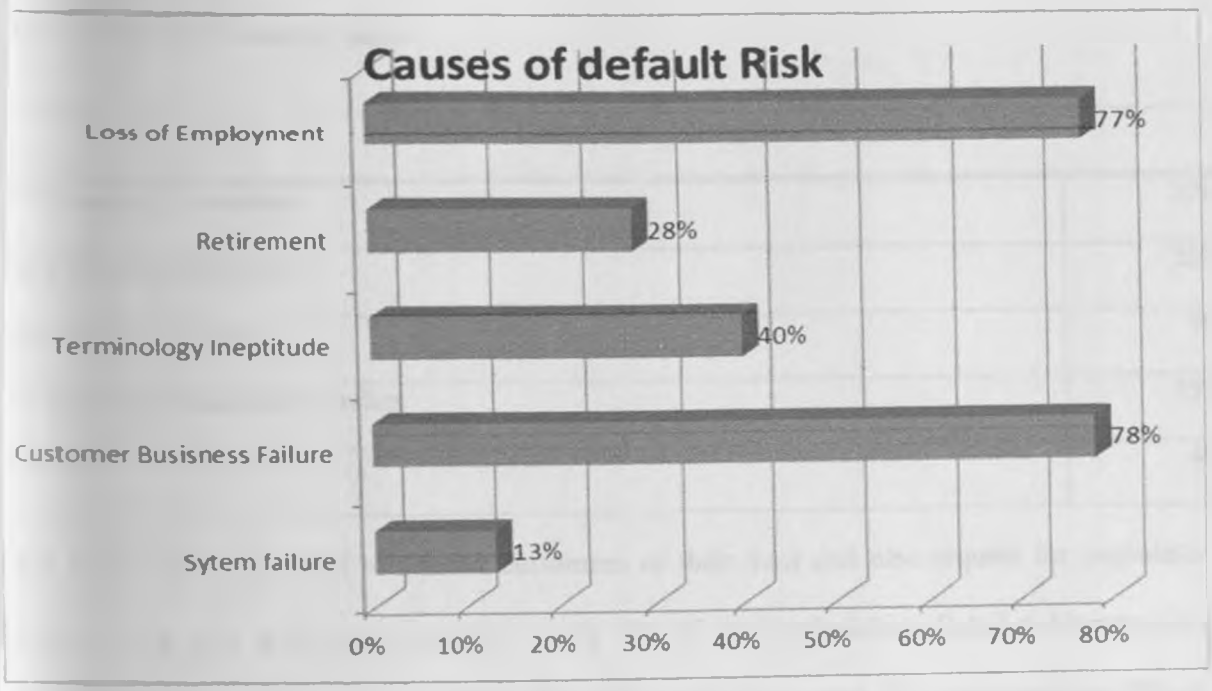


Figure 7: Source; Research Data

4.7 Ways of Default Rate Management

Owing to the potential of default, Banks employ several measures to check default rates. These are also employed to ensure customers in mild default stage do not mutate to harsh delinquency. It was found that most Banks relied on telephone calls. This was both to serve as a reminder to make payments or informing the customers of unpaid dues. 37% of defaulters reacted to telephone calls. This was followed closely by Short Messages on whom 26%

Table 9: Source; Research data

Ways of Default Rate Management	
Telephone call Reminders	37%
Short Message Reminders	26%
Land-Mail Reminders	9%
Relationship Managers Reminders	25%
E-Mail	4%

Land mails were also used to remind customers of their dues and also request for payments. However this was used and responded to by 9% of the cardholders. Relationshipmanagers playedakey role especially when dealing with 'high value' customers. This accounted for 25% of custome repayment. This usage was lower than that of telephone calls majorly because it aimed at a clique while telephone calls were for all cardholders. E-mails were also used minimumly at the level of 4%. This might be attributable to confidentiality with which credit card business is accorded and thevolatility of such information when leaked to the wrong party through the internet.

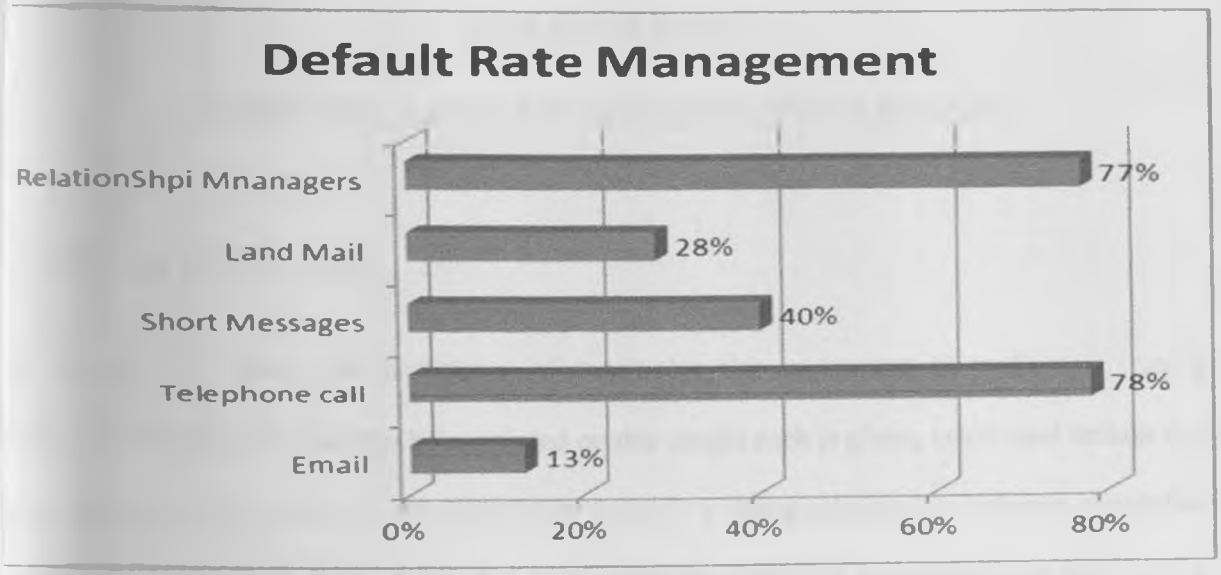


Figure 8

4.8 Data Analysis

Table 10

X1	X2	Rank 1	Rank 2	Rank1-Rank 2	(Rank1-Rank 2)^2
79%	13%	5	5	0	0
88%	78%	2	1	1	1
90%	40%	3	3	0	0
93%	28%	4	4	0	0
99%	77%	1	2	-1	1
					2

The calculated $\rho = 1 - \frac{6\sum d_i^2}{n(n^2-1)}$. is 90%

There is a strong positive correlation between qualitative assessment and default risks among the credit card issuing banks in Kenya as evidenced by a high score of 90%.

CHAPTER FIVE

SUMMARY, LIMITATIONS AND CONCLUSIONS

1 Summary of findings

he research has found the importance of qualitative risk assessment in credit card issuing siness in Kenya. The findings have pointed on the weight each is given, credit card default risk anagement among others. It was found that there is a strong relationship between qualitative ssessment and default. It was found that bank value the 'quality of customers' they deal with to educe default rates.

5.5 Limitation to the Study

Some of the respondents were essentially not so umpteen with the topic. This suspicion to the study led reluctance to fill in the questionnaire. This can be attributed to the confidentiality with which banks view information. The assurance that the information thus provided were be subject to no other purpose than academic did little to palliate the fear that the information were somehow percolate to competition

Time was a highly limited resource in the study. Data collection specifically bore the biggest setback. As such, with more time available an ardent effort could have made to convince and pursue the respondents who never filled or returned the questionnaire.

The cost factor in practically all parts of the research hamstrung the easiness with which the various stages of the study were conducted. Particularly it was expensive to follow-up the questionnaires than it was planned for.

Credit card business in Kenya has not enjoyed much literature bath, especially published works. This has led into the reliance on literature on other forms of loans which may provide a different perspective to similar subjects.

There was established were a blurred line between personal information provided by the respondents and the company view. It was thus presupposed that the respondents spoke for the company they work for.

5.6 Recommendation

The central Bank should have a credit card related information bank as it does on various other areas in financial systems. Credit card issuing banks should loosen their grip on credit card related information. It is recommended that credit card issuing commercial banks need to release data to researchers with lesser hampering. This will open new scopes in understanding the credit card business in the country. The CRB Africa should also be readily reachable by researchers on credit card. This will provide insight to deeper knowledge to default and if the defaulters finally pay their dues, after how long and if so, why do they pay? This information will be invaluable to credit card issuing banks and other stakeholders in the business.

5.7 Suggestion For Further Research

Further research (es) can be undertaken on the importance of credit card in a growing economy as Kenya. A research can be done on the impact of credit card usage to credit cardholders. Relationship between Profitability levels of credit card business and credit risk in Kenyan market. Another research can be done on the repayment patterns by credit card deafulters and the reason floated as the key catalyst to repayment.

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Appendix 1 Credit card issuing banks

1. **Barclays Bank of Kenya Ltd**
2. **Kenya Commercial Bank Ltd**
3. **Co-operative bank of Kenya Ltd**
4. **NIC bank ltd**
5. **Prime Bank Kenya Ltd**
6. **I&M Bank Kenya Ltd**
7. **Imperial bank, Kenya Ltd**

APPENDIX II: Letter to the respondent

Dear Sir/ Madam

I am a post-graduate student at the school of business, university of Nairobi. As a required fulfillment for the award of Master of business administration, (MBA), as I research on THE RELATIONSHIP BETWEEN QUALITATIVE CREDIT ASSESSMENT AND DEFAULT RATES IN CREDIT CARD BUSINESS IN KENYA, I humbly request for your assistance.

In filling in the Questionnaire attached to the best of your ability, you were have aided me with academic information. The information so provided, shall be used solely for academic purpose and at no instance will the name of the bank be named in the report. The information will be treated with absolute confidence.

Yours Faithfully,

Maundu Caleb Nzioka

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APPENDIX III: QUESTIONNAIRE

ection 1 General information

a) Name of the Bank (Optional)

b) Is your bank locally or Multi-nationally owned (Tick where appropriate)

locally owned		**Internationally owned**	

Other(Specify).....

a) How many credit cardholders does the bank have in Kenya (In numbers).....

Section 2 Credit Card Default Management

I) Does your bank have a Credit Card Default Management department?

YES		NO	

ii) If yes, what is the title of the person responsible for Credit Card Default Management?

.....

iii) Who do they report to? .....

a) I) who is responsible in payment tracking? .....

ii) After how many months does your bank 'sense' default risk.....

b) What is the level of involvement of the following person in checking Credit card default?

vel of involvement	Highly Involved 5	Fairly Involved 4	Involved 3	Not Involved 2
ard of Directors				
nior Management				
her Employees				

ners (Specify).....

How regularly does your bank review default risk policies. Tick where applicable

Monthly		Quarterly		Semi-Annually Annual	

3) i) Does your bank allow cash withdrawal by credit card?

YES		NO	

ii) By percentage, how many times in a month does a customer access cash with their credit cards?

Number of Cash withdrawals	
Number of Cash withdrawals per Month	%age of total
Nil	
1-5	
6-9	
Above 10	

iii) Do customers who regularly access cash on their credit cards differ in defaulting with those who do not?

YES		NO	

iv) if yes by what percentage does each post on average.

YES		NO	

Section 3: Default rate management

a) i)What is the percentage default rate in of the following cards in your bank relative to others you provide

Classic cards …… …….. High Value Credit cards……

Ii) What is the level in percentage of each causes default risk……..

b) In percentage, which type of a card usage is key to credit card usage?

CREDIT CARD USAGE	
Cash (%)	
Shopping (%)	
Cash &Shopping (%)	

c) Who is responsible for default risk management?

Credit Risk manager		Credit committee	
Credit Analyst		Branch Manager	
Relationship manager			

Others (Specify)……

d) Which of the following most accurately describes your qualitative credit card assessment method?

Customer Based ☐ Market specific ☐

Others (Specify).....

e) When a new customer applies for credit card, how does your Bank rank the following requirements and the information each requirement provide?

equirement	Not Important 1	Least Important 2	Important 3	Fairly Important 4	Highly Important 5
Term of Employment					
Gross Salary					
Net Salary					
Age					
Employer					
Credit History					
Other (Specify)					

Customer Characteristic	Not Important 1	Least Important 2	Important 3	Fairly Important 4	Highly Important 5
Character of the Customer					
Capital					
Capacity to pay					
Condition					
Collateral					
Other					

f) In application and awarding credit cards, how does your bank rate the following requirements?

Requirement	Not Important 1	Least Important 2	Important 3	Fairly Important 4	Highly Important 5
Term of Employment					
Gross Salary					
Net Salary					
Age					
Employer					
Credit History					
Other (Specify)					

g) How does your bank matrix the following requirement as pointers to customer characteristic?

Requirement Customer Characteristic	Character of the Customer	Capital	Capacity to pay	Condition	Collateral
Term of Employment					
Gross Salary					
Net Salary					
Age					
Employer					
Cedit History					
Other (Specify)					

h) How does you bank rate the following as causes of default risk.

Causes of default risk	Not Important 1	Least Important 2	Important 3	Fairly Important 4	Highly Important 5
Loss of Employment					
Retirement					
Business Failure					
Terminology ineptitude					
Operational Errors					

Others (Specify).....

i) How do the following classes of defaulters respond to payment

Classes of defaulters response to payment	Not Responsive 1	Least Responsive 2	Responsive 3	Fairly Responsive 4	Highly Responsive 5
Mild Delinquency					
Harsh Delinquency					

j) i) What is your bank's preference in following a default customer?

Negotiation ☐ Credit Rating Bureau ☐

ii) Give a degree in percentage of success to each above.

Very Low	Low	Average	High	very High
20%	40%	60%	80%	100%

Negotiation ☐ Credit Rating Bureau ☐

iii) If negotiation has the higher percentage, how do you rank the following strategies?

Strategies to Check Default Risk	Not Important 1	Least Important 2	Important 3	Fairly Important 4	Highly Important 5
Face to face (relationship Managers)					
Telephone conversation					
Land Mails					
Electronic Mail (E-mail)					
Short Messages					

Thank you for taking your time to answer this questionnaire