THE FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN KENYA:
A CASE STUDY OF STANDARD CHARTERED BANK

BY

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DECLARATION

I, the undersigned, declare that this is my original work and has not been submitted to any other college, institution or university other than the United States International University in Nairobi for academic credit.

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Date: 07/10/03

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

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Finally, I wish to thank all the respondents and especially Mr. Mwalimu and Mr. Kitenge.
DEDICATION

This project is dedicated to my loving parents whose prayers, love and support has sustained me throughout my life.
ABSTRACT

The objective of this study was to establish how Standard Chartered Bank (SCB) continued to register high profits in a time of economic recession. Specifically the study set out to:

1. Assess Standard Chartered bank's lending and investment policy
2. Establish the factors that contribute to profitability at SCB
3. Find out how the SCB bank manages its cost and bad debts.

The study was a case study of Standard Chartered Bank. It relied mainly on secondary and primary data. The study was an explorative case study. Secondary data was collected from the Standard Chartered Bank's audited Financial Statement as presented in the Bank's financial reports and from the Central Bank of Kenya publications. Primary data was collected from three branches of the Standard Chartered Bank and the head office Finance section. The researcher interviewed the branch credit managers and the branch managers of each of the three branches chosen and the head of finance in the bank head office. Descriptive statistics in the form of frequencies and graphs were used to analyse secondary data. Microsoft Excel was used as a tool to analyse the information. Primary data was analysed using content analysis. Content analysis involves identifying coherent and important themes and patterns and pulling together all the data that address a particular research question. Primary results were presented in form of frequency tables.

The major findings from the study were that SCB has a strong Lending Policy that guides towards prudent lending and that SCB relied on investing in Government Securities as
opposed to Lending to the public due to guaranteed high returns and Government Securities were also risk free.

Secondly, restructuring, technology, wise investment and prudent lending were the key factors that lend to the improved profitability. In 1993, SCB became the first bank in Kenya to embark on a restructuring programme. This gave the bank a greater share in the market, as it became the leader in terms of technology. This act also improved the banks clientele, deposit and hence the profitability. As the other banks try to catch up SCB is already reaping the benefits. The strong strategic team of managers also continue to lead the bank into making strategic decisions, especially on investment and this has served as a competitive factor.

Finally the study found out that the major cost component for SCB was the Staff cost which increased during the period under review due to the on going restructuring process. SCB also mainly outsource the non-core products. SCB formed a special unit to address the bad debts.

The major recommendations from the study are that, SCB should focus on a more customer friendly policy and be more aggressive in innovation. SCB should invest more and more on technology and innovations thereby differentiating its products offering from those of its competitors because the competitors are quick to copy the technology. Further the bank should speed up restructuring process in order to reduce staff costs. Staff
costs form a major component of the bank's expenses and were found to have been increasing during the period under review.
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<td>Description</td>
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<tr>
<td>SCB</td>
<td>Standard Chartered Bank (K) Ltd</td>
</tr>
<tr>
<td>BBK</td>
<td>Barclays Bank (K) Ltd</td>
</tr>
<tr>
<td>NBK</td>
<td>National Bank Of Kenya Ltd</td>
</tr>
<tr>
<td>CBK</td>
<td>Central Bank Of Kenya Ltd</td>
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<tr>
<td>KCB</td>
<td>Kenya Commercial Bank (K) Ltd</td>
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<tr>
<td>CPC</td>
<td>Credit Policy Committee</td>
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<tr>
<td>ALCO</td>
<td>Asset - Liability Management</td>
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<tr>
<td>AMC</td>
<td>Asset Management Corporation</td>
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<tr>
<td>CRM</td>
<td>Customer Relationship Management</td>
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<tr>
<td>BPO</td>
<td>Business Process Outsourcing</td>
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<tr>
<td>CEO</td>
<td>Chief Executive Officer</td>
</tr>
<tr>
<td>ATM</td>
<td>Automated Teller Machine</td>
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<td>IT</td>
<td>Information Technology</td>
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CHAPTER ONE

1.0 INTRODUCTION

1.1 Background of the Study

Banking institutions hold a unique position in the economy as custodians of the bulk of the nation's deposit, the primary allocators of credit and managers of the country's payment system, (Batavia, 1999). The primary role of the banking sector is to mobilize funds from savers and to channel them to borrowers to finance their productive investments. Banks are key to the progress of any economy, principally because they act as intermediaries between depositors and borrowers (Heferman, 1996). Banking system is important in regulating the flow of money and credit in order to achieve a balanced and orderly development of the economy and to maintain the stability of the currency. Banks are institutions that traditionally provide deposit and loan products. By paying out money on demand or after some notice, banks are in the business of managing the liabilities and creating bank assets. These assets are financed by claims in the form of deposits or other liabilities and shareholders fund. (Mutuota, 2000). Kimura (1990) observes that the Kenyan banking system is very diverse in terms of institution's sizes and structure. At the end of July 2002, the banking system comprised 46 commercial banks, 3 non-financial institutions, 2 mortgage finance companies, 4 building societies and 48 forex bureaus (CBK, 1999).

1.1.1 A Brief History of Banks in Kenya

The first commercial bank in Kenya was the National bank of India established in 1896, followed by standard bank of South Africa in 1916. The former merged with the Anglo-
Egyptian Bank in 1926 to form the 3 Barclays Bank (Dominion, colonial and overseas) the predecessor to one of the largest banks in Kenya. The Banking sector recorded no significant changes until the 1950s when several continental and foreign banks emerged (Kimura, 1990). Until independence in 1963, most of the commercial banks operating in the country were either foreign owned or foreign controlled. This prompted the establishment of the co-operative Bank of Kenya in 1965 and the National Bank of Kenya in 1968 to look after the co-operative and national interest respectively. The foreign banks dominated the banking business through most of the 1970’s although the three locally owned commercial banks (Co-operative, National and Commercial bank of Kenya) had branches in various parts of the country. By 1972, there were twelve Commercial banks operating in Kenya but three of them, Barclays Bank, Standard Bank and Kenya Commercial Bank controlled most of the business in terms of branch network deposit and advances. Following the coffee boom era of 1976-77, Kenyans started investing in banking industry by registering non-bank financial institutions, (CBK, 2002).

Mbugua (1999) contends that currently the Kenyan banking system is troubled. An estimated 41 percent of loans are non-performing, with most of these loans held by state-controlled banks. Two state-controlled banks (Kenya Commercial Bank and National Bank of Kenya) dominate the banking sector along with two international banks (Barclays and Standard Chartered). Citing the U.S. Department of State, Mbugua argues that a significant number of Kenyan banks are struggling, including the National Bank of Kenya, which had to be bailed out by the government in 1999. Mutuota (2000), argues that the banking problems in Kenya are the result of poor bank management, inadequate government supervision, political pressure to make loans that are rarely paid, and current economic conditions. Interest rates
are very high on average due to high risk in repayment and collecting collateral. Efforts to resurrect legislation to cap interest rates on loans and put a minimum interest rate on savings failed in April 2002. Citing Nyaga (2001), Ochieng (2001) argues that Banks appear to be moving away from traditional activities (loans and advances), to offering non-banking financial services such as credit card, investment services and so on. According to Ochieng, the concern is that commercial banks have sharply reduced lending to the private sector and increased their demand for Treasury bills.

Mbogua (1999) contends that the enhancement of disclosure and provisioning requirements exposed some of the irregularities that were going on in the banking industry. Tales of improper lending practices, insider lending and mismanagement championed by the state controlled banks and the so-called political banks begun to emerge. The consequence was a high level of non-performing loans. A number of banks have had to be closed down. Presently, the banks are sorting out some of their own in-house problems, mainly the huge portfolio of non-performing loans and operational inefficiencies. Among the big banks, National Bank is still in the wood while Kenya Commercial Bank is showing signs of a remarkable recovery. The early starters like Standard Chartered and Barclays Banks are already enjoying the fruits of their labour argues Mbogua. Citing Nyaga (2001), Ochieng (2001) asserts that it is the availability of credit that enhances growth. Denial to the productive economic activities adversely affects the overall performance of the economy. However, since 1999, banks have become excessively risk averse, loans and advances, which are mostly extended, to the private sector fell from KShs. 220 billion in 1999 to KShs. 219 billion in September 2001.
1.2 Statement of the Problem

The period between 1999 and 2002 in Kenya was characterized by poor performance of the economy (CBK, 2002). Even as other sectors continued declining, Standard Chartered Bank (SCB) appears to have registered a steady growth in its profit year after year. However, Standard Chartered’s key competitors Barclays Bank of Kenya, Kenya Commercial Bank (KCB) and National Bank of Kenya (NBK) did not experience the steady growth in profitability.

1.2.1 Growth in net Profit of major Banks in Kenya

Table 1 shows growth in profitability of four major banks in Kenya. The figures are presented in billions of Kenya shillings (Audited annual Financial Statement of SCB, BBK, KCB, NBK for the period 1999-2002).

<table>
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<tr>
<td></td>
<td>1999</td>
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<td></td>
<td>Kshs in Billions</td>
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<tr>
<td>SCB</td>
<td>1.737</td>
</tr>
<tr>
<td>BBK</td>
<td>2.715</td>
</tr>
<tr>
<td>KCB</td>
<td>(2.244)</td>
</tr>
<tr>
<td>NBK</td>
<td>(2.412)</td>
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Table 1 shows that SCB was the only Bank that registered a continuous growth in profits each year from 1999 to 2002. SCB registered a percentage growth of at least 25% each year.

During the year 2000 Barclays bank (BBK) realised a net profit of KShs. 2.068 billion down from KShs. 2.715 billion in 1999. However, the net profit of the year 2001 rose to KShs. 2.955 billion but it fell again to KShs. 1.783 billion in the year 2002. KCB on the other hand
in the year 2000, registered an after tax loss of KShs. 0.765 billion but in the year 2001 KCB posted an after tax profit of KShs. 0.369 billion. However in the year 2002 the bank realized an after tax loss of KShs. 4.132 billion. NBK on the other side only registered losses during the years 1999-2002. They posted an after tax loss of KShs. 2.412 billion in the year 1999, KShs. 2.634 billion in the year 2000, KShs. 0.298 billion in the year 2001 and during the year 2002 NBK posted an after tax loss of KShs. 0.198 billion.

Batavia (1999) documented the performance of the banking sector with respect to growth. Mutuota (2000) documented the performance of banks with respect to assessing whether big banks have better performance than their smaller counterparts. This study will concentrate on the performance of Standard Chartered Bank in respect to profitability. The study intended to find out why Standard Chartered Bank appeared to be making high profits while other sectors were in recession.

1.3 Objectives of the study

1.3.1 General Objectives

The main objective of this study was to investigate why Standard Chartered Bank registered a high growth in profitability during the years 1999 to 2002 when the Kenyan economy was in recession.

1.3.2 Specific Objectives

Specifically the study set out to:

1. Assess Standard Chartered Banks lending and investment policy

2. Establish the factors that contribute to the profitability of Standard Chartered Bank
3. Find out how Standard Chartered Bank manages its costs and bad debts

1.4 Importance of the Study

This study will be of benefit to many. First the Standard Chartered Bank itself. The study will highlight the bank’s major weaknesses and strengths and also give recommendations, which might help the decision-makers in drafting successful strategies that will improve the performance of the bank. The policy makers will also be able to formulate policies through the use of the information gathered and all the institutions in the sector may use those policies. The future researchers can use the study for their literature review and for further research that can help banks. The general public can apply the revealed tips in their business and they will also get to know more about their bank.

1.5 Scope of the Study

The study was carried out on one bank i.e. Standard Chartered Bank of Kenya Ltd. The bank was chosen because according to the CBK publications SCB was the only bank that maintained high growth in profits during the time of the economic recession. The study targeted the Credit managers and the Branch Managers of the SCB’s Nairobi branches. The study was limited to four years (1999-2000).

1.6 Definition of terms

Non-funded incomes: This is other income sources apart from the incomes derived from the interest on loans and other advances. They include the fees and commission charged by the banks (Hanson, 1998).
Non-financial institutions: These are the institutions that receive deposit and advance loans but unlike commercial banks they are not members of the clearing house (Hanson, 1998).

Funded income: This is the income derived from the interest on loans and other advances (Hanson, 1998).

Deposit plus: This is an overdraft or loan facility secured by cash held either in savings or fixed deposit accounts (Hanson, 1998).

Credit: It is the delivery of money, goods or services today in exchange for promise to pay in the future (Hanson, 1998).

Unsecured loans: It is defined as a loan whereby no collateral is attached. It is usually advanced to the salaried people (Hanson, 1998).

Secured loans: It is the loan whereby properties or other collaterals are attached before a loan is advanced (Hanson, 1998).

Assets: This include loans and advances to customers, cash and balances with central bank of Kenya, government securities, deposits and balances due from banking institutions, interest receivable, goodwill, and property and equipment (Barclays Bank Annual review and Financial statement, 2001).

Liabilities: This include the customer deposits, deposits and balances due to banking institutions, administered funds, interest payable and other liabilities and amount due to group companies (Barclays Bank Annual review and Financial statement, 2001)

Personal loans: These are the loans given to the salaried people (CBK, 2002).

Credit risk or default risk: involves inability or unwillingness of a customer or counterparty to meet commitments in relation to lending, trading, hedging, settlement and other financial transactions. The Credit Risk is generally made up of transaction risk or default risk and portfolio risk (Eppie, 2000).
Counterparty risk: The counterparty risk is the risk that arises from non-performance of the trading partners. The non-performance may arise from counterparty's refusal/inability to perform due to adverse price movements or from external constraints that were not anticipated by the principal. The counterparty risk is generally viewed as a transient financial risk associated with trading rather than standard credit risk (Eppie 2000).

Foreign cheque negotiation facility: This is a facility that provides immediate credit for foreign currency (CBK, 2002).

Performance: Performance is the ability to sustain income, stability and growth. It is a measurement of relative investment and can be relative to one of the following factors: Assets, capital adequacy, liquidity, number of employees and other size measures (Walter, 1968).

1.7 Chapter Summary
Chapter one highlights the emergence of banking sector in Kenya, discussing the importance of banking sector in the economy and the shortfalls all alike. The study aimed at finding out why Standard Chartered Bank appears to have registered a steady growth in its profits during the period of economic recession. The primary role of the banks which is lending has been neglected and banks are moving away to offering non bank financial services such as credit cards investment services and so on. The two major international banks Standard Chartered and Barclays were the early starters in sorting out the portfolio of the bad debts and are now enjoying the fruits of their labour. The history of the commercial banks in Kenya is briefly covered. Further the chapter covers the statement of the problem, importance of the study and the definition of terms.
CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Introduction

This chapter examines the previous studies on the banks lending policy, investment, cost and the bad debt management. It highlights factors that contribute in bank's better performance and hence profitability.

2.2 Profitability Analysis

This is the most common measure of financial performance Walter, (1998). The measures are used to assess how well management is investing the firm’s total capital and raising funds. Profitability is generally the most important to the firm’s shareholders. Profits serve as cushion against adverse conditions such as losses on loans, or losses caused by unexpected changes in interest rates. Consequently, creditors and regulators concerned about failure also look at profit to protect their interests although the measures ignore firm’s risk.

Profit depends on three primary aspects of financial institutions: Financial leverage, Net interest margin and non-portfolio income sources. Return on equity (RoE) and Return on Assets (RoA) are the most commonly applied profitability ratios used to assess financial performance Walter (1998).

- **RoE** = Net income / Total equity capital (%)

  It measures overall profitability of financial institutions per dollar of equity
- RoA=Net income/Total assets (%)  

This ratio measures profit generated relative to the financial institution’s assets

2.3 Banks Lending and Investment Policy

Banks in the process of financial intermediation are confronted with various kinds of financial and non-financial risks viz., credit, interest rate, foreign exchange rate, liquidity, equity price, commodity price, legal, regulatory, reputational, operational. These risks are highly interdependent and events that affect one area of risk can have ramifications for a range of other risk categories. Thus, top management of banks should attach considerable importance to improve the ability to identify, measure, monitor and control the overall level of risks undertaken (Eppie, 2000).

According to (Eppie 2000), the broad parameters of risk management function should encompass:

- Organisational structure;
- Comprehensive risk measurement approach;
- Risk management policies approved by the Board which should be consistent with the broader business strategies, capital strength, management expertise and overall willingness to assume risk;
- Guidelines and other parameters used to govern risk taking including detailed structure of prudential limits;
- Strong MIS for reporting, monitoring and controlling risks;
- Well laid out procedures, effective control and comprehensive risk reporting framework;

- Separate risk management framework independent of operational Departments and with clear delineation of levels of responsibility for management of risk; and periodical review and evaluation.

2.3.1. Risk Management Structure

According to Van, Henrie and Bratanovic (2000), a major issue in establishing an appropriate risk management organisation structure is choosing between a centralised and decentralised structure. The global trend is towards centralising risk management with integrated treasury management function to benefit from information on aggregate exposure, natural netting of exposures, economies of scale and easier reporting to top management. The risk management is a complex function and it requires specialised skills and expertise. Banks have been moving towards the use of sophisticated models for measuring and managing risks. Large banks and those operating in international markets should develop internal risk management models to be able to compete effectively with their competitors. As the domestic market integrates with the international markets, the banks should have necessary expertise and skill in managing various "types of" risks in a scientific manner. At a more sophisticated level, the core staff at Head Offices should be trained in risk modelling and analytical tools. It should, therefore, be the endeavour of all banks to upgrade the skills of staff.
Van et al. (2000) found that Internationally, a committee approach to risk management is being adopted. While the Asset - Liability Management Committee (ALCO) deal with different types of market risk, the Credit Policy Committee (CPC) oversees the credit /counterparty risk and country risk. Thus, market and credit risks are managed in a parallel two-track approach in banks. Banks could also set-up a single Committee for integrated management of credit and market risks. Generally, the policies and procedures for market risk are articulated in the ALCO policies and credit risk is addressed in Loan Policies and Procedures.

Currently, while market variables are held constant for quantifying credit risk, credit variables are held constant in estimating market risk. The economic crises in some of the countries have revealed a strong correlation between unhedged market risk and credit risk. Forex exposures, assumed by corporations who have no natural hedges, will increase the credit risk which banks run vis-à-vis their counter parties. The volatility in the prices of collateral also significantly affects the quality of the loan book. Thus, there is a need for integration of the activities of both the ALCO and the CPC and consultation process should be established to evaluate the impact of market and credit risks on the financial strength of banks. Banks may also consider integrating market risk elements into their credit risk assessment process (Eppie, 2000).
2.3.2. Credit Risk

Lending involves a number of risks. In addition to the risks related to creditworthiness of the counterparty, the banks are also exposed to interest rate, forex and country risks.

Credit risk or default risk involves inability or unwillingness of a customer or counterparty to meet commitments in relation to lending, trading, hedging, settlement and other financial transactions (Van et al, 2000). The Credit Risk is generally made up of transaction risk or default risk and portfolio risk. The portfolio risk in turn comprises intrinsic and concentration risk. The credit risk of a bank's portfolio depends on both external and internal factors. The external factors are the state of the economy, wide swings in commodity/equity prices, foreign exchange rates and interest rates, trade restrictions, economic sanctions, Government policies, etc. The internal factors are deficiencies in loan policies/administration, absence of prudential credit concentration limits, inadequately defined lending limits for Loan Officers/Credit Committees, deficiencies in appraisal of borrowers' financial position, excessive dependence on collaterals and inadequate risk pricing, absence of loan review mechanism and post sanction surveillance, etc (Eppie, 2000).

The management of credit risk should receive the top management's attention and the process should encompass:

- Measurement of risk through credit rating/scoring;

- Quantifying the risk through estimating expected loan losses i.e. the amount of loan losses that bank would experience over a chosen time horizon (through tracking portfolio behaviour over 5 or more years) and unexpected loan losses i.e. the amount
by which actual losses exceed the expected loss (through standard deviation of losses or the difference between expected loan losses and some selected target credit loss quantile);

- Risk pricing on a scientific basis; and
- Controlling the risk through effective Loan Review Mechanism

In Kenya, Commercial banks have sharply reduced lending to the private sector and increased their demand for Treasury bills. Since 1999, banks have become excessively risk averse, loans and advances, which are mostly extended, to the private sector fell from KShs. 229 billion in 1999 to KShs. 219 billion in September 2001 (Ochieng 2001). Meanwhile, bank’s holdings of the government securities increased by 13.4% to KShs. 89.1bn in June 2002 and accounted for 20% of banks total assets (CBK, 2002). In Mexico banks would collude to under loan so that at least in comparison with what would happen in a competitive system they could overcharge (Gillespie, 2002). Standard Chartered Bank was the earliest bank to sort out its portfolio of bad debts (CBK, 2002).

2.4 Factors that Contribute to the Profitability of Banks

Banks profitability is dependent on good management of costs and bad debts proper lending practices, risk management and the technology (Eppie, 2001). The big banks generate a significant portion of their income from non-interest sources especially fees, commissions and foreign currency dealings (Mutuota, 2000).
Mutuota (2000) argues that the non-interest income has been a high contributor to the large bank’s profitability, because large banks have a large clientele that provides them with the opportunity for other income. Batavia (1999) observes that profitability of a bank will partly depend on the interest earned from giving out loans and other advances. In a way of support, Heffernan (1996) argues that commercial banks derive their profitability from strong loan growth and the improved asset quality. Moreover, profitability will also depend on the quality of lending so as to avoid or reduce the level of Bad Debts, which ultimately affect profitability. Banks that reports large growth in Advances and at the same time report large growth in Provision of Bad Debts will mean the quality of lending is poor. Provisions on Bad Debts “eat up” one’s profitability, especially when it comes to writing-off the debt. When this happens, both the depositors and shareholder's funds are partly lost, as these are not recoverable. The increase in advance will guide which bank increased their business so as to earn substantial amount of interest income, which contribute to overall profitability (Hanson, 1998).

Banks that report increase in provision figures imply that their quality of lending is poor. Should there be a decrease this will mean the bank's profitability will have been reduced by having the debt written off. Depositors and investors need to find out which banks maintain such level so that their funds are safe (Hanson, 1998). Heffernan (1996) observes that bank share prices tend to rise relatively more than other sectors as interest rates fall because net margins (the difference between average loan rates and deposit rates) widen. However, as banks diversify into fee based financial products, their performance may be less sensitive to interest rate fluctuations. Banks are moving away from traditional activities (loans and advances), to offering non banking financial services such as credit card, investment services
and so on. Besides this the non-funded income is still the major contributor of the profit in banking sector.

In Kenya, at the end of June 2002, the level of non-performing loans was estimated at KShs. 72.5 billion or 29.5% of total loans, compared with KShs. 79.0 billion or 31.1% of total loans in June 2001 (CBK, 2002). The decline is attributed to the liquidation of one major bank that had a major level of non-performing loans. However it is observed that the level of provisions for bad and doubtful loans declined to KShs. 30 billion in June 2002 from KShs. 34.5 billion in June 2001 (CBK, 2002). For the profitability, with slight improvement in the country’s economic performance as reflected in the real GDP of about 0.8% in year 2001 compared to negative 0.3% the previous year, the banking industry profitability improved remarkably. Net profit before tax for the entire banking sector increased to KShs. 8.9 billion in the year 2001 from KShs. 2.8 billion in the year 2000. This was attributed mainly to the liquidation of a major bank (Trust Bank LTD) that had been weighing down the banking sector due to huge losses it was making. The other reason was due to the reduced losses reported by some major loss-making banks as well as reduced charges for bad and doubtful loans (Economic Survey, 2002).

Altogether, 11 institutions made a cumulative loss of KShs. 2.6 billion while 46 institutions made a profit of KShs. 11.5 billion in the year 2001. However results for year 2002 showed a decline in the banking sector (CBK, 2002). 41 institutions, made profit of KShs. 3.8 billion while the other institutions made losses of 0.5 billion giving an overall net profit before tax of KShs. billion (CBK, 2002).
2.5 Cost Reduction and Debt Management

2.5.1 Cost Reduction

Banks across the globe have embarked on restructuring as way of reducing costs. This reform strategy will involve the bank’s organization framework, planning management, credit policy, its information and technology systems, internal controls, human resources and payment systems (Marlin, 2002).

Marlin (2002) argues that banks are investing in Information Technology (IT) in order to reduce costs, improve customer service and manage risk. Cost reduction, achieved through service providers, outsourcing and new technologies and processes, is the top priority. Cost reduction is the rationale behind the large outsourcing contracts signed recently by JP Morgan Chase, Bank of America, Deutsche Bank and ABN AMRO with IBM and EDS. Argues Marlin. These banks have restricted and established four major departments: corporate banking, individual banking, and real estate credit and intermediary business.

According to Gillespie (2002) banks are expected to plow a portion of their profits back into IT investments designed to assure future growth. Among these are building a standards-based, layered IT architecture containing a middle tier of core business components. By mixing and matching these components, banks will be able to more easily bring out new products and services, as well as support their Customer Relationship Management (CRM) initiatives. "The fastest way to bring new electronic banking offerings to market is through good integration of this middle tier with legacy mainframe systems," wrote Gillespie (2002).
Business process outsourcing (BPO), involving such functions as check imaging, document management, loan processing and others, has been and will continue to be a way for banks to cut costs. Under pressure to invest in technology and business processes in order to remain competitive, many banks are choosing BPO as a way to reduce back-office expenses (Marlin, 2002). Further Marlin argues that business-to-employee applications, such as employee self-service portals and e learning, provide yet another cost-saving opportunity for banks. E learning, for example, delivers one of the highest ROIs among business technologies by reducing travel, HR, regulatory compliance and customer support costs, as well as increasing employee performance.

According to Gillespie (1999), successful banks under the category of improving customer services continue to invest in CRM processes, organizations and techniques that enable them to identify high-potential customer segments. Deciding which processes should be centralized and which should be located at points of customer contact is a matter of importance for banks. Gowland (1994) observes that the bank of China seeks to streamline customer-facing processes and has built a single platform for customer communications. The ultimate goal for the bank is to gain a unified view of customers and insight into their preferences. Banks that fail to integrate customer data to deliver personalized services risk falling behind, Gowland said. One-to-one directed selling and intelligent response based on customer profiles is a key differentiating factor. Under the category of risk management fall IT investments associated with complying with new regulations on disaster recovery, operational risk and information security. Disaster recovery guidelines promulgated by the Federal Reserve, the Office of the Comptroller of the Currency and the Securities and Exchange Commission require that settlement and clearing functions be restored within four
hours and that recovery sites and other resources be located "out of region." These requirements present a formidable challenge, especially if "out of region" means more than 30 miles. The technology can't perform at this distance, and a four-hour maximum precludes use of commercial hot-site services (Gillespie, 2002). By requiring banks to maintain at least two years' worth of historical data on operational risk, Basel II will challenge their information gathering capabilities.

According to Ochieng (2000) the former group CEO of standard Chartered Rana Tawar argues that banks should concentrate on fee-based sources of revenue like foreign exchange transactions, trade finance and corporate finance and that it is the trend globally. The bank is also leading in the industry in terms of technology. Tawar observes that Standard Chartered Bank was the first bank to recruit professional employees. The bank invests highly on training of its personnel.

2.5.2 Bad Debt Management

Kasper (2003) observes that successful banks to evaluate loan applicants use a large variety of systems. The objective of such credit scoring models typically is to minimize default rates or the number of incorrectly classified loans. Bad debts are by far the most common cause of bank failure. In recent years international banks have suffered very large losses due to the non-payment of loans or because of provisions against non-payment and the size of these debts have sometimes posed serious threat to financial stability.
Banks restructure to address bad debts. Munaita (1999) says that delayed restructuring and worsening economic conditions will see Kenyan banks return even more disappointing results. Banks with a huge portfolio of under secured debt will be the worst hit with provisions for dreadful and doubtful amount overdue rising across the industry. Munaita (1999) asserts that of the banks quoted on the Nairobi Stock Exchange, Standard Chartered Bank is expected to return another increase in profits following its timely restructuring in 1996. Standard Chartered adequately provided for bad debt. In the year 1999, the bank provided for KShs.1.3 billion ($17 million) of KShs.1.7 billion ($22 million) in non-performing debts and suspended interest. Despite the high provisions, the bank was still able to return a profit before tax of KShs.2.6 billion ($34 million) in 1999 and KShs.2.3 billion ($30 million) in 1998, attributed to a comprehensive cost-cutting programme that restricted operational expenses to under KShs. 3 billion, while its peers were spending at least twice as much (Munaita 1999).

Barclays Bank of Kenya, now midway through its reorganisation programme, may not be far behind. Munaita (1999) says that the bank has over the years provided prudently for bad debts, but its costs remain high due to delayed restructuring. In the year 1999, the bank provided for KShs.440 million ($5.7 million) in bad debts and returned a pre-tax profit of KShs.3.6 billion ($46.7 million), down from KShs.4.5 billion ($58.4 million) in 1998.

Kenya Commercial Bank (KCB), which announced its restructuring programme in 1999, was expected to exhaust provisions for historic debt and return to profitability with the closure of a number of branches. KCB has a non-performing debt of KShs.17.5 billion ($227 million) out of which KShs.7.1 billion ($92 million) is provided for. A further provision of about KShs. billion ($26 million) is expected to leave the bank in a good
position for a return to profitability. The National Bank of Kenya has suffered a record loss of KShs.6.5 billion ($84.4 million) over the past years, but it is optimistic that an ongoing restructuring programme will reverse the trend in the coming years. The bank considered itself back on the right track after providing for KShs. billion ($65 million) between 1998 and 1999 equivalent to 32 per cent of its KShs.15.4 billion ($200 million) in bad debts. Analysts, however, say the provision should be raised to 50 per cent of non-performing debts before the bank can confidently stride into the future (Munaita, 2000).

Small operations, unrecoverable bad debts and low capital adequacy ratio are major problems that need to be addressed to improve confidence in Viet Nam's commercial banks (Gowland, 1994). According to Gowland, the director of the Ministry of Finance's Department of Finance and Banking gave Viet Nam News some insights into the banking system’s restructure. So the restructuring of the banking system does not merely mean pumping in more money. It involves classifying and restructuring debts and finding solutions to handle them. Thailand’s commercial banks set up a national assets management corporation (AMC) to restructure hundreds of billions of Baht in non-performing loans. Schutze (1999) asserts that banks across Germany are enhancing their credit risk management systems to try to control their credit risks more actively. WestLB, for example, bought SunGard’s credit risk

Batavia (1999) assessed the financial performance of 19 commercial banks in Kenya with a focus on growth with an overall finding that the financial performance of newly established banks was better than that of the long established ones. Not withstanding the findings, the
study failed to examine the impact of other performance measures that depict individual bank's profitability. Mutuota (2000) on the other hand set to establish differences in financial performance of banks and rank them and to determine whether large banks have better financial results than medium ones. He concluded that large banks were more profitable but they did not necessarily perform better financially than the medium and smaller banks. However he also failed to examine the impacts of the performance measures that depict the banks profitability.

2.6 Chapter summary

This chapter mainly discusses the other similar materials that have been studied by other people. In particular the chapter addresses the banks lending policy. It is observed that commercial banks are mainly investing in the risk free government securities. Successful banks also evaluate loan applicants with an objective to minimize default rate. Banks are also concentrating more on fee based financial services in order to improve their profits. They have also embarked on cost reduction measures through investment in IT.
CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1. Introduction

In this chapter we highlight the research design, the population and sampling design, data collection methods, research procedures and data analysis.

3.2. Research Design

This study was a case study. Case study research gives an understanding of a complex issue or object and can extend experience or add strength to what is already known through previous research. Case studies emphasize detailed contextual analysis of a limited number of events or conditions and their relationships. Researchers have used the case study research method for many years across a variety of disciplines. Social scientists, in particular, have made wide use of this qualitative research method to examine contemporary real-life situations and provide the basis for the application of ideas and extension of methods. Citing Yin (1984), Emory (1997), defines case study research method as an empirical inquiry that investigates a contemporary phenomenon within its real-life context; when the boundaries between phenomenon and context are not clearly evident; and in which multiple sources of evidence are used.

Critics of the case study method believe that the study of a small number of cases can offer no grounds for establishing reliability or generality of findings. Others feel that the intense exposure to study of the case biases the findings. Some dismiss case study research as useful
only as an exploratory tool. Yet researchers continue to use the case study research method with success in carefully planned and crafted studies of real-life situations, issues, and problems. Reports on case studies from many disciplines are widely available in the literature. A key strength of the case study method involves using multiple sources and techniques in the data gathering process. The researcher determines in advance what evidence to gather and what analysis techniques to use with the data to answer the research questions. Data gathered is normally largely qualitative, but it may also be quantitative. Tools to collect data can include interviews, documentation review, observation, and even the collection of physical artefacts.

This particular case study was an exploratory type of the case study. It was exploratory because it sought to study a certain aspect of a particular bank that has not been studied before.

3.3. Population and Sampling Design

The study intended to analyse the performance of Standard Chartered Bank of Kenya. The research was conducted on three branches of SCB and the Head Office. SCB has 31 branches countrywide and 11 branches in Nairobi. SCB has greatly standardized its branch operations and therefore a sample of three main branches is a representative of all branches countrywide. The Researcher chose SCB’s main branches, Kenyatta Avenue, Moi Avenue and Ruaka Branch to represent the bank branches. In addition, the head office is the central area where branch activities are administered and so then the research
at the Head Office was to give the overall picture of the organisation. The researcher conducted the research at the Head office and three branches of the Standard Chartered Bank. At the Head office, the researcher interviewed the head of credit and Finance while in each branch the researcher interviewed the Credit Manager and the Branch manager.

3.4. Data Collection Method

Descriptive statistics in form of frequencies and graphs were used to analyse quantitative data. Qualitative data was analysed using content analysis. Content analysis involves identifying coherent and important examples, themes and patterns in the data. Qualitative data was summarised according to common themes and presented in frequency distribution tables.

Secondary data was collected from the Standard Chartered Bank's audited Financial Statement as presented in the Bank’s Annual financial reports, The Daily Nation, The East African and The East African standard. The secondary data was also extracted from the Central bank of Kenya publications. The information collected was based on the Specific objectives. While primary data was collected from the head office and the three branches of the Standard Chartered Bank of Kenya limited. The researcher developed an Interview guide based on each research question. The researcher using interview guides, interviewed the head of credit and finance, Branch managers and the Branch credit managers.

3.5. Research Procedures

The steps to taken in conducting the research are as follows
The researcher first collected and analysed the secondary data so that interviews could assist in providing more insights and classifications.

Then the researcher did a preliminary visit to the bank.

The researcher then proceeded to make appointments with the Standard Chartered Bank head of finance, branch managers and the credit managers.

The researcher gave the interview guide to all the respondents a week before the interview.

The researcher interviewed the Managers in different Branches on different days.

3.6 Data Analysis Method

The researcher used both qualitative and quantitative approaches to analyse the data. The data analysis tools that were used are Microsoft Excel which is a computer application package. The researcher used the Microsoft Excel package for storage and data analysis. The package also sorted out the data in order. The results were presented in form of graphs and tables. Descriptive statistics in the form of frequencies and graphs have also been used to analyze the quantitative data. Qualitative data was analysed using content analysis. Content analysis involves identifying coherent and important examples, themes and patterns in the data. The analysis involved pulling together all the data that address a particular research question. Then the researcher classified the data accordingly.

3.7 Chapter summary

Chapter three mainly describes the research methods that were used in conducting the study. It was an exploratory case study and the researcher used both secondary and primary data. The primary data was derived from the interviews conducted with the seven managers. Data
analysis was done using a software package Microsoft Excel and content analysis for qualitative primary data. Findings were presented in form of tables and graphs as depicted in the next chapter.
CHAPTER FOUR

4.0 RESULTS AND FINDINGS

4.1 Introduction

Chapter four mainly presents the results and findings of the study obtained from secondary and primary data. A survey was carried out as outlined in chapter 3. The general characteristics of the respondents are outlined here below. The result obtained from the interviews and the secondary data were analyzed. The analysis was done under the headings as per the objectives of the research so as to lead to an accurate interpretation of the result. The headings of the analysis as per the research objectives are as follows:

I. Standard chartered Bank’s lending and investment policy,
II. The factors that contribute to the profitability of Standard Chartered Bank
III. How Standard Chartered Bank manages its costs and bad debts

General Characteristics of the Sampled Respondents

Table 2 shows the general characteristics of the sampled respondents

Table 2: General Characteristics of the Sampled Respondents

<table>
<thead>
<tr>
<th>HEADQUATER BRANCHES</th>
<th>Ruaraka Branch</th>
<th>Moi Avenue</th>
<th>Kenyatta Avenue</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Head of finance</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>1</td>
</tr>
<tr>
<td>Branch Manager</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>Branch Credit Manager</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>7</td>
</tr>
</tbody>
</table>

From table 2 it can be seen that the study is a case study as it focused on one bank. The branches used are, Moi Avenue Kenyatta Avenue, Ruaraka Branch and the head office. The
number of managers totaled 7 as this involved the Head of Finance at the Headquarters. The branch managers were three from the three branches while branch credit managers were also three. This was to give a true picture of the organization.

4.2 Standard Chartered Bank’s Lending and Investment policy

The first objective sought to assess the SCB’s lending and investment policy. The results were analyzed as per the questions asked to the interviewees. Secondary data findings on this research question are presented in figures 1 and 2, while primary findings on the same question are presented after the secondary findings.

Figure 1 shows the growth in investment in treasury bills, bonds and government securities for the period 1999 to 2002.

![INVESTMENTS IN TREASURY BILLS, BONDS AND GOVERNMENT SECURITIES](image)

**Figure 1:** Investment in Treasury Bills, Bonds and Government Securities
Figure 1 shows that investment in the Government securities has been rising since the year 1999. In 1999 the bank invested Kshs. 1.6 billion and Kshs. 3.2 billion in the year 2002.

Figure 2 shows the trend in investment in loans and advances to the public by SCB during the years 1999-2002.

![Growth in Loans and Advances]

Figure 2. Growth in Loans and Advances

Figure 2. Shows a fall from Kshs 2.8 billion in 1999 to Kshs 1.8 billion in 2002.

The findings indicate that SCB heavily invested in government securities unlike loans and advances to the public. Investment in government securities rose steadily during the period under review while investment in loans and advances to the public assumed a downward trend during the same period.
4.2.1 Results from the interviewees

The head of credit and finance described SCBs lending policy as guidance towards prudent lending. The policy seeks to generate revenue while avoiding losses. Further, the head of Finance said that the bank has 3 different policies that govern the three categories of the customers i.e. the personal customers, business customers and corporate and institutional. In addition, the other six Respondents agreed that the purpose of the banks lending policy was to ensure prudent lending. The policy recommends a detailed appraisal process which seeks to eliminate lending to non-viable projects and unqualified customers as this could result into bad debts. The 3 branch credit managers described the credit appraisal process as a blend of financial and personal qualities reviewed by the lender.

According to the head of finance and credit, the policy on investment is dependent on the economic conditions and the market factors. During recession most sectors of the economy are unstable and this makes lending very risky. This makes banks risk averse and they choose a risk free way of investing their funds. From the year 1999-2002, the Kenyan economy was in recession and the government relied heavily on borrowing from the public at a very impressive rate. This risk free and lucrative investment attracted SCB and therefore during the period under review the bank invested a huge proportion of its fund on government securities and nearly neglected the public.

All the six managers said that their policy on lending was stricter as compared to their competitors due to the mandatory appraisal process entailed. They further, stated that the bank controls the risk involved in lending through strict adherence to the lending policy. According to the three interviewees the branches are not allowed to advance any amount of money to the customers. The branch credit managers examine the credit worthiness of customers. If they are convinced that the customer is credit worthy, then they send a
recommendation to an independent team of credit officers at the head office who further examines the credit worthiness of the customer. The team of credit officers can either approve or disapprove the loans based on the credit worthiness of the customer. Therefore lending in the bank is based on committee and not individual. This is to avoid lending to unqualified customers and non-viable projects.

In order to determine the kind of a facility to offer the customers, the bank credit managers said that they normally probe the customers to understand their needs and thereafter advice them on facility that best suits their needs.

4.2.2. The Credit Categories of Standard Chartered Bank

Table 3 shows the categories of credits offered by SCB. The tables also show how the categories of credit were rated by the respondents on a scale of 1-5 in order of preference with 5 being the most preferred and 1 being the least preferred.

Table 3. Credit Categories of Standard Chartered Bank

<table>
<thead>
<tr>
<th>Categories</th>
<th>Frequency Distribution</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Most preferred</td>
</tr>
<tr>
<td>Secured loans</td>
<td>6</td>
</tr>
<tr>
<td>Unsecured loan</td>
<td>6</td>
</tr>
<tr>
<td>Overdrafts</td>
<td>3</td>
</tr>
<tr>
<td>Letters of Credit</td>
<td>2</td>
</tr>
<tr>
<td>Deposit Plus</td>
<td>0</td>
</tr>
<tr>
<td>Contingent Liability</td>
<td>1</td>
</tr>
</tbody>
</table>
According to table 3, the credit categories in Standard Chartered Bank are: Secured loan, unsecured loan, Overdraft, Deposit Plus, and contingent liability.

The table result further shows that secured loans and the unsecured loans are the most preferred followed by the overdrafts. All the six respondents rated the two factors five while the overdrafts was rated 5 by 3 respondents and 4 by the other 3 respondents. Contingent liability is the least preferred of all the five categories. The facility was rated 5 by one respondent and 1 by 5 respondents.

4.2.3. The Risk Factors Involved in Lending

Table 4 shows the risk factors involved in lending and their rating according to the risks on a scale of 1-5 with 5 being the most risky and 1 being the least risky.

Table 4. The Risk Factors Involved in Lending

<table>
<thead>
<tr>
<th>Risk Category</th>
<th>Frequency distribution</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Most Risky</td>
</tr>
<tr>
<td>Financial Risk</td>
<td>6</td>
</tr>
<tr>
<td>Business Risk</td>
<td>6</td>
</tr>
<tr>
<td>Management Risk</td>
<td>6</td>
</tr>
<tr>
<td>Structural Risk</td>
<td>6</td>
</tr>
<tr>
<td>Account performance</td>
<td>2</td>
</tr>
</tbody>
</table>
Table 4 shows the data collected on the risk factors involved in lending. This shows that the risk factors are the financial risk, business risk, management risk, structural risk and the account performance risk.

Further table 3 shows that the financial risk, business risk, management risk, and the structural risk are the most risky factors involved in lending. All the respondents felt that the 4 factors were the most risky. 2 respondents felt that the account performance risk was a very risky factor, 3 managers felt that the same factor was risky and 1 felt that the factor fairly risky.

4.2.4 Duration To Advance Credit

Table 5 shows the duration taken to advance a personal loan by SCB and the number of the respondents.

<table>
<thead>
<tr>
<th>Duration</th>
<th>No. Of Respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Two days</td>
<td>6</td>
</tr>
<tr>
<td>One week</td>
<td>0</td>
</tr>
<tr>
<td>One Month</td>
<td>0</td>
</tr>
<tr>
<td>Over a month</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>6</td>
</tr>
</tbody>
</table>

Based on the results above, the duration taken to advance a personal loan is two days. All the 6 respondents said that it takes 2 days to advance a personal loan.

4.2.5 The Duration to Advance a Business loan

Table 6 shows the duration taken to advance a business loan in SCB as answered by the six Respondents.
Table 6: The Duration to Advance a Business Loan

<table>
<thead>
<tr>
<th>Duration</th>
<th>No. Of Respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than a week</td>
<td>0</td>
</tr>
<tr>
<td>One week</td>
<td>0</td>
</tr>
<tr>
<td>One Month</td>
<td>6</td>
</tr>
<tr>
<td>Over a month</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>6</td>
</tr>
</tbody>
</table>

The results show that it takes one month to advance business loan as all the 6 interviewees selected the option.

4.3 Factors that Contributed to the Profitability of SCB

Figure 3 shows the growth from foreign exchange dealings

![INCOME FROM FOREIGN EXCHANGE DEALINGS](image)

**Figure 3 Income from Foreign Exchange Dealings**

The growth in income rose in the year 2000 but fell again in 2001 and then rose again 2002.
Figure 4 shows the trend of income from fees and commission for the period under review.

![Income from Fees and Commission](chart)

**Figure 4: Income from fees and commission**

Income from fees and commissions increased from 1.6 billion in 1999 to 1.9 billion in 2002.
Figure 5 shows the growth in liabilities for the years 1999-2002.

![Growth in Liabilities](image)

**Figure 5: Growth in Liabilities**

Since 1999, total liabilities for SCB have been on the growth trend. Total liabilities for the year 1999 was KShs. 38,250,082 Billions, in the year 2000, KShs. 43,002,782 Billion, in the year 2001, KShs. 48,679,929 Billions, and in the year 2002, KShs. 56,158,002 Billions. This reflects a growth percentage of since 1999.
Figure 6 shows the growth in assets for SCB during the year 1999-2002.

![Growth in Assets Chart]

**Figure 6: Growth in Assets**

Total assets of SCB have been on a growth trend from 1999-2002. The total assets were KShs. 42,772,169 Billion in 1999, KShs. 49,188,750 Billion in 2000, KShs. 54,480,344 Billion in 2001, and KShs. 61,650,128 in 2002. This is an increase of 62%, which by any standards is recommended.

The results from the figures above indicate that SCB derived a good portion of its income from fees and commissions, foreign exchange dealings and strong improvement in assets and liabilities. Income from fees and commissions increased steadily during the period under review. Income from foreign exchange dealings was fairly good. Growth in assets and liabilities also improved steadily during the period under review.
4.3.1. Results from the Respondents

According to the respondents, the major revenue components of SCB during the period under review were the funded income obtained from the interests charges and the non-funded income which are obtained from the fees and commissions charged, foreign currency dealings and advisory services. All the respondents said that the two factors were equally important. In addition, all respondents felt that their tariff was at par with their competitors. On target market, the three respondents said that the SCB targets the upper and middle class customers. The middle class are those who can maintain kshs.50,000-Kshs.200,000 while the upper class are those who can maintain Kshs 500,000 and above in their accounts. This was for both business and personal customers.

4.3.2. The Factors that Contributed to the Profitability of SCB

Seven Respondents addressed this question. The question sought to find out the unique factors that made SCB register a remarkable growth in profitability during the period under review. The factors are presented in table 7. They are ranked on a scale of 1-5 in order of importance with 5 being the most important and 1 being the least important.
Table 7: The Factors that Contributed to the Profitability of SCB

<table>
<thead>
<tr>
<th>Factors</th>
<th>Frequency Distribution</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Most important</td>
</tr>
<tr>
<td>Restructuring</td>
<td>7</td>
</tr>
<tr>
<td>Change management</td>
<td>4</td>
</tr>
<tr>
<td>Product range</td>
<td>0</td>
</tr>
<tr>
<td>Strategic Management</td>
<td>7</td>
</tr>
<tr>
<td>Suppression of cost</td>
<td>0</td>
</tr>
<tr>
<td>Centralization</td>
<td>0</td>
</tr>
<tr>
<td>Excellent services hence high charges</td>
<td>4</td>
</tr>
<tr>
<td>Highly Qualified Staff</td>
<td>0</td>
</tr>
<tr>
<td>Wise investment</td>
<td>7</td>
</tr>
<tr>
<td>Prudent lending</td>
<td>7</td>
</tr>
<tr>
<td>Monitoring and control of cost</td>
<td>7</td>
</tr>
<tr>
<td>Strong management and information systems</td>
<td>7</td>
</tr>
<tr>
<td>Technology</td>
<td>7</td>
</tr>
</tbody>
</table>

The factors that were ranked as the most important are: Restructuring, strategic management, prudent lending, monitoring and control of cost, strong management information systems, prudent lending and wise investment. Change management and good customer services came second. Cost suppression is third. Centralization was rated 4th by 1 respondent and 3rd by 3 interviewees while 7 respondents rated highly qualified staff 3rd.
4.3.3. To what extent did the 1993 restructuring affect your profits?

Table 8 shows the extent to which the 1993 restructuring affected the profitability of the bank as answered by the respondents.

<table>
<thead>
<tr>
<th>Effect Category</th>
<th>No. of Respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>To a very great extent</td>
<td>7</td>
</tr>
<tr>
<td>To a great extent</td>
<td>0</td>
</tr>
<tr>
<td>To some extent</td>
<td>0</td>
</tr>
<tr>
<td>To a little extent</td>
<td>0</td>
</tr>
<tr>
<td>No extent at all</td>
<td>0</td>
</tr>
</tbody>
</table>

All the respondents indicated that restructuring affected the profits to a very great extent.

The respondents said that restructuring was the major contributor towards the profitability of the bank during the period under review. Restructuring came with improved technology that lengthened the business time especially through the ATMs that operate 24 hours. Through restructuring the bank got rid of mediocre staff. This reduced costs and improved efficiency. Improved technology also led to improved market share.
4.4. Cost and Bad Debt Management

Figure 7 shows the growth of non-interest expense during the year 1999-2002

![NON INTEREST EXPENSE](image)

**Figure 7: Non-Interest Expense**

The non-interest expense rose steadily during the period under review from 2.8 billion in 1999 to 3.3 billion in 2002.
Figure 8 shows the trend in provisions for losses on loans and advances from 1999 to 2002.

![PROVISIONS FOR LOSSES ON LOANS AND ADVANCES](image)

**Figure 8: Provisions for Losses on Loans and Advances**

SCB’s provision for losses on loans and advances has been falling. The bank provisioned KShs. 325,640 in 1999, KShs. 214,823 in 2000 KShs. 185,589 in 2001 and KShs. 122,387 in the year 2002 reflecting a percentage drop of 62.41%.

The results indicate that non-interest expense was a major cost in the bank during the period under review. Provisions for loans and advances constituted a small portion of the cost during the period under review and it was falling during the period under review.
4.4.1. Findings from the Respondents

The respondents advised that in order to control the costs at the branch level, SCB concentrated on its core function, which is banking and outsourced the non-core functions. They gave an example of salary processing, share management, and pension, which were given to other organization. On the portfolio of bad debts the respondents said that SCB restructured the bad debts. They formed a unit called special asset management unit, which helped the bank recover 90% of the bad debts. The unit is comprised of experienced lawyers and bankers.

4.4.2. The major causes of bad debts and how they were rated

Table 9 shows the major causes of the bad debts and how they were ranked by the seven respondents in order of importance with 5 being the most important and 1 being the least important.
Table 9: Causes of Bad Debts

<table>
<thead>
<tr>
<th>Causes of Bad Debts</th>
<th>Frequency Distribution</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Most important</td>
</tr>
<tr>
<td>Poor lending policy</td>
<td>7</td>
</tr>
<tr>
<td>Poor appraisal process</td>
<td>7</td>
</tr>
<tr>
<td>High interest rate</td>
<td>2</td>
</tr>
<tr>
<td>Political interference</td>
<td>0</td>
</tr>
<tr>
<td>Poor development of judicial process</td>
<td>0</td>
</tr>
<tr>
<td>Bad economy</td>
<td>7</td>
</tr>
<tr>
<td>Lack of understanding of customer needs</td>
<td>1</td>
</tr>
</tbody>
</table>

Poor lending policy, poor appraisal process and bad economy are the major causes of the bad debts. All the respondents ranked the factors as the major causes of bad debts. Two of the respondents felt that high interest was a major cause of bad debts another two felt that the same factor was fairly important and one of them said that it was least important.

Six respondents said that political interference was less important and the remaining respondents said that it was least important. The poor development of judicial process was only answered by three respondents whereby two said that it was least important and one said that it was fairly important. Lack of understanding customer needs was said to be most
important by one respondent and two respondents ranked it 4th. The remaining respondents did not mention it.

4.4.3. Cost components

Table 10 shows the major components of costs for SCB during the period under review and how they were ranked in order of the impact they had on profitability on a scale of 1-5 with 5 being the most important and 1 being the least important.

<table>
<thead>
<tr>
<th></th>
<th>Most important</th>
<th>Important</th>
<th>Fairly important</th>
<th>Less important</th>
<th>Not important</th>
</tr>
</thead>
<tbody>
<tr>
<td>Staff</td>
<td>7</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Rental buildings and equipment maintenance</td>
<td>1</td>
<td>0</td>
<td>6</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Telephone cost</td>
<td>0</td>
<td>0</td>
<td>6</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>Provisioning for bad debts</td>
<td>0</td>
<td>0</td>
<td>7</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Stationery cost</td>
<td>0</td>
<td>0</td>
<td>7</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

All the seven respondents ranked the staff cost as the major cost component of the bank. Rental buildings and equipment maintenance was ranked 5 by 1 respondent while the remaining 6 respondents ranked it 4th. Six respondents ranked telephone cost 3rd while one respondent ranked it 4th. All the seven respondents ranked the provisions on bad debts and the stationery cost 3rd.
According to SCB’s head of credit and finance, the above costs components assumed different trends during the period under review. Staff cost increased during the period under review while Provision for bad debts decreased and the other costs components assumed a downward trend.

4.5 Chapter Summary

Chapter four mainly reported the findings and conducted the analysis of both secondary and primary data. Secondary data was presented in form of graphs and tables while primary data was analyzed using statistical frequencies and percentages. Result from primary data were presented in form of tables.
CHAPTER FIVE

5.0 DISCUSSIONS, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction
The section provides the summary of the study, discussion of the findings of the study, the conclusions derived from the findings and recommendations for improvement and
Further research. The chapter was also presented as per the research questions.

5.2 Summary
The purpose of the study was to investigate why SCB registered a growth in profitability during the year 1999 to 2002 when the Kenyan economy was in recession. Specifically the study set out to:
1. Assess Standard Chartered Banks lending and investment policy
2. Establish the factors that contribute to the profitability of Standard Chartered Bank
3. Find out how Standard Chartered Bank manages its costs and bad debts

The research was a case study. It mainly relied on primary and secondary data. The secondary data was obtained from the SCB’s audited financial statements as presented in the bank’s financial reports and from the Central Bank publications while the primary data was collected by way of interviews conducted by the researcher. The researcher interviewed 3 branch credit managers, 3 branch managers and 1 senior finance and credit manager.
Quantitative data was analysed using Microsoft excel and results were presented in form of graphs and frequency tables. On the other hand, qualitative data was analysed using content analysis. The major findings from the study was that prudent lending, restructuring, technology and wise investment were the key factors that lend to the improved growth in profitability of SCB during the period under review.

It was revealed that SCB’s lending policy is well designed with a detailed appraisal process that protects the bank against careless lending that cause bad debts. Lending is also committee based and ensures that the policy guidelines are strictly followed. The policy on investment changes with time depending on the prevailing economic conditions.

Restructuring and technology were the key contributors of the profitability. SCB was the first bank to embark on restructuring programme in Kenya. This gave the bank a greater market share and the clientele base also improved due to the efficiency as a result of the technology.

Finally, the findings also reveal that the bank concentrates on its core business and out sources the non-core business in order to control costs.

5.3 Discussions

This section is structured along three research questions.

5.3.1 Lending and Investment Policy

The first objective sought to assess the banks lending and the investment policy. The researcher found out the bank has five major categories of credit and that the secured and the
unsecured loan were the most preferred by the customers. The business customers mostly preferred secured loan. Unlike the other categories of credit, secured loan is more long-term. The salaried people mostly prefer the unsecured loan and its pegged on the salaries. The bank has three detailed policies that govern lending to personal customers, business customers and the corporate and institutional customers. The policies are different because the 3 different sections are faced with different problems and have got totally different needs. The policies spells out checks and balances and act as guidance towards prudent lending. This supports the argument in the Literature review that strong lending policies minimize the credit risk.

In addition, before lending, the bank conducts a detailed appraisal process in order to review the financial and the personal qualities of the customers. The appraisal involves discussions and probing the customers to understand their needs and the ability to repay the debts. All the respondents said that this was a major strength of the bank that makes it lower the possibility and the provision of bad debt, which are afflicting many Kenyan banks. The respondents observed that their policy on lending was a bit stricter than their competitors due to the detailed appraisal process, which saves the bank losses from the bad debts and provisions. It was observed that no credit approvals are allowed at the branches. This was to avoid improper lending. This supports the argument by Van (2000) that inadequately defined lending limits for loan officers are the major cause of losses involved in lending.

The study found that the bank takes two days to advance a personal loan and this was because the personal loan is unsecured and is based on the salaries of the customers and due to this the risk of default is low. In addition, the bank has got a list of approved companies whose employees are entitled to this form of loan. This arrangement with the employers
makes the loan secure as it's guaranteed. On the other hand, the secured loan takes a month to advance. The reason given for this was that the secured loan required collateral and were considered more risky. The bank takes time to evaluate the collateral and the ability of the customer to pay.

It was observed that the bank faces five risk factors in lending. Business risk, financial risk, management risk, management, structural and the security risk are the most occurring risk factors in the bank. Financial risk involves the business capitalization, money usage and the profitability of the business ventures. Business risk involves the competition in the industry, the location and the entry barriers into the business. Management risk includes the personnel risk. The detailed credit appraisal spelt out in the policy takes the full consideration of the above factors and this lowers the possibility of careless lending.

The study found out that the bank relied mainly on investment in the government securities and had advanced little to the public during the period under review. This supported the figures obtained from secondary information. Investment in government securities rose from 1.6 billion in 1999 to 3.2 billion in 2002 while growth in loans fell from 2.8 billion in 1999 to 1.8 billion in 2002. During the years 1999 to 2002, the Kenyan economy was in recession and therefore many sectors were not doing well. This made investment in the public very risky. The government on the other hand relied on borrowings from the public at a very impressive rate. Lending to the government was also risk free and this explains the upward trend in investment in government securities and the fall in investment in loans and advances. This confirms the argument in the literature review Nyagah (2002) raised a concern that banks in Kenya had become risk averse and that banks were moving away from tradition responsibilities of lending to the public.
5.3.2. Factors that contributed to profitability of the Standard Chartered

Based on the findings, restructuring is said to have improved the profits to a very great extent. Restructuring, change management, product range, cost control and monitoring, centralization, Good customer services, wise investment, technology, prudent lending, strong management information system were the factors that contributed to the upward growth in profitability. Restructuring brought about most of the above factors. Standard Chartered Bank was the first bank to embark on restructuring process in Kenya. This earned the bank a bigger market share hence improving its assets and liabilities. With this, the bank became a market leader in terms of technology and this served as a key profitability driver. Technology brought about the ATMs that lengthened the business time. SCBs ATMs are the most reliable in Kenya and this attracted more customers and enhanced the reduction of the staff who are the major cost component. The interviewees agreed that technology helped the bank in cost reduction. Therefore the continued growth in profitability during the period under review is greatly attributed to the timely restructuring. This supports the argument in the literature review section. In this section, Marlin (2002) argues that banks across the globe embarked in restructuring so as to reduce cost. He further argued that IT helps in improving customer services, cost reduction, and risk management.

The strong strategic management team makes good forecast and good decisions that earn the bank good profits. Besides that, the team helps the bank in making wise investment decisions.
The major revenue source for the bank was funded and non-funded income. Initially the funded income was the major revenue components for the banks. Due to the risk involved in public lending SCB sought other means of making profits. They offered good services to the customers and they continuously reviewed the tariff to match their services. This explains the growth in income from fees and commissions from 1.6 billion in 1999 to 1.9 billion in 2002. SCB also relied on the income from foreign exchange dealings.

The funded income was mainly derived from the investment in government securities that assumed an upward trend as discussed in the question 1 above.

The downward growth in loans during the period under review contradicts Hefferman’s argument that commercial banks derive their profitability from strong loan growth.

5.3.3 Management of costs and bad debts

The study found out that the major causes of the bad debts which is a major cause of bank failure and losses are poor lending policy, poor appraisal process, high interest rate, bad economy, lack of understanding customer needs, poor appraisal process and poor development of judicial process. Poor lending policy, poor appraisal process and bad economy were rated as the major causes of the bad debts. Poor lending policy leads to poor appraisal process and hence careless lending which is a major reason for the bad debts. They also argued that bad economy leads to the failure of businesses and hence their inability to repay loans. Failure to understand customer needs comes second. The managers argued that many banks do not probe their customers and they therefore give them the wrong loans, which they are later unable to pay. Probing of customers is one advantage that makes SCB be ahead of its customers as it gives every customer facilities that that suits them. Two interviewees felt that high interest rate charged by the banks is also a major cause of the bad debts as the customers are not able to repay especially when the economy is recession as it
was during the period under review. Another two felt that High interest rate fairly caused the bad debt. They argued that the interest rate alone may not be a major cause unless if it is coupled with the bad economy. One manager felt that high interest does not cause bad debts at all.

In order to control the bad debts, the bank has got a strong policy that guides towards prudent lending. The bank ensures close monitoring and control of lending. For instance no loan is approved at the branch level, as this would create biases. Someone who does not know the customer approves loan applicants and evaluation is based purely on the customers ability to pay and the risks involved but not on the basis of friendship. Centralization of lending ensures that the policy is fully followed.

The major components of costs for the period under review were the staff costs followed by the rental buildings and equipment maintenance. Telephone costs provisioning for bad debts and the stationery cost come third, fourth and fifth respectively. The information from the secondary data also shows an increase in salaries and employee benefits. The rise in employee benefit is attributed to the packages given to the retrenched employees and the packages extended staff in order to motivate them and improve their productivity.

Provisioning for bad debts was said to fairly important and this supports the fall indicated by the graphs from the secondary data. SCB reviewed its lending policy and carried out a debt restructuring in order to avoid future increases in provisioning of bad debts. Bad debts eat into ones profitability, as it is a loss of funds. This supports the argument in the literature review section by Kasper (2003) that banks restructure to address bad debts.

The study found that Standard Chartered bank mainly concentrates on its core products and mainly outsource the non-core products and this reduces the cost. This confirms (Marlins,
2002) argument that cost reduction is the rationale behind the large outsourcing signed by the major banks such as JP Morgan.

5.4 Conclusions

5.4.1 Lending and Investment Policy

The overall findings from the study are that the banks policy on investment is also dependent on the prevailing economic circumstances. For instance during the period under review the bank relied on investing in government securities because the economy was in recession therefore making investing in the public risky. On the other hand the government offered good interest rate and the risk involved was free this attracted SCB which was really becoming risk averse. The bank has strict policy with a detailed appraisal process that guides it towards prudent lending. This way provisioning for the bad debts and the occurrence of the bad debts itself is lowered.

5.4.2 Factors that contributed to profitability of the SCB

Restructuring and technology are the key contributors towards the profitability of Standard Chartered Bank. Technology reduced the costs in the bank for instance the ATMs heavily reduced the work force and also improved the clientele base. Restructuring is also another reform strategy adopted by the bank in order to reduce the costs. The two factors brought about efficiency which improved the clientele base and also improved the banks customer services and hence the income from the fees and commissions.
5.4.3 Management of costs and bad debts

SCB restructured its bad debts and formed a separate segment in the bank called a special asset management unit to handle the bad debts. They also ensure close monitoring and control in lending. The costs were reduced through the restructuring and technology improvement. This process ensured that the bank concentrated on its core products and outsource the non-core functions.

5.5 Recommendations

SCB should focus on a more customer friendly Lending Policy. That is they should reduce time taken to advance a loan to customer while being careful on covering all the aspects that reduce the bad debts. This way they will have more customers. The interest rate on the government securities has also come down so the bank should also change the policy to focus on customers so that they can lend.

Banks across the globe are known to copy the technology. So market leaders in terms of technology should be constantly innovating so that they can retain their market positions. SCB should be more aggressive in its innovation. They should invest heavily on technology and innovations thereby differentiating their products more and more offering from their competitors.
Restructuring to SCB has been an ongoing process. According to the findings SCBS major component of cost are staff cost which had been increasing during the period under review. So they should look more on the staff benefits and speed up the restructuring process this will avoid further costs.
REFERENCES


Kasper, R. (2003). *Bank lending policy, credit scoring and value at risk* Journal of Banking and Finance, VOL.27, April, No.4 pages 615-633


INTERVIEW GUIDE FOR THE BRANCH MANAGERS

Q1. Banks Lending and The Credit Policy

- What is the purpose of your lending policy?
- How would you rate your policy in comparison with your competitors?
- Up to how much Kenya shillings are you allowed to advance a customer at the branch level?
- Are the lending limits individual or committee based?
- How many categories of credit do you have? Rate them in order of preference with 5 being the most preferred and 1 being the least preferred.
- Have there been any changes during the last five years? If yes what factors can you attribute to those changes?
- What risk factors do you consider when lending? Rate them in order of risks on a scale of 1 – 5 with 5 being the most risky and 1 being the least risky.
- How do you control the risk involved in lending?
- How long does it take you to advance a personal loan to a customer?
  a) 2 days
  b) One week
  c) One month
  d) More than one month
- How long does it take you to advance a BFS loan to a customer?
  a) 2 days
  b) One week
  c) One month
  d) More than one month
• Have you classified the customers into different categories?

• If yes what are the categories?

Q.2 Profitability

• According to banks annual reports your profit increased from a net of 1.737 billion in 1999 to 2.235 in the year 2002. What factors could you attribute to this growth?

• Could you rate the factors on a scale 1 to 5 in order of the importance with 1 being the most important and 1 being the least important?

• How do you rate your tariff in comparison with the other bank’s tariffs?

• To what extent has the 1993 restructuring affected your profits?

   A) To a very great extent
   B) To a great extent
   C) To some extent
   D) To a little extent
   E) No extent at all

• Could you explain the above answer please?

• What is your target market?

Q.3. Cost Reduction

• How do you control cost at the branch level?

• What are the components of cost in your bank for the years 1999 to 2002? Could you rate them based on the impact they had on profitability on a scale of 1 to 5 with 5 being the major components and 1 being the least component?

• What would you say are the major cause of bad debts?
• Could you rate them in order of importance on a scale of 1 to 5 with 1 being the major cause and 5 being the least cause?

• Your bad debts have been falling since the year 1999 how did you sort out the portfolio of the bad debts that afflicts many Kenyan banks?
INTERVIEW GUIDE FOR THE HEAD OF CREDIT AND FINANCE

- Could you please describe your lending policy?
- Has your bank classified its customers? If yes how? And are the different categories of the customers governed by different policies?
- What is your policy on investment? i.e. what proportion of your funds do you invest in loans and advances, Government securities and other securities?
- Your annual statements for the years 1999-2002 show an improvement in investment on the government securities unlike the public sector. Kindly explain the reasons.

Q2. PROFITABILITY

- What are the major revenue components in the bank? Rate them in order of contribution with 5 being the most contributors and 1 being the least contributor.
- According to banks annual reports your profit increased from a net of 1.737 billion in 1999 to 2.235 in the year 2002. What factors could you attribute to this growth?
- Rate the factors above on a scale of 1 to 5 in order of importance with 5 being the most contributor and 1 being the least contributor.
- How do you rate your tariff in comparison with the other banks tariffs?
- To what extent has the 1993 restructuring affected your profits?
  a) To a very great extent
  b) To a great extent
  c) To some extent
  d) To a little extent
  e) No extent at all
- Could you explain the above question?
Q3. COST REDUCTION

- What is your cost income ratio for the year 2000?
- How do you control cost in your bank?
- What are the components of cost in your bank for the years 1999 to 2002? Could you rate them based on the impact they had on profitability on a scale of 1 to 5 with 5 being the major components and 1 being the least component?
- What has been the trend of these cost components?
- What would you say are the major cause of bad debts?
- Could you rate them in order of importance on a scale of 1 to 5 with 5 being the major cause and 1 being the least cause?
- Your bad debts have been falling since the year 1999 how did you sort out the portfolio of the bad debts that afflicts many Kenyan banks?
INTERVIEW GUIDE FOR BRANCH CREDIT MANAGERS

Q1. Banks Lending and The Credit Policy

- What is the purpose of your lending policy?
- What factors do you consider before sanctioning an advance? Could you rate those factors on a scale of 1-5 in order of importance with 5 being the most important and 1 being the least important?
- What is your credit appraisal process?
- How do you determine when to give a customer a loan, an overdraft or any other facility that you offer?
- How would you rate your policy in comparison with your competitors?
- How many categories of credit do you have at the branch level? Rate them in order of preference on scale of 1-5 with 5 being the most preferred and 1 being the least preferred.
- What risk factors do you consider when lending? Rate them in order of risks on a scale of 1-5 with 5 being the most risky and 1 being the least risky.
- How do you control the risk involved in lending?
- How long does it take you to advance a personal loan to a customer?
  a) 2 days
  b) One week
  c) One month
  d) More than one month
- How long does it take you to advance a BFS loan to a customer?
  a) 2 days
  b) One week
  c) One month
  d) More than one month

Q.2 Profitability
- What are the major revenue components in the bank? Rate them in order of contribution with 1 being the most contributor and 5 being the least contributor.
- According to banks annual reports your profit increased from a net of 1.737 billion in 1999 to 2.235 in the year 2002. What factors could you attribute to this growth?
- Rate the factors above on a scale of 1 to 5 in order of importance with 5 being the most contributor and 1 being the least contributor.
- How do you rate your tariff in comparison with the other bank tariffs?
- To what extent has the 1993 restructuring affected your profits?
  a) To a very great extent
  b) To a great extent
  c) To some extent
  d) To a little extent
  e) No extent at all
- Could you explain the above question?
Q3. Cost Reduction

- How do you control cost at the branch level?

- What are the components of cost in your bank for the years 1999 to 2002? Could you rate them based on the impact they had on profitability on a scale of 1 to 5 with 5 being the major components and 1 being the least component?

- What would you say are the major cause of bad debts?

- Could you rate them in order of importance on a scale of 1-5 with 5 being the major cause and 1 being the least cause?

- Your bad debts have been falling since the year 1999 how did you sort out the portfolio of the bad debts that afflicts many Kenyan banks?