CREDIT RISK MANAGEMENT STRATEGIES AND PERFORMANCE OF STANDARD CHARTERED BANK, KENYA

BY

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DECLARATION

I declare that this research study is my original work and has not been presented for a degree in any other University or an examination body.

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

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DEDICATION

I dedicate this research project to my daughters Natasha and Renata who are my inspiration in everything I do and the choices I make in life. To my husband Eric Njoroge who has always supported, encouraged and inspired me in my endeavours. To my parents, you made me who I am today**.**

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Finally I thank my family for instilling in me unquestionable values and morals, thank you for your love, guidance and for always believing in me throughout the year.

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ABBREVIATIONS AND ACRONYMS

ATM	**-**	Automated Teller Machine
CEO	-	Chief Executive Officer
CG	-	Credit Grade
LGD	-	Loss Given Default
NSE	-	Nairobi Securities Exchange
PD	-	Probability of Default
RBV	-	Resource Based View

ABSTRACT

Credit risk has always been a vicinity of concern not only to bankers but to the entire business world because the risks of a trading partner not fulfilling his obligations in full on due date can seriously jeopardize the affairs of the other partner. The objective of the study was to determine credit risk management strategies and performance of Standard Chartered Bank, Kenya. The study used a case study design to achieve the objective of the study. The main advantage of a case study was that it provided a good understanding of a certain phenomenon. The study utilized primary data which was collected through an interview guide that had broad open ended questions. The data obtained from the interview guide was analysed using content analysis. This approach was more appropriate for the study because it allowed for deep sense, detailed account in changing conditions. Thus the qualitative method was suitable for this research because this research was conducted within the environment where the credit risk management strategies are applied and the impact of the same felt. The findings of the study were that the strategies used by standard chartered bank to control credit risk were: establishing an appropriate credit risk environment; operating under a sound credit granting process; maintaining an appropriate credit administration, measurement and monitoring process; and ensuring adequate controls over credit risk. The study also established that the assessment methods used by standard chartered bank in measuring credit risk included the risk assessment and approval procedures. The study concluded that Standard Chartered Bank review and controls credit risk by using risk avoidance which involves actions to reduce the chances of particular losses from standard banking activity by eliminating risks that are superfluous to the institution's business purpose. The study recommended that credit risk monitoring and supervision efforts should be intensified by the bank. The bank should ensure that credit officers perform periodic follow-ups on borrowers to ensure that loans are used for the intended purpose.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

The nature of risk is itself primarily dependent on the industry characteristics and the strategy pursued (Bettis, 2009). All human actions entail some risks. Some will be risk seekers or accepters by temperament while others are risk avoiders. There is even evidence that removal of some risks will cause persons purposely to subject themselves to a new one, suggesting that they seek some kind of undefined risk balance in their lives. The classical definition of risk was provided by Knight (1994) as the situation in which the decision maker has the advantages of knowledge of the problem structure, understanding of the complete range of possible outcomes and ability to objectively assess the likelihood of each outcome occurring. At its simplest level, Knight (1994) saw risk as a form of measurable as opposed to un-measurable uncertainty. Other than industry characteristics and organizational strategy, risk partly determines an organization's performance.

Bluhm, Overbeck & Wagner (2004) describes credit as the provision of resources such as granting a loan by one party to another party where the second party does not reimburse the first party immediately, thereby generating a debt, and instead arranges either to repay or return those resources or material(s) of equal value at a later date. According to Lam (1999), credit risk occurs when there is a loss in value as a result of a debtor's non-payment of a loan or other line of credit, either the principal or interest (coupon) or both. Credit risk is the potential that a bank borrower or counterparty will fail to meet its obligations in accordance with agreed terms. The goal of credit risk management is to maximise a bank's risk-adjusted rate of return by maintaining credit risk exposure within acceptable parameters. Banks need to manage the credit risk inherent in the entire portfolio as well as the risk in individual credits or transactions. Banks should ensure that their strategies are in place for effective management of credit risk and other risks.

A strategy is a high level plan to achieve one or more goals under conditions of uncertainty. Strategic management is the process in which an organization develops and implements plans that espouse the goals and objectives of that organization. The several key concepts that characterise strategic management are goal setting, analysing strategy formation, strategy formulation, and strategy implementation and monitoring the effectiveness of the strategies (Holton, 2004). Strategy management in organizations ensures that the goals set and the objectives should be in such a way that they mitigate or avoid risk at all cost. Analysis of an organization's strengths and weaknesses is a key concept of strategic management. It helps to develop specific actions, and then put the actual strategy into practice to meet organizational goals.

The theoretical foundation of the study is based on Resource Based View and Knowledge Based Theory. Rodriguez, Ricart & Sanchez (2002) proposes that an analysis of a firm's internal strengths and weaknesses should address the four questions on the value and rareness of a resource, ease of imitability of a capability and resources, and organizations capability to exploit its resources. The knowledge based theory of the firm considers knowledge as the most strategically resource of the firm. This knowledge is embedded and carried through multiple entities including organizational culture and identify, policies, routines, documents, systems and employees.

Kenyan banking industry advances credit to people of different categories including low-cadre earners and self-employed individuals whose default risks are very high yet the banks cannot be pushed out of the niche. In addition, the business environment has become too competitive to the extent of not letting go any quality of clientele. This implies that the banks are subject to a heightened credit risk levels as opposed to other economies with higher-income earning potentials (Holton, 2004). Given that the industry is still growing with new entrants still finding space, great effort must be spent to ensure that comprehensive and effective strategies are developed that minimize risk and maximize loan performance at any particular point while in operation. If appropriate set of tools are not determined and sustained in time, the likelihood of loss will gradually increase and subject the banks into penalties of illiquidity and downsized profitability.

1.1.1 Credit Risk Management

Risk is an elusive element in most decisions, largely because it is so hard to pin down. Also, there will always be risks associated with mitigation strategy developments and maintenance (Jappelli, 2006). Risk is an exposure to a proportion of which one is uncertain (Holton, 2004). BIS (2002) states that a number of major world's commercial banks have developed sophisticated systems to quantify and aggregate credit risk upon which their lending is determined. The pervasiveness and complexity of credit risk presents strong challenges to managers, one of the most important being lack of efficient determination of credit worthiness of a potential customer. This, therefore, means establishing mechanisms of insulating the company's value against huge defaults (Bowman, 1982).

Credit risks are defined as changes in portfolio value due to the failure of counter-parties to meet their obligations or due to changes in the market's perception of their ability to continue to do so. Credit risk refers to the probability of loss due to a borrower's failure to make payments on any type of debt (McMenamin, 1999). Ideally, a bank risk management system would integrate this source of risk with the market risks to produce an overall measure of the bank's loss potential. Traditionally, banks have used a number of methods like credit scoring, ratings, credit committees, to assess the creditworthiness of counter-parties. At first glance, these approaches do not appear to be compatible with the market risk methods. However, some banks are aware of the need for parallel treatment of all measurable risks and are doing something about it. Unfortunately, current bank regulations treat these two sources of risk quite differently subjecting credit risk to arbitrary capital requirements that have no scientific validity.

If banks can "score" loans, they can determine how loan values change as scores change. If codified, these changes would produce over time a probability distribution of value changes due to credit risk. With such a distribution, the time series of credit risk changes could be related to the market risk and we would be able to integrating market risk and credit risk into a single estimate of value change over a given horizon. Credit risk management, meanwhile, is the practice of mitigating those losses by understanding the adequacy of both a bank's capital and loan loss reserves at any given time – a process that has long been a challenge for financial institutions (Oviatt & McDougall, 2005). To comply with the more stringent regulatory requirements and absorb the higher capital costs for credit risk, many banks are overhauling their approaches to credit risk. But banks who view this as strictly a compliance exercise are being short-sighted. Better credit risk management also presents an opportunity to greatly improve overall performance and secure a competitive advantage.

1.1.2 Concept of Strategy

In management, strategy is defined as a unified, comprehensive and integrated plan designed to ensure that basic objectives of the enterprise are achieved. The company that is strategically positioned performs different activities from rivals or performs similar activities in different ways. According to Pearce and Robinson (2007) Strategy is the unified, comprehensive and integrated plan that relates the strategic advantage of the firm to the challenges of the environment and is designed to ensure that basic objectives of the enterprise are achieved through proper implementation process. Oviatt and McDougall (2005) depict strategy as a set of beliefs on how a firm can achieve success. They affirm that strategy the main route to attain corporate goals and an objective, leading to enhanced long-term performance meaning that strategy is much more than beliefs and encompasses a deliberate search for a plan that will develop a business's competitive advantage and compound it.

Strategy is a framework through which an organization can assert its vital continuity while managing to adapt to the changing environment to gain competitive advantage. Strategy is a mediating force between the organization and its environment; there are consistent streams of organization decisions to deal with the environment (Mintzberg, 1994). According to Ansoff & McDonnell (1990) strategic management is a systematic approach to the major and increasing important responsibility of general management to position and relate the firm to its environment in a way which will assure its continued success and make it secure from surprises. Understanding strategy has been hurt by the tendency to view strategy as a stand-alone phenomenon, rather than a causally linked element in the management process of institutions (Ansoff & McDonnell, 1990).

Sokol (2005) proposes that strategic management is a process, directed by top management to determine the fundamental aims or goals of the organization, and ensure a range of decisions which will allow for the achievement of those aims or goals in the long-term while providing for adaptive responses in the short-term. The three core areas of corporate strategy include: strategy analysis, strategy development and strategy implementation. Strategy analysis deals with examining the environment within which the organization operates strategy development deals with developing goals and achieving success.

Strategy formulation is concerned with determining where the organization is, where it wants to go and how to get there. It involves carrying out situation analysis that leads to setting of objectives. Vision and mission statement are crafted and overall objectives, strategic business unit objectives and tactical objectives are also developed. Strategy implementation is the process of allocating resources to support an organization's chosen strategies. This process includes the various management activities that are necessary to put strategy in motion and institute strategic controls that monitor progress and ultimately achieve organization goals. Strategy evaluation involves review of external and internal factors that are bases for strategies formulated, measuring performance and taking corrective action, if necessary. This is important as all strategies are subject to future modification depending on environmental turbulence (Robbins & Coulter, 1996).

Strategy formulation and implementation is an on-going, never-ending integrated process requiring continuous reassessment and reformation. Strategic management is dynamic and involves a complex pattern of actions and reactions. It is partially planned and partially unplanned. Strategy is planned, emergent and interactive (Thompson & Strickland, 1980). Pearce and Robinson (2007) states that to effectively direct and control the use of firm's resources, mechanisms such as organization structure, information systems, leadership styles, assignment of key managers, budgeting, rewards and control systems are essential strategy implementation ingredients.

1.1.3 Organization Performance

Organization performance comprises the actual output or results of an organisation as measured against its intended outputs or goals and objectives. The performance of an organization can be measured in various ways which include qualitative and quantitative. Firstly, how efficient the organization utilises its resources to produce a profit and secondly is to set of measure based on the prevailing price of an organization's stock (Delaney & Huselid, 2006).

The organization performance is affected by the strategies that the organization has chosen, thus performance may take many forms depending on whom and what the measurement is meant for. Organization performance encourages three specific areas of firm outcomes: finance performance (profits, return on assets and return on investment), product market performance (sales and market share) and shareholders return (total shareholder return and economic value added) Richard et al., (2009). Organizational performance can also be used to view how an enterprise is doing in terms of level of profit, market share and product quality in relation to other enterprises in the same industry. Consequently, it is a reflection of productivity of members of an enterprise organization.

Organization performance is the final achievement of an organization and contains a few things, such as the existence of certain targets are achieved, period of time in achieving the targets and the realization of efficiencies and effectiveness (Gibson et al., 2010). Organizational performance is affected by myriad factors including: the lines of communication and command connecting these individuals (organizational authority structure and degree of centralization), the resources and information to which the individuals have access, the nature of the task faced by the individuals, and the type and severity of the crisis under which the individuals operate. Ultimately, performance lies at the heart of any managerial process and organizational construct and is therefore considered as a critical concept in the strategic management field.

1.1.4 The Banking Industry in Kenya

The banking industry in Kenya is regulated by Central bank of Kenya Act, Banking Act, and The Companies Act among other guidelines issued by the Central Bank of Kenya. Central Bank of Kenya is tasked with formulating and implementation of monetary and fiscal policies. Financial systems across Africa have seen a deepening and broadening over the past years, partly benefiting from the Great Moderation and global liquidity glut, but also from improvements in macroeconomic policies and progress in institutional reforms (Beck, Fuchs, 2009). By African standards and in comparison the other East African economies, Kenya’s banking sector has for many years been credited for its size and diversification. Kenya has a variety of financial institutions and markets – banks, insurance companies, and stock and bond markets - that provide an array of financial products. Notwithstanding this relative advantage, Kenya's financial system has failed to provide adequate access to banking services to the bulk of the population. While the larger proportion of savings comes from small depositors, lending is skewed in favour of large private and public enterprises in urban areas. Financial services are expensive, as evidenced by high interest rate spreads and account fees.

1.1.5 Standard Chartered Bank Kenya

Standard Chartered Bank Kenya was the first foreign bank in Kenya. In January 1911, it opened its first two branches, one in the national capital, Nairobi, and another in the port city of Mombasa. In 1969, the bank's name was changed to Standard Chartered Bank of Kenya when the its parent company, the Standard Bank of South Africa, merged with the Chartered Bank of India, Australia and China forming the Standard Chartered Bank. In 1987, Standard Chartered sold all its shareholding in Standard Bank of South Africa, entirely divesting from the group.

The stock of Standard Chartered Kenya was listed on the Nairobi Securities Exchange (NSE) in 1989, offering 21 million shares to the public. This was the largest single placing at the NSE at the time. Today, the bank is one of the leading banks in Kenya with an excellent franchise of 40 branches spread across the country, 98 automated teller machines (ATMs), one electronic banking unit and 1698 employees. The bank provides a wide range of products and services for personal and business clients which include loans, mortgage and home loans, life insurance, investment services among others.

Everything the bank does is about being here for good - in business, through life and when it matters most for its client which is its brand promise. The bank strives to be the world's best international bank hence it's important that it conducts its business to the highest standards it's guided by the bank core values. In doing so, the bank acts in an open, innovative and collaborative manner to advance the best interest of it clients.

As of December 2013, the bank's total assets were valued at about US$2.539 billion (KES: 220.39 billion), with shareholders' equity of about US$417.1 million (KES: 36.2 billion). At that time, Standard Chartered Kenya was the 4th largest bank, by assets, out of the 43 licensed banks in the country. In 2006, Standard Chartered Kenya acquired 25% shareholding in First Africa Capital, a financial services advisory company with headquarters in Nairobi and offices in London and Johannesburg, co-founded by Wanjiku Mugane, a Kenyan attorney and investment banker, who served as its CEO. In 2009, Standard Chartered acquired 100% of First Africa stock, renaming the company Standard Chartered Securities (SCS), to reflect the new ownership. Caroline Wanjiku Mugane served as the Chief Executive Officer at SCS from 2006 until Standard Chartered Bank closed the subsidiary in 2013.

Credit risk measurement plays a central role, along with judgment and experience in the bank, in informing risk taking and portfolio management decisions. It is a primary area for sustained investment and senior management attention. Since 1st January 2008, Standard Chartered has used the advanced Internal Ratings Based approach under the Basel II regulatory framework to calculate credit risk capital requirements. For IRB portfolios, a standard alphanumeric credit risk grade (CG) system is used in both

Wholesale and Consumer Banking. The grading is based on the bank internal estimate of probability of default over a one-year horizon, with customers or portfolios assessed against a range of quantitative and qualitative factors (Levitsky, 1997). The numeric grades run from 1 to 14 and some of the grades are further sub-classified A, B or C. Lower credit grades are indicative of a lower likelihood of default. Credit grades 1A to 12C are assigned to performing customers or accounts, while credit grades 13 and 14 are assigned to non-performing or defaulted customers.

1.2 Research Problem

Recent financial crises in financial institutions due to increased default rates have proven that credit risk management practices are essential for organization, large and small and therefore, risk awareness should be made a key component of strategy development in any organization. However, according to Khan et al. (2008), most of these risks are beyond the control of a given organization although he observed that an organization can prepare and protect themselves in time-honoured ways. A business ability to prosper in the face of risks at the same time responding to unplanned events, good or bad, is prime indicator of its ability to compete. To many firms, this simply means being alert to any direct and obvious threats to their well-being. Quite worrying, it is often the indirect and seemingly unconnected events that pose the biggest danger to the organization and this clearly shows that credit risk exposure is becoming greater, more complex, diverse and dynamic. By an organization incorporating credit risk management practises it will be able to identify beforehand the risks it is about to face and more so put in place mechanisms to avoid or mitigate the impact it is to cause.

In a world of volatile cash movement and increasing global lending and borrowing of funds, few commercial banks if any remain unaffected by borrowers late and non-repayment of loan obligations, thus result in banks inability to collect anticipated interest earnings as well as loss of principal amount resulting from loan repayment. Banks prefer to provide loans to individuals, organizations and businesses that have an established relationship with them, for security reasons in order to reduce the risk default (Levitsky, 1997). Although this reduces the risk involved in giving out credit, it creates a problem of limited access to finance for potential investors, first time borrowers, and new enterprise that that are yet to establish a credit worthiness record. In order to mitigate such, Credit Risk management Strategies are seen as the most important instrument used by financial institutions and particularly standard chartered bank to achieve financial access by various borrows.

A number of studies have provided the discipline with insights into the practise of credit management within corporate institutions. Owusu (2008) studied credit practices in rural banks in Ghana and found that the appraisal of credit application did not adequately assess the inherent credit risk to guide the taking of appropriate decisions. In his recommendations, he stated that credit amount should be carefully assessed to identify projects in order to ensure adequate funding. Another research on credit risk management include a research done on evaluating credit risk exposure in agriculture (Lyubov, 2003). The research adapts loan portfolio management tools to agricultural lending and provides guidance on appropriate capital allocation and portfolio management using the tools. The framework is identified for modelling credit risk in agriculture.

Locally, few studies have been done on risk management. These includes; Silikhe (2008) studied credit risk management in microfinance institutions in Kenya and found out that despite the fact that microfinance institutions have put in place strict measures to credit risk management, loan recovery is still a challenge to majority of institutions. Safari (2003) took a survey of risk factors in the strategic planning process of selected parastatals in Kenya. He noted that with a risk based approach to strategic execution process, it will allow managers to focus on the opportunities outlined in their firm's strategic plans, while at the same time minimise the potential impact of any threats. On the other hand, he observed that a risk-based management control system allows managers to quickly and confidently react to opportunities arising in the business set up. While the above research outcomes provide insights on credit risk management techniques, there is a research gap on credit risk management and performance strategies and hence the need to carry out a study on credit risk management and performance strategies and specifically in standard chartered bank, Kenya. What are the credit risk management strategies and performance of Standard Chartered Bank, Kenya?

1.3 Research Objective

The objective of this study was to determine credit risk management strategies and performance of Standard Chartered Bank, Kenya.

1.4 Value of Study

The study will provide direction and solutions to managers and board of directors of standard chartered bank Kenya with information on credit risk management strategies. The result of the study will also be important to the scholars, academicians and researchers in investigating the influence of context, validating previous research, facilitating theory building and contributing to the existing body of knowledge in the area of credit risk management. The study can also be a source of reference material for future reference to those academicians who undertake the same topic in their studies.

This study will also be important to central bank of Kenya regulator that will assist them in determining the size and risk profile of the institution. This will be by monitoring the market share index that is a composite of net assets, deposits, capital, number of loan accounts and number of deposit accounts.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter provides information from publications on topics related to the research problem, it examines what scholars and authors have said about the concept of credit risk management strategies. The chapter covers: Theoretical foundation, credit risk management, factors in credit risk management strategies and the challenges of credit risk management.

2.2 Theoretical Foundation

This study was guided by Resource Based View and Knowledge Based Theory.

2.2.1 Resource Based View

Wernerfelt (1984) provides that resource based view (RBV) essentially argues that any form of sustainable competitive advantage that a firm may develop results from the unique resources endowment of the firm. Sanchez (2004) proposes that an analysis of a firm's internal strengths and weaknesses should address the four questions o the value and rareness of a resource, ease of imitability of a capability and resources, and organizations capability to exploit its resources. The organization determines the value, rareness, imitability to ensure sustainability of resources that are required during the period of strategy implementation process.

The key concept in the RBV framework is the identification of the properties of resources that are necessary in creating a competitive advantage to ensure effective strategy formulation, implementation, growth, sustainability and earn above average profits.

According to Peteraf and Bergen (2003), firm's resources must be heterogeneous. The resource and capability that a firm develops, for its value creation and strategy implementation process must be distinctive and different from the resources used by or available to other firms. Secondly, the heterogeneous resources that make a firm successful must originate in imperfect factor of markets, which means that a competing firm either cannot acquire the distinctive resources that a successful firm possess or must pay such a high price for such a resource or capability to an economic profit.

The distinctive resources that make an organization successful must be imperfectly imitable and substitutable, so that the competing firm cannot imitate or substitute other resources in value creation process. Fourthly, the distinctive resources of a firm must be subject to imperfect mobility, so that the key resources of the firm cannot easily leave the firm and thus remain inside the firm. Barney (2003), RBV approach recognises that the resources inherent in the company's human capital represent one of the principal strategic factors that a firm currently possess, particularly the so called individual competence of employees. The RBV exploit the distinctive competencies at work organization; its resources and capabilities. An organization resource can be divided into tangible, (human, technological, physical and financial) and intangible (brand-name, reputation and knowhow) resources.

2.2.2 Knowledge Based Theory

According to (Alavi and Leidner, 2001) Information technology can play an important role in the knowledge-based theory of the firm since information systems can be used to synthesize, enhance and expedite large-scale intra-firm and inter-firm knowledge management. The knowledge based theory of the firm considers knowledge as the most strategically resource of the firm. This knowledge is embedded and carried through multiple entities including organizational culture and identify, policies, routines, documents, systems and employees. Knowledge based resources builds on the resource based view which was promoted by Penrose (1959) by treating it as a specific resource rather than a general resource as proposed by resource based view.

2.3 Credit Risk Management Strategies

Credit risk management has become part of the overall risk management of any financial institution. Effective management of credit risk contributes towards better profitability. For institutions to be able to manage credit risk, they need to identify the risks they are facing, be in a position to know how much risk exists and the direction of risk trends in the market or industry in which they are operating. The lending function is considered by the banking industry as the most important function for the utilization of funds (Stomper, 2004). Since, banks earn their highest gross profits from loans; the administration of loan portfolios seriously affects the profitability of banks. Indeed, the large number of non-performing loans is the main cause of bank failure. Banks are learning to review their risk portfolios using the criteria laid down by Basel II (Stomper, 2004). Cole and Cumming (1999) indicated that Basel's goal is to induce bankers to improve their risk management capability, including how the institutions price products, reserve for loss, and control their operations (Rehm, 2002). The purpose of Basel II is to reduce a bank's operational risk during the lending process through a better monitoring of the employees in the lending department.

Throughout the contractual relationship between the credit institution and its borrowers, economic developments may bring about changes that have an impact on risk (Stomper, 2004). Banks should monitor their credit exposures continuously to detect such changes in time. In general, this is done by means of so-called periodic and regular checks. Individual exposures are checked at fixed periodic intervals. Many banks integrate these checks in the roll-over of credit exposures which becomes due as periods expire. The key to reducing loan losses and ensuring that capital reserves appropriately reflect the risk profile is to implement an integrated, quantitative credit risk solution. This solution should get banks up and running quickly with simple portfolio measures. It should also accommodate a path to more sophisticated credit risk management measures as needs evolve. The solutions are; better model management that spans the entire modelling life cycle, real-time scoring and limits monitoring, robust stress-testing capabilities and data visualization capabilities and business intelligence tools that get important information into the hands of those who need it, when they need it (McMenamin, 1999).

In order to detect risks already prior to the periodic check to be carried out due to the expiry of a specified term, many banks use early warning systems (Raaij et al, 2005). Based on early warning indicators which have to be defined for each segment, a differentiated review process is triggered. Among other things, these early warning systems take into account defaults with regard to the contractual relationship between bank and borrower. Of great importance here is the insufficient performance of interest and principal repayment obligations (Bessis, 2010). In order to react to these situations, banks set up reminder procedures to inform the debt or of the default. Credit risk is managed through a framework that sets out policies and procedures covering the measurement and management of credit risk. There is a clear segregation of duties between transaction originators in the businesses and approvers in the Risk function. All credit exposure limits are approved within a defined credit approval authority framework. The bank manages its credit exposures following the principle of diversification across products, geographies, and client and customer segments.

2.4 Effects of Credit Strategies on Firm Performance

The main purpose of credit strategies is to meet customers' needs and this is achieved when all departments in firms, are co-ordinating efforts and working in harmony. Firms with well-conceived and effective strategic activities will facilitate the achievement of typical organizational objectives such as higher sales, market share, profits and competitive advantage. Okoroafo and Russow (1993) discovered that marketing strategy is an important contributor to performance in economic reform economies. Many businesses will adopt a new attitude to marketing in transition environments, formulating strategies which demonstrate a focus on customers. Thus for firms to be competitive in such environments, it is essential to conduct effective product, pricing, promotion and distribution activities, where customers are central to all marketing efforts and to the extent that these strategies are successfully implemented, they are expected to result in improved performance.

In addition to a market penetration, organizations need competitive strategies to help focus their efforts. Day (1990) stated that competitive strategy specifies how a business intends to compete in the markets it chooses to serve. This strategy provides the conceptual glue that gives shared meaning to all the separate functional activities and programs. A well-developed strategy in firms, therefore, serves to coordinate the competitive actions of the firm. For the market –driven firm, creating superior customer value is the objective of strategy formulation and implementation. To do this, customer value-based differentiation strategies will drive the firm's market research efforts, its selection of target-markets, its product development processes, and its market communications programs (Day, 2004).

The competitive-force perspective argues that competitive advantage lies in a firm's correct positioning in a market. The sustainability of the competitive advantage that stems from such a position critically depends on the relative influence of the environmental forces that the firm encounters (Porter, 1980). Lumpin and Dess (1996), firms with strategies are willing to act proactively relative to environmental opportunities, be aggressive toward competitors, take risks and utilize their limited resources better. Availability of resources allows firms to experiment with proactive, risky and aggressive strategies that might not be approved in a resource-constrained environment, by doing things better, more efficient and more effective than rival firms is therefore a major component in gaining competitive advantage. A unique configuration of the capabilities will strengthen its source of competitive advantage and will often raise the barrier for rival companies to imitate the activity system.

For organizations to achieve superior competitive advantage in all its credit applications, they must provide customers with products and services with superior value in comparison with its competitors. If a company does not have or cannot obtain the necessary resources to take advantage of opportunities, gaining competitive advantage is unrealizable. Companies must therefore keep the strengths and weaknesses of their business system in mind; however, it should not limit the potential of the opportunities. Slater (2012) noted that firms pursue cost reduction in order to achieve competitive advantage as it will contribute to process improvement through cost reductions and increased performance of the organization.

2.5 Challenges of Credit Risk Management

The execution of the credit review is based on external and internal data on the credit applicant (Raaij et al, 2005). Especially for extensive exposures, considerable resources may be tied up in the process of collecting the data, checking the data for completeness and plausibility, and passing on the data to people in charge of handling, analyzing, and processing the exposure within the bank. These steps can also lead to a large number of procedural errors. Since the data included form the basis for the credit review, errors in collecting, aggregating, and passing them on are especially relevant also from a risk perspective (Bessis 2010).

Further, risk is essentially an endogenous variable because strategic managers tend to assume, both explicitly and implicitly, that it is a variable that can be managed. The nature of risk is itself primarily dependent on the industry characteristics and the strategy pursued (Bettis, 2009). All human actions entail some risks. Also, there will always be risks associated with mitigation strategy developments and maintenance (Jappelli, 2006). The pervasiveness and complexity of credit risk presents strong challenges to managers, one of the most important being lack of efficient determination of credit worthiness of a potential customer. This, therefore, means establishing mechanisms of insulating the company's value against huge defaults (Bowman, 1982). Kenyan banking industry advances credit to people of different categories including low-cadre earners and self-employed individuals whose default risks are very high yet the banks cannot be pushed out of the niche. In addition, the business environment has become too competitive to the extent of not letting go any quality of clientele. This implies that the banks are subject to a heightened credit risk levels as opposed to other economies with higher-income earning potentials.

Before a credit exposure is subjected to a comprehensive credit review, the employee initially charge should conduct a plausibility check and preliminary review (Bol, 2003). This check should look at the completeness and consistency of the documents filed by the borrower to minimize any process loops and the need for further inquiries with the customer. In addition, the sales department should carry out an initial substantive check based on a select few relevant criteria. The objectives include the creation of awareness and active assumption of responsibility for credit risk on the part of the sales department (Raaij et al, 2005). The preliminary check is especially significant in segments with high rejection rates, as a comprehensive credit review ties up considerable resources in these segments. The high rejection rates are a big challenge to banks because of tying up capacities in risk analysis.

The quality of the credit appraisal process from a risk perspective is determined by the best possible identification and evaluation of the credit risk resulting from a possible exposure (Bettis, 2009). This evaluation has to take into account various characteristics of the borrower (natural or legal person), which should lead to a differentiation of the credit appraisal processes in accordance with the borrowers served by the financial institution (Knight, 1994). Hence it is important to address the viability of the underlying business model because in addition to the understanding and analysis of the information about capacity and condition, it is also necessary to determine whether any future changes will affect the financial situation and the loan repaying ability of an enterprise which if not done possess a challenge to the bank.

The valuation of the collateral provided by the credit applicant is an essential element in the credit approval process and thus has an impact on the overall assessment of the credit risk involved in a possible exposure (Holton, 2004). The main feature of a collateralized credit is not only the borrower's personal credit standing, which basically determines the probability of default (PD), but the collateral which the lender can realize in case the customer defaults and which thus determines the bank's loss. Via the risk component of loss given default (LGD) and other requirements concerning credit risk mitigation techniques, the value of the collateral is included in calculating the capital requirement under Basel II (Kamp, Pfingsten and Porath, 2005).

Interest rate is also a challenge facing credit risk management. One factor that influences the level of interest rates in the banking industry is the actions of the Central Bank. In trying to avoid massive swings in the business cycle, the Central Bank of Kenya will adjust short-term interest rates. It raises interest rates to slow down an economy that is expanding too rapidly and lowers them when the economy is heading for a recession (Holton, 2004). Rising and falling interest rates will directly affect consumer and personal financial decisions. Rising interest rates make saving relatively more attractive and borrowing relatively more expensive. The level of interest rates has a direct effect on a consumer's ability to repay a loan. For example, Bessis (1999), assert that when interest rates are low, people are willing to borrow because they find it relatively easy to repay their debt. When interest rates are high, people are reluctant to borrow because repayments on loans cost more. Some consumers may even find it difficult to meet their existing loan repayments, especially if interest rates increase faster than the rise in a consumer's income. If interest rates rise sharply and stay high for a long period, some consumers will default on their loans.

2.6 Summary of Empirical Review and Gaps

Research-based on credit risk management differ in many respects. From the review done in this study, Owusu (2008) studied credit practices in rural banks in Ghana and found that the appraisal of credit application did not adequately assess the inherent credit risk to guide the taking of appropriate decisions. Another research on credit risk management includes a research done on evaluating credit risk exposure in agriculture (Lyubov, 2003). The framework is identified for modelling credit risk in agriculture and adapts to loan portfolio management only. This does not adequately consider other factors affecting credit risk like fraud, money laundering etc. Silikhe (2008) studied credit risk management in microfinance institutions in Kenya and found that despite the fact that microfinance institutions have put in place very strict measures to manage credit risk; loan recovery is still a challenge to majority of institutions. In summary, most of the prior researches on credit risk management have not focused on strategies to manage credit risk hence the need for this research.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter presents the research methodology that was used to carry out the study, what informed the selection of the research design, data collection and data analysis.

3.2 Research Design

The research was conducted through a case study. Babbie (2004) defines a case study as an in- depth examination of a single instance of some social phenomenon. In this case the phenomenon that was studied was standard chartered bank, Kenya. One of the main advantages of a case study was that it provided a good understanding of a certain phenomenon.

Therefore a case study is a reliable instrument to inquire a certain phenomenon. It put more emphasis on full contextual analysis of fewer events or conditions and their interrelation. It was aimed at getting detailed information and understanding of strategies employed by standard chartered bank, Kenya in managing credit risk.

3.3 Data Collection

Primary data was collected through an interview guide that had broad open ended questions. The interview guide was preferred over other methods of collecting data because of their capability to extract information from the respondents as well as giving the researcher a better understanding and more insightful interpretation of the results from the study. The interviewees in this study were ten heads of credit risk department in standard chartered bank, Kenya since the topic under consideration relates to credit risk management strategies adopted by standard chartered bank, Kenya and the ten heads were managers who had been in the bank for more than five years and they understood the banks policies and procedures quite well. The reason for choosing few interviewees was to make it easier to get adequate and accurate information necessary for the research.

3.4 Data Analysis

The data obtained from the interview guide was analysed using content analysis. Content analysis is the systematic qualitative description of the composition of the objects or materials of the study (Hsieh and Shannon, 2005). It involves observation and detailed description of objects, items or things that comprise the object of study. Content analysis, as a class of methods at the intersection of the qualitative and quantitative traditions, is used for rigorous exploration of many important but difficult to study issues of interest to management research.

This approach was more appropriate for the study because it allowed for deep sense, detailed account in changing conditions. Thus the qualitative method was suitable for this research because this research was conducted within the environment where the credit risk management strategies are applied and the impact of the same felt.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

4.1. Introduction

This chapter reports the data analysis and interpretation of the results. The focus was on analyzing the data collected from all the respondents in the organization and giving a clear interpretation of the results. The focus of the study was to determine the credit risk management strategies and performance of Standard Chartered Bank. Data was collected by use of an interview guide which contained open ended questions that aided in gathering of as much data.

4.2 Response rate

A total of one ten (10) questionnaires had been distributed to the Standard Chartered Bank, out of which eight (8) were completed and returned. This gave a response rate of 80%. According to Mugenda and Mugenda (2003) a response rate of 50% is adequate for a study, 60% is good and 70% and above is excellent. Thus, a response rate of 80% was fit and reliable for the study.

4.3 Credit Risk Management Strategies

The study sought to establish the credit risk management strategies used by Standard Chartered Bank to control credit risk. The study established that the strategies were appropriate credit risk environment; sound credit granting process; appropriate credit administration, measurement and monitoring process; and adequate controls over credit risk. This credit risk management strategies contributes towards better profitability.

4.3.1 Appropriate Credit Risk Environment

The respondents indicated that the board of directors has the responsibility for approving and periodically reviewing the credit risk strategy and significant credit risk policies of the bank. The strategy has to reflect the bank's tolerance for risk and the level of profitability the bank expects to achieve for incurring various credit risks. Senior management has the responsibility for implementing the credit risk strategy approved by the board of directors and for developing policies and procedures for identifying, measuring, monitoring and controlling credit risk. Such policies and procedures have to address credit risk in all of the bank's activities and at both the individual credit and portfolio levels.

4.3.2. Sound Credit Granting Process

The study established that the bank operates within sound, well-defined credit-granting criteria. These criteria include a clear indication of the bank's target market and a thorough understanding of the borrower or counterparty, as well as the purpose and structure of the credit, and its source of repayment. The bank has established overall credit limits at the level of individual borrowers and counterparties, and groups of connected counterparties that aggregate in comparable and meaningful manner different types of exposures, both in the banking and trading book and on and off the balance sheet.

4.3.3. Appropriate Credit Administration, Measurement and Monitoring Process

The respondents indicated that the bank has a system for the ongoing administration of their various credit risk-bearing portfolios. The bank has a system for monitoring the condition of individual credits, including determining the adequacy of provisions and reserves. The bank has developed and utilizes an internal risk rating system in managing credit risk. The rating system is consistent with the nature, size and complexity of a bank's activities. The respondents also indicated that the bank has information systems and analytical techniques that enable management to measure the credit risk inherent in all on- and off-balance sheet activities.

4.3.4. Adequate Controls over Credit Risk

The respondents indicated that the bank has the authority to grant credit, the bank has an efficient internal review and reporting system in order to manage effectively the bank's various portfolios. These systems provide the board of directors and senior management with sufficient information to evaluate the performance of account officers and the condition of the credit portfolio. Internal credit reviews conducted by individuals independent from the business function provide an important assessment of individual credits and the overall quality of the credit portfolio. Such a credit review function can help evaluate the overall credit administration process, determine the accuracy of internal risk ratings and judge whether the account officer is properly monitoring individual credits.

4.3.5. Assessment of Credit risk

The respondents were requested to indicate how the bank assesses/ measures credit risk. The respondents indicated that the assessment methods included the risk assessment and approval procedures, which use both qualitative and quantitative methods in establishing a borrower's needs, which involves that the appropriate information about a credit approval is placed at the disposal of a customer. It also ensures that credit limits are not breached, covenants are respected, collaterals are perfected, risk ratings are monitored, credit reports are generated for management's attention, review, rescheduling or refinancing of credit after beneficiaries have submitted relevant documents, risk control procedures which ensures that the bank is able to control any risk which might result from credit.

The respondents further stated that the policies and practices of credit risk management applied by standard chartered bank were evaluated by looking at the available credit risk management strategies of the bank. This established whether these strategies available are appropriate enough to achieve the necessary objectives. On the financial capacity the measures that were utilized included asset utilization/efficiency ratios, deposit mobilization, loan performance, liquidity ratio, leverage/financial efficiency ratios, profitability ratios, solvency ratios and coverage ratios to evaluate the bank's financial performance.

4.3.6. Review and Control of Credit Risk

The respondents were requested to indicate how the bank controls its credit. They indicated that the bank uses risk avoidance which involves actions to reduce the chances of particular losses from standard banking activity by eliminating risks that are superfluous to the institution's business purpose. Common risk avoidance practices here include the standardization of process, contracts and procedures to prevent inefficient or incorrect financial decisions is the first of these. Standard chartered uses the processes of construction of portfolios that benefit from diversification across borrowers and that reduce the effects of any one loss experience are another. In each case the goal is to rid the bank of risks that are not essential to the financial service provided, or to absorb only an optimal quantity of a particular kind of risk.

The respondents indicated that the bank has been able to control credit risk by establishing a system of independent, on-going assessment of the bank's credit risk management processes and the results of such reviews have been communicated directly to the board of directors and senior management. Also the respondents indicated that the bank has established and enforced internal controls and other practices to ensure that exceptions to policies, procedures and limits are reported in a timely manner to the appropriate level of management for action.

The respondents further indicated that the bank reviews its credit by hiring a number of credit risk officers who have the experience, knowledge and background to exercise prudent judgement in assessing, approving and managing credit risks to assist those members who do not have experience in credit risk management. Individual members are given the responsibility of monitoring credit quality; including ensuring that relevant information is passed to those responsible for assigning internal risk ratings to the credit. In addition, individuals are made responsible for monitoring on an on-going basis any underlying collateral and guarantees.

4.3.7. Credit Risk Strategies and Performance of Standard Chartered Bank, Kenya

The respondents were requested to indicate how credit strategies impacts on performance of Standard Chartered Bank. The respondents indicated that the bank provided customers with products and credit services which were more superior to the ones being provided by its close competitors. This increases sales, market share, profits and competitive advantage. The respondents also stated that the bank avoided bad debts by not lending money to credit defaulters. This ensures that the bank does not lose money to its customers. This also contributes to increased efficiency and the overall performance of the bank.

4.4. Discussion

The study found that the strategies used by standard chartered bank to control credit risk were appropriate credit risk environment; sound credit granting process; appropriate credit administration, measurement and monitoring process; and adequate controls over credit risk. This credit risk management strategies contributes towards better profitability. This concurs with a study by Stomper, (2004) who asserted that effective management of credit risk contributes towards better profitability. For institutions to be able to manage credit risk, they need to identify the risks they are facing, be in a position to know how much risk exists and the direction of risk trends in the market or industry in which they are operating.

The study also established that assessment methods included the risk assessment and approval procedures, which use both qualitative and quantitative methods in establishing a borrower's needs, which involves that the appropriate information about a credit approval is placed at the disposal of a customer. It also ensures that credit limits are not breached, covenants are respected, collaterals are perfected, risk ratings are monitored, credit reports are generated for management's attention, review, rescheduling or refinancing of credit after beneficiaries have submitted relevant documents, risk control procedures which ensures that the bank is able to control any risk which might result from credit. This agrees with a study done by McMenamin, (1999) who stated that banks should monitor their credit exposures continuously to detect such changes in time. In general, this is done by means of so-called periodic and regular checks. Individual exposures are checked at fixed periodic intervals. Many banks integrate these checks in the roll-over of credit exposures which becomes due as periods expire.

Finally the study established that Standard Chartered Bank reviews and controls credit by the use risk avoidance which involves actions to reduce the chances of particular losses from standard banking activity by eliminating risks that are superfluous to the institution's business purpose. Common risk avoidance practices here include the standardization of process, contracts and procedures to prevent inefficient or incorrect financial decisions is the first of these. Standard chartered uses the processes of construction of portfolios that benefit from diversification across borrowers and that reduce the effects of any one loss experience are another. In each case the goal is to rid the bank of risks that are not essential to the financial service provided, or to absorb only an optimal quantity of a particular kind of risk. This is in agreement with a study by Bessis, (2010) who argues that banks set up portfolios to manage credit risk. Credit risk is managed through a framework that sets out policies and procedures covering the measurement and management of credit risk.

The study found that the bank reviews its credit by hiring a number of credit risk officers who have the experience, knowledge and background to exercise prudent judgement in assessing, approving and managing credit risks to assist those members who do not have experience in credit risk management. Individual members are given the responsibility of monitoring credit quality; including ensuring that relevant information is passed to those responsible for assigning internal risk ratings to the credit. In addition, individuals are made responsible for monitoring on an on-going basis any underlying collateral and guarantees. This concurs with a study done by stomper (2004) who asserted that banks should monitor their credit exposures continuously to detect such changes in time. In general, this is done by means of so-called periodic and regular checks. Individual exposures are checked at fixed periodic intervals.

The study found that the bank provided customers with products and credit services which were more superior to the ones being provided by its close competitors. This would increase sales, market share, profits and competitive advantage. The respondents also stated that the bank avoided bad debts by not lending money to credit defaulters. This ensures that the bank does not lose money to its customers. This also contributed to increased efficiency and the overall performance of the bank. Lumpin and Dess (1996), asserts that firms with strategies are willing to act proactively relative to environmental opportunities, be aggressive toward competitors, take risks and utilize their limited resources better.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Introduction

This section provides the summary of findings, conclusions and recommendations of the study. It further provides a recommendation on the areas for further studies.

5.2 Summary of Findings

The study established that the strategies used by standard chartered bank to control credit risk. The study established that the strategies were appropriate credit risk environment; sound credit granting process; appropriate credit administration, measurement and monitoring process; and adequate controls over credit risk. This credit risk management strategies contributes towards better profitability.

The study also established that that the assessment methods included the risk assessment and approval procedures, which use both qualitative and quantitative methods in establishing a borrower's needs, which involves that the appropriate information about a credit approval is placed at the disposal of a customer. It also ensures that credit limits are not breached, covenants are respected, collaterals are perfected, risk ratings are monitored, credit reports are generated for management's attention, review, rescheduling or refinancing of credit after beneficiaries have submitted relevant documents, risk control procedures which ensures that the bank is able to control any risk which might result from credit.

The study also established that Standard Chartered Bank review and controls credit risk by using risk avoidance which involves actions to reduce the chances of particular losses from standard banking activity by eliminating risks that are superfluous to the institution's business purpose. Common risk avoidance practices here include the standardization of process, contracts and procedures to prevent inefficient or incorrect financial decisions is the first of these. Standard chartered uses the processes of construction of portfolios that benefit from diversification across borrowers and that reduce the effects of any one loss experience are another. In addition, the study found that the implementation of incentive-compatible contracts with the institution's management which require that employees be held in case of occurrence of a risk. In each case the goal is to rid the bank of risks that are not essential to the financial service provided, or to absorb only an optimal quantity of a particular kind of risk.

The study established that the bank reviews its credit by hiring a number of credit risk officers who have the experience, knowledge and background to exercise prudent judgement in assessing, approving and managing credit risks to assist those members who do not have experience in credit risk management. Individual members are given the responsibility of monitoring credit quality; including ensuring that relevant information is passed to those responsible for assigning internal risk ratings to the credit. In addition, individuals are made responsible for monitoring on an on-going basis any underlying collateral and guarantees.

Finally the study found that the bank provided customers with products and credit services which were more superior to the ones being provided by its close competitors. This would increase sales, market share, profits and competitive advantage. The respondents also stated that the bank avoided bad debts by not lending money to credit defaulters. This ensured that the bank did not lose money to its customers. This also contributed to increased efficiency and the overall performance of the bank.

5.3 Conclusion of the Study

First the study concluded that senior management has the responsibility for implementing the credit risk strategy approved by the board of directors and for developing policies and procedures for identifying, measuring, monitoring and controlling credit risk. Secondly the study concluded that bank has to establish overall credit limits at the level of individual borrowers and counterparties, and groups of connected counterparties that aggregate in comparable and meaningful manner different types of exposures, both in the banking and trading book and on and off the balance sheet.

Third the study concluded that credit reviews conducted by individuals independent from the business function provide an important assessment of individual credits and the overall quality of the credit portfolio. Finally the study concluded that the policies and practices of credit risk management applied by standard chartered bank were be evaluated by looking at the available credit risk management strategies of the bank.

5.4 Recommendation

The government should strengthen the securities market which will have positive impact on the overall development of the banking sector by increasing competitiveness in the financial sector. The bank should ensure that credit officers perform periodic follow-ups on borrowers to ensure that loans are used for the intended purpose. There should be development of a strategic plan process to ensure appropriate focus on both the pre- and post-implementation challenges of credit management strategies and should build customers trust and gain their commitment to the core values and objectives of the bank.

5.5. Limitations of the Study

The findings of this study are only directly applicable to Standard Chartered Bank in Kenya hence may not be directly applicable to any other bank since the management may be different. It is also important to note that the relevance of this information is limited to the duration within which the study was carried out. Changes are bound to occur that may transform the way activities are carried out in the bank thus making significant changes in future.

5.6. Suggestion for Further Research

The researcher conducted a study of the Standard Chartered Bank only and therefore recommends that for a more generalized conclusion to be made to improve the current credit risk management strategies and how they impact on performance. Repeat studies, will also offer a distinct advantage as they enable us to capture the net effect changes. By repeating the survey at a different time and asking fairly similar questions, it enables us to collect information that can easily be compared.

5.7 Implication for Policy and Practice

In light of the results presented above, the implication on policy and practice is that managers and investors should take advantage of the effectiveness of credit risk practices in development of management policies in banks credit risk management strategies.

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APPENDIX I: INTERVIEW GUIDE

1. What policies has the bank put in place to measure performance, monitor and control credit risk?
2. What credit risk management strategies does the bank use to control credit risk and monitor its performance?
3. What are the defined business processes that the bank employs to manage credit risk and how often are they reviewed. Do you feel they work for the bank in managing credit risk and improving the bank performance or they need to be looked into?
4. What working analysis does the bank employ in its assessment of credit? Do the approvers have sufficient knowledge on credit risk management and they don't expose the bank to credit risk and is the same reflected on the bank's performance?
5. In generating credit risk strategies, has the bank been successful in the same in forms of centralization, standardization and timeliness of generating the same?
6. When the bank comes up with new strategies to manage credit do all of the members involved to implement the strategies get the necessary support in all ways e.g. policy support, motivation and ownership, financial capacity etc.?
7. How would you rate the banks current practices as they relate to the ongoing assessment of strategic initiatives if any, how would you measure performance of the strategies and are you able to identify corrective action where necessary?

8. What challenges does the bank face in credit risk management and performance and what measures has been put in place to mitigate the challenges?
9. Is the performance of the bank linked to the credit risk management strategies that the bank formulates?
10. How do you evaluate the banks performance with regard to its policies, practices and financial capacity?
11. What performance challenges is the bank facing and what measures have been put in place to cushion such challenges?