

THE EFFECTIVENESS OF CREDIT RISK MANAGEMENT PRACTICES UTILIZED
BY KENYA COMMERCIAL BANK IN SMALL AND MEDIUM ENTERPRISE
CREDIT IN KENYA

by

Willy Kimutai Cheruiyot

A thesis presented to the School of Business and Economics

of

Daystar University
Nairobi, Kenya

In partial fulfillment of the requirements for the degree of

MASTER OF BUSINESS ADMINISTRATION
in Finance

May 2012

THE EFFECTIVENESS OF CREDIT RISK MANAGEMENT PRACTICES
UTILIZED BY KENYA COMMERCIAL BANK IN SMALL AND MEDIUM
ENTERPRISE CREDIT IN KENYA

by

Willy Kimutai Cheruiyot

In accordance with Daystar University policies, this thesis is accepted in partial fulfillment
of the requirements for the Master of Business Administration degree.

Date:

Evans Amata, M.F.C. (Master of Finance & Control)
Supervisor

Jinnah Waweru, M.A (Economics)
Reader

Thomas Koyier, MSc
Head of Department, Commerce

Muturi Wachira, MPhil, MSc, CPA (K), CPS (K).
Dean, School of Business and Economics

THE EFFECTIVENESS OF CREDIT RISK MANAGEMENT PRACTICES UTILIZED
BY KENYA COMMERCIAL BANK IN SMALL AND MEDIUM ENTERPRISE
CREDIT IN KENYA

I declare that this thesis is my original work and has not been submitted to any other college or university for academic credit.

Signed: _____

Date: _____

Willy Kimutai Cheruiyot

DEDICATION

I dedicate this work to my family, for their loving care, support and help during my study, may the Almighty God continue to bless you all abundantly

DAYSTAR UNIVERSITY

ACKNOWLEDGMENTS

I would like to give a special consideration to my Wife Hellen and our child Joy for all their love and support. May God keep you and bless you.

My sincere appreciation goes to my parents Wilson Birir and Ann Birir and to all my siblings for their moral support.

I am also particularly grateful to Mr. Evans Amata, my Supervisor for his advice, constructive criticisms, continuous encouragement and firm guidance at all stages of the writing of this thesis paper. I also would like to extend my thanks to Mr. Jimnah Waweru, my Reader who has taken time to devotedly read my work with commitment and patience.

Finally and above all I wish to thank the Almighty God who is merciful and gracious and who has carried me through life to this stage. To God be the glory, great things He has done.

DAYSTAR UNIVERSITY

TABLE OF CONTENTS

DECLARATION.....	ii
DEDICATION	iii
ACKNOWLEDGMENT	iv
TABLE OF CONTENTS	v
LIST OF TABLES	vii
LIST OF FIGURES	viii
ABBREVIATIONS AND ACRONYMS.....	ix
ABSTRACT	xi
CHAPTER ONE.....	1
INTRODUCTION AND BACKGROUND OF STUDY.....	1
Small and Medium Enterprise	1
Development of SME sector in Africa	2
SME banking in Kenya	3
Risk Management.....	5
Back ground of Kenya Commercial Bank.....	6
Problem Statement.....	7
Purpose statement.....	9
Research Objectives	9
Research Questions	9
Significance of the study	11
Assumptions of the study	11
Scope of study	11
Limitations of the study.....	12
Definition of Terms	12
Summary.....	13
CHAPTER TWO.....	14
LITERATURE REVIEW.....	14
Introduction	14
Importance of SMEs.....	15
Challenges Facing SMEs.....	17
Access to finance as a constraint to SMEs	19
Informal sources of Finance	19
Credit risk management practises and SME access to Finance.....	24
Importance of Credit Risk Management	25
Credit Risk Management Framework	26
Board and senior management oversight	26
Measurement of Credit Risk.....	27
Financial performance of KCB	27
Credit Administration.....	28
Relationship lending	29
Stress testing.....	29
Intensive Loan Monitoring and Credit Risk Control Methods.....	30

Internal controls and Audit	30
Credit Scoring	31
Theoretical framework	33
Conceptual Framework	36
Summary	37
CHAPTER THREE	38
METHODOLOGY	38
Introduction	38
Research Design	38
Population of the study	40
Sampling Design	41
Data collection instruments	43
Data Collection Procedures	45
Questionnaire Pre-testing	45
Data Analysis	45
Ethical Considerations	46
Summary	46
CHAPTER FOUR	47
DATA ANALYSIS, PRESENTATION AND INTERPRETATION	47
Introduction	47
CHAPTER FIVE	61
SUMMARY, CONCLUSIONS AND RECOMMENDATIONS	61
Introduction	59
Conclusions	63
Recommendations	63
REFERENCES	65
APPENDICES	71

LIST OF TABLES

Table 4. 1: <i>Qualification level</i>	49
Table 4. 2: <i>Qualification related to credit risk management</i>	50
Table 4. 3: <i>Training on SME</i>	50
Table 4. 4: <i>Influence of perceived SME credit risk on credit provision to SME</i>	52
Table 4. 5: <i>Factors to consider in appraisal</i>	53
Table 4. 6: <i>Frequency of monitoring SME loans</i>	53
Table 4. 7: <i>Early signs of problematic SME loans</i>	54
Table 4. 8: <i>Whether credit risk managed practices utilized by KCB are effective or not</i>	55

DAYSTAR UNIVERSITY

LIST OF FIGURES

Figure 2. 1: <i>Conceptual framework</i>	37
Figure 4. 1: <i>Number of years worked for KCB</i>	48
Figure 4. 2: <i>Perceived credit risks faced by KCB when lending to SMEs</i>	51
Figure 4. 3: <i>Credit risk management practices utilized by KCB</i>	55
Figure 4. 4: <i>Challenges faced by KCB in SME credit risk management</i>	56

DAYSTAR UNIVERSITY

ABBREVIATIONS AND ACRONYMS

ASCAs	Accumulating Savings and Credit Associations
ASSOCHAM	Associated Chamber of Commerce and Industry of India
CAMPARI	Character, Ability, Margin, Purpose, Amount, Repayment, Insurance
CBK	Central Bank of Kenya
EAC	East African Community
FSD	Financial Sector Deepening
ICDC	Industrial and Commercial Development Corporation
IFC	International Finance Corporation
GDP	Gross Domestic Product
GOK	Government of Kenya
KAM	Kenya Association of manufacturers
KCB	Kenya Commercial Bank
KNBS	Kenya National Bureau of Standards
KRA	Kenya Revenue Authority
K-REP	Kenya Rural Enterprise Program
KWFT	Kenya Women Finance Trust
KYC	Know Your Customer
MSE	Micro and Small Enterprises
MSME	Micro, Small and Medium Enterprises
NPL	Non Performing Loan
NGO	Non Governmental Organization

OECD	Organization for Economic Co-operative & Development
PAR	Portfolio At Risk
USAID	United States Agency for International Development
ROSCAs	Rotating Savings and Credit Associations
SACCO	Savings and Credit Corporative Society
SME	Small and Micro Enterprises
WBCSD	World Business for Sustainable Development
WUSME	World Union of Small and Medium Enterprises

DAYSTAR UNIVERSITY

ABSTRACT

The purpose of this research was to assess the effectiveness of credit risk management practices utilized by KCB in SME credit in Kenya. The problem addressed by this research was the high rates of non-performing SME loans. The objectives of the study were; to find out the role of credit risk management practices in the provision of SME credit by KCB, to establish the credit risk management practices used by KCB in SME credit, to determine the effectiveness of credit risk management practices utilized by KCB in SME credit and to identify the challenges faced by KCB in SME credit risk management.

The researcher used descriptive research design. The population for this study was 3,914 employees at KCB Kenya while the target population was 115 employees of SME lending and credit risk departments based at head office accessible to be served with questionnaires. Census was carried out on the target population whereby 78 out of the 115 members responded; translating to 68% response rate.

Self-administered questionnaires were used to collect primary data while secondary data were collected through extensive reading. Data analysis was done using SPSS software and findings presented using descriptive statistical tools namely: tabulation, graphical presentation, percentages and ratios. In line with the objectives, the researcher found out that credit risk management practices played a key role in identifying the perceived SME credit risks and that KCB relied on credit administration and intensive loan monitoring as the main credit risk management practices at 100% and 80% respectively leading to 53% of the respondents concluding that the practices utilized were not effective since PAR was still high. KCB also faced several challenges while managing SME credit risk, with data integrity and collection strategies the highest at 96% and 86% respectively.