CREDIT POLICY AND THE PERFORMANCE OF COMMERCIAL BANKS IN KENYA. A CASE STUDY OF EQUITY BANK,KISUMU BRANCH.

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A RESEARCH DISSERTATION SUBMITTED TO THE SCHOOL OF BUSINESS AND MANAGEMENT IN PARTIAL FULLFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF A BACHELORS DEGREE IN BUSINESS ADMINISTRATION OF KAMPALA INTERNATIONAL UNIVERSITY

2012

DECLARATION

I Arek Monica do hereby declare that, this is my own original research dissertation and to the best of my knowledge this same work has never been presented in any institution for academic purpose.

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Date 10/04/2012......................................

APPROVAL

I approve that this work was carried out under my supervisor.

Signature ....

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Date 10/04/2012..

DEDICATION

This research dissertation is dedicated to my Dear late father Mr. Joseph Ayok. It is so painful to see that you never lived to see the output of your daughter. May his soul rest in eternal peace.

ACKNOWLEDGMENT

First I wish to acknowledge the invaluable assistance I got from my supervisor Mr. Michael Ruteganda, without you I wouldn't have finished this research in the required time. Special thanks also go to him for his necessary guidance through this research work. I am also indebted to all my lecturers.

A very special thanks go to fellow students. I could not have done it without all of you.

May God bless you all

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ABSTRACT

THE study aimed at assessing the effects of credit policies on the performance of commercial banks in Equity bank of Kenya. And to propose measures to improve credit policy in equity banks.

For the effectiveness of the research, the researcher used a research design of a cases study of Equity bank Kisumu branch Kenya. Data collection and analysis were used to arrange the information in such a way that enabled the researcher to come up with the reliable recommendations and conclusion. Different methodologies were employed which were research instruments and analysis of data where the researcher used pie charts and presentation done in bar graphs.

The researcher found out that the good performance of Equity bank was mainly contributed by the credit control measures as a result of well established credit policy screening mechanism in place before credit is extended to clients. It's evident from this study that indigenous commercial banks in Kenya use all the elements of credit policy management process, but are not comprehensively using the aspects of the various elements of the process in the management of their credit function.

There is a significant and positive relationship between the elements of credit policy management and the performance of Equity bank thus these findings reveal that the credit policy management in the bank has a strong impact of the quality of the bank's portfolio and thus the performance of the bank.

ABBREVIATIONS

C.B.K	CENTRAL BANK OF KENYA
E.B.S	EQUITY BANK SOCIETY
E.B.L	EQUITY BANK LIMITED
C.M.S	CREDIT MANAGEMENT SOCIETY

CHAPTER ONE

INTRODUCTION

1.0 Background of the study

A country's financial system, including its banking institutions is the oil that greases the engine of its economic growth. Commercial banks provide the vital functions of mobilizing saving from those who have it and allocate such savings to those who wish to borrow to invest in economic development. When these two cardinal functions are not effectively provided by a country's banking institutions, then its economic performance is seriously hampered. Indigenous commercial banks and other credit institutions design credit policies effectively administering credit but they are faced with poor management of their loan portfolios.

Equity Bank started its operations in 1984 as Equity Society. Its establishment was motivated by the desire to create a financial service provider which would touch base with majority of the Kenyan population. The need to come up with the institution was base with the institution was out of the realization that most Kenyan lacked access to financial services or simply could not afford them. The initial focus was to offer Mortgage services but in the early 1990's EBS changed its business focus to micro finance services. EBS grew to become a leading micro finance institution providing a wide range of products and services. The growth in business volume and outreach necessitated the conversion to a commercial bank which was dully registered on December 31, 2004 as Equity Bank Limited (EBL).

The bank experienced difficult times in the early 1990s and in 1992 almost faced liquidation by Central Bank of Kenya (CBK).however, due to the bank's (then EBS) laudable record of creating affordable and easy access of financial services by ordinary Kenyans, CBK opted to apply rational judgments to allow EBS re-invents itself.

Equity Building Society comprehensively implemented the management of change process according to international standards - putting emphasis on quality customer service. For 16 years, Equity survived the difficulties of manual system until June 2000 when it launched computerized management information system. This change contributed to an increase in productivity and an expansion of the portfolio.

Equity Building Society committed itself towards human resource development by engaging in staff training, recruiting professionals and sourcing experienced staff from outside. This contributed to growth in business volume which necessitated its conversion to Equity Bank Limited 2004. Since then, the Bank has grown at a high rate and expanded its business volume. There is no doubt today that the bank is a leader in the microfinance sector in the country and is giving competitors a run of their money.

1.1 Statement of the problem.

Commercial banks have from time immemorial continued to ignore the fact that credit policy has an impact on their performance. As a result, most of them, Equity Bank included have closed some of their branches where malicious people in the form of clients have taken advantage of their ignorance. Bad credit policy has therefore led to poor achievement of the commercial banks.

1.2 Purpose of the study.

The study aimed at assessing the effects of credit policies on the performance of commercial banks in Equity bank of Kenya. And to propose measures to improve credit policy in equity banks.

1.3 Objective of the study.

- To determine the existence and use of credit policies by employees of Equity bank.
- To establish the relationship between credit policy and performance in commercial banks.
- To determine how Equity bank has reviewed their credit policy in regard to performance.

1.4 Research questions

- How effective are the credit policy in terms of credit standards, credit terms and collection efforts in commercial banks?
- What is the relationship between credit policy and the performance of Equity bank?
- To what extent has equity bank reviewed its credit policy in regard to performance?

1.5 Scope of study

The research focused on the aspect of credit management policy and the performance of commercial banks in Kenya but was restricted to Equity bank in Kisumu for the period between 2005 – 2009 due to limited time and security of resources. The data collection took two months, of which data analysis followed.

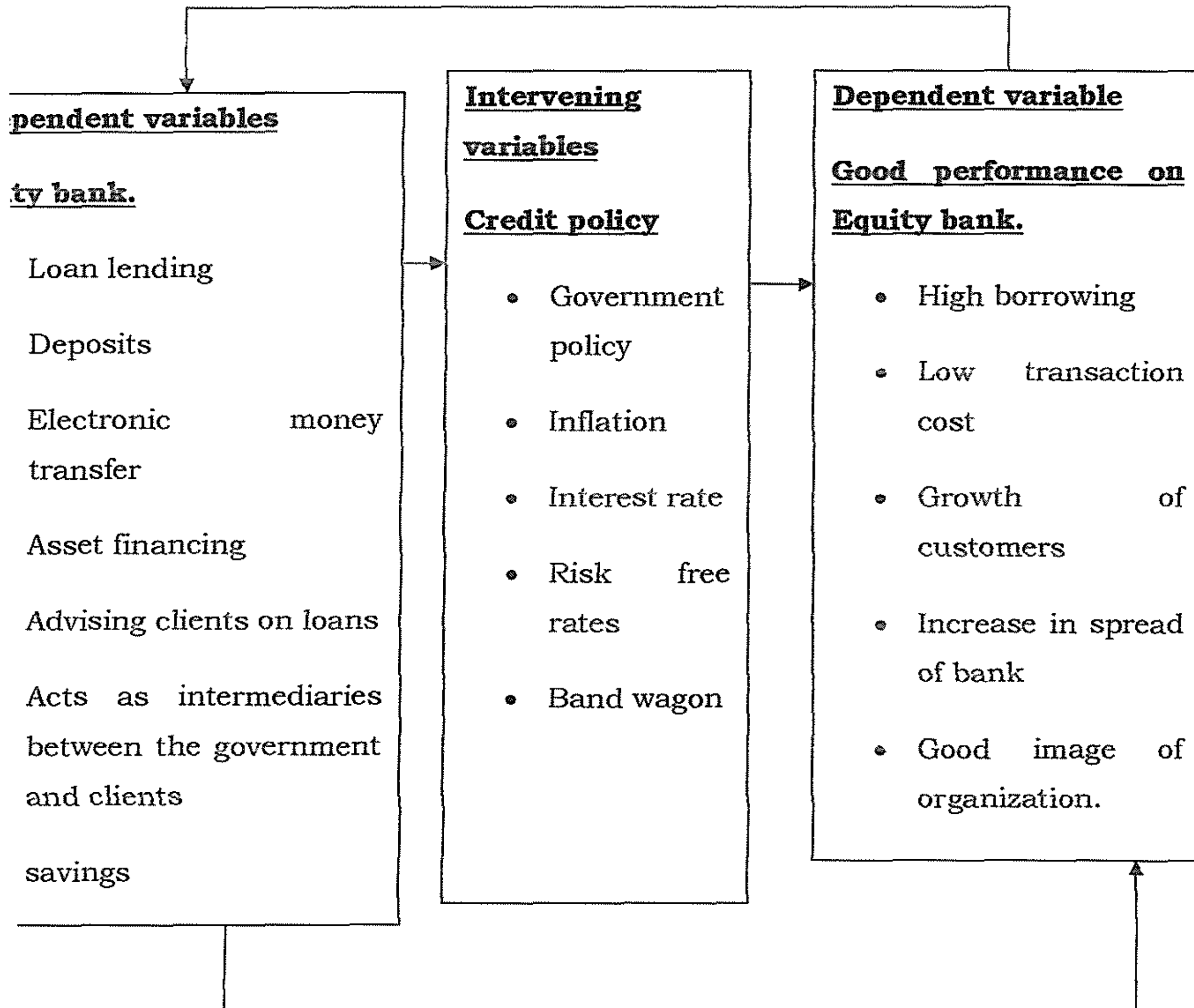
1.6 Significance of the study

It will give an insight into the management of the credit function by Equity bank of Kenya as well recommendations that helped them better their performance.

The research will help the clients on how and where to invest and in calculating the risk for high returns.

This study will benefit scholars and academicians with particular interest in credit management policies in banking industries as well as acting as secondary data for future researchers.

1.7 The conceptual framework.



CHAPTER TWO:

LITERATURE REVIEW

2.0 Introduction.

This chapter is an analysis of some of the major issues of the existing literature on the credit management of commercial banks that have been explored and studied by different scholars. It is worth noting that the greatest part of the existing literature on credit management is as a result of studies which were conducted in other countries thus the literature review is drawn from empirical survey of credit management practices. Journals and textbooks with credit management.

Credit policies are guidelines set by the lending institutions to establish the features and rules for the types of credit products that they offer.

According to Joanna Ledger Wood (2000), micro finance institutions provide credit regardless of the approach selected, the actual loan product need to be designed according to the demands of the target market. This involves establishing appropriate loan amounts, loan terms, collateral requirement (or substitutes), interest rates and fees, and potentially compulsory savings or group contribution requirements. And according **to Frederic Mishkin, the Economics of Money, Banking and Financial Management 1992,** credit management is the activity of:

- Deciding whether a firm should grant credit to a customer and how much credit (that is, for what amount of money and the length of time) should be granted.
- Ensuring that customers who have been granted credit are paying on time.

Many policies are written to safe guard the lenders' assets by limiting the risk on the loan. For example, an institution may have a policy of limiting age of an automobile for securing a car loan to no more than three years.

2.1 Credit risk Model

According to **Gerald O Halter: Bank Investment and funds management second edition 1991**, page 55 credit risk is the probability that the borrower of a loan or issue of security may be unable to meet interest and payments when they fail due. This failure of borrowers to carry on their financial obligations to their lenders as pledged by contract is known as defaults. A borrower may be unable to perform up to expectations for variety of reasons many of which are not always predictable, thus anything that affect the borrower's financial position may contribute to credit risk. Credit risk always encompasses the possibility that a borrower may choose not to or may attempt to defraud its creditors. Credit risk therefore can change during the term of a debt and the successful handling of problems by the borrower may improve an investor's claim.

According to the journal for the capital markets industry, Uganda volume 11 No 3 July –September 2007; credit rating is the assessment of both qualitative and quantitative information which may impact on an entities ability to repay its loans. Quantitative factors may include financial information on liquidity and debt while quantitative information may include management depth and lately corporate governance structure of the bank. However credit evaluation is the core competence f the commercial banks. However credit risk evaluation (credit rating model) focuses narrowly on the likelihood of default on a loan.

According to **Kemmer Donald (1998),** Credit risk management has to begin from a well designed risk transform process from a particular loan risk to a diversified portfolio risk and the share holder's desire risk level by isolating the credit risk from other markets and business risks.

In building such a process, it requires four phases in the process namely specification phase, design phase, test phase and implementation phase, individuals have clear roles and responsibility for each phase and their performances are measured by bench marks.

The requirement phase determines the objectives and limits of the credit risk exposure. They will ensure that these requirements will satisfy the stakeholders or shareholders needs. The design phase specifies the characteristics of the loan portfolio exposure to sectors, creditworthiness, and level and mature for loans. The test phase uses the specified portfolio characteristic to determine benchmark portfolio. Finally, the line business buys loans using model portfolio as a guide and performance of the loan portfolio is continuously monitored to ensure that the requirements are met.

In the process credit risk model is used to measure the loan portfolio credit risk exposure. Therefore the model should be consistence to the banks credit evaluation system in a traditional financial analysis based loan evaluation so that the model results can be interpreted in a consistence fashion, consistence between the traditional financial analysis based evaluation and the value at risk (expressed as a multiple of the standard deviation of the portfolio return) types of risk management techniques.

2.2 consumers Bank Credit

Mueller P. Henry (1976), defines credit policy a tool that provide framework for the entire credit management process. A credit policy or Credit management system (CMS) is aimed at optimizing the efficiency of credit management of commercial banks and other related credit institutions. The banks must gain an acceptable level of confidence to extend the facilities at the lowest possible risk of loss since the bank's funds are committed for returns.

From **Equity Bank Credit operation manual Director Report and accounts (2005);**

Credit management system specifically supports credit assessment and analysis, loan disbursement and credit monitoring. Also credit policy guides loan or credit officers in balancing quality and quality in support of the bank's earning objectives. It ensures consistent approach to credits and a uniform lending style.

Lawrence D.Schall and Charles W.Harey page 518; Customer attributes that is credit managers based their evaluations on the risk in extending risk on their assessments of the attributes of particular customers. This can be in 5 C's' that is Character, capacity, collateral, capital and conditions.

Character; this is a customer own desire to pay off debts hence this is the most *important attribute.*

Capacity: this is the ability to pay debt as reflected in the cash flows of the *individual of firm.*

Conditions; these are general economic circumstances of the firm's industry or *the individual employment.*

Capital: this refers t financial strength of customer which depends primarily on *the customer's net worth relatively to outstanding debt obligations.*

Collateral: this is asset that the customer has available to pledge against the debt.

2.3 Importance of Credit

According to Sennoga Richard (2001) designing and delivering a saving product for micro-finance institutions in Uganda, the micro finance banker, vol 9 No.2, page 5-7; The principle function of credit in commercial banks is to transfer the property from those who own it to those who wish to use it, as in the granting of loans by banks to individuals who plan to initiate or expand their business venture. This transfer is temporary and is made for a price known as interest

which varies with the risk involved and also with the demand for and supply of credit.

2.4 Credit policy

According to fundamental of financial management 9th edition by Eugene F Brigham and Joel F Houston page 726 -728;The term credit policy refers to the combination of the three decision variable namely credit standards, credit terms and collectors efforts that influence the amount of credit extended by commercial banks. Credit period which is the length the customers are given to pay their dues. Credit customers, collection policy, which is measured by its toughness or laxity in attempting to collect or slow paying accounts.

A credit policy provides a framework for the entire credit risk management exercise and is the cornerstone of a credit management, that is **McNaughton D and Diets (1996)** Building strong management and responding to change, managing the credit risk, Washington D.C it provides parameters, defines responsibilities and establishes a system of checks and balances.

A credit policy should be specific, clear concise and relevant supported by the credit procedures. It should include general policies, specific loan procedures, miscellaneous loan policies, quality control and committees to clearly guide the credit decision made in commercial bank. The credit policy should define the bank's acceptable and unacceptable risks.

According to K.C Shekhar (1997), credit policy of commercial banks lacked any policy orientation and displayed a strong bias in favour of the big corporate customers thus this came to the conclusion that security oriented lending had led to over financing of industry in relation to their trends in production. Credit policy is a concise effort of thee part of the banks to allocate their loan able funds among sectors according to priorities in terms of the overall national policies. This is good omen especially because it may be remembered that a fruitful orientation of banking policy require a credit plan attuned to the targets

of investments and production laid down. The credit plans prepared by some of the lead banks contain development schemes in the various sector of the economy, which can be financed by the commercial and co-operative banks and other financial agencies operating in the district concern.

2.4.1 Credit standards and analysis.

According to Stanley B. Block and Geoffrey A .Hirt (2002), Credit standards refer to financial strength and creditworthiness a customer must exhibit in order to qualify for credit. It is a basic stage in leading process. It's a process by which the financial institutions established the credit worthiness of a customer. It involves the appraisal of customers to identify possible risks in lending as well as establishing the customers capacity to repay the loan. The successful credit standards and analysis would require the use of the standard credit application form looking for characters, which indicates the possibility of risk and other relevant information for credit analysis. Setting credit standards requires a measurement of credit quality which is defined in terms of probabilities of a customer's default. The probability estimate for a given customer is , for the most part ,a subjective judgment.

According to Douglas R. Emery, John D Finnerty (1997) Credit standards are criteria used to grant credit. They depend on variable that determine net present value, probability of payment, investment, required rate of return and payment period. A higher probability of default, delayed payment and the expensive collection efforts all reduced the net present value.

Ross Westerfield Jeff, (1996), suggests that different institutions should use credit information to analyze credit thus banks will generally provide some assistance to their business customers in acquiring information of the creditworthiness of other firms. Customer's payment history with the firm: this is the most obvious way to obtain an estimate of a customer's probability of a non-payment whether he or she has paid previous bills. Financial statements: A bank may ask the customer to supply financial statements. This rule of

thumbs based on financial ratios can be calculated. Credit reports on customer's payment history with other firms: many organization sell information on the credit strength.

2.4.2 Credit Terms

According to **Stanley B .Block, and Geoffrey A Hirt (2002)** once the decision regarding the terms of credit follows. Credit terms specify the duration of credit that is credit period and terms of payment in any commercial bank. He also articulated that credit period affects profitability, liquidity and survival since increases in credit period increases the loan portfolios.

2.4.2.1 Determinants of credit terms in commercial banks.

Greuning H.V and Bratonivic B. (1999) the World Bank Washington D.C concluded that in determining the credit terms of any customer, the following need to be considered credit policies and procedures, prior loss experiences, loan growth, quality and depth of management in the landing areas, loan collection like recovery procedures, changes in natural and local economic business conditions and general economic trends. Therefore many banks and regulations believe that an understanding of a bank's credit risk management provides a leading indicator of the quality of the bank's loans portfolio at a given period of time.

Muello p, Henry (1994), pointed out that to consider when adopting credit terms which include credit application history with his or her banks viability of project to be financed, willingness to repay the principal and interest accused, loan write off, purpose of the loan and loan security documentation.

2.4.3 Collection policy

According to Brigham F Eugene (1985) collection policy refers to the procedures the banks or firms use to collect past dues accounts or receivable. A collection policy is needed because all customers do not pay the firm bills in time .some customers are slow payers while others are not payers. The

collection efforts should therefore aim at accelerating collection from slow pay and reducing bad debt losses. The firm's collection policy is measured by its toughness or laxity in following up slow paying accounts.

Attaining a high rate of loan collection is a necessary condition for a commercial bank to become self sustainable ,losses have been the largest coat borne by banks and the principle causes of insolvency and in liquidity. This emphasize the fact that loans not paid decreases the funds available to lend , make it difficult to assure safe deposits and to attract savings, absorb scarce marginal time, undermine the financial integrity of the lender tarnish the intermediary's reputation. When an individual does not pay loan, the process of creating debt capacity is reserved and payment capacity destroyed.

According to Ross Westerfield Jeff (1996), high percentage of non performing loans means tat funds are not available to provide loan to new borrowers and if loans are not repaid, they eventually affect the profitability of the bank.

2.5 Effect of credit on performance of commercial banks.

Credit policy provides a framework for the harmonization of the lending process which affects the performance of the commercial bank. However loans have carrying costs when unpaid in time as they constitute the credit risk factor with associated costs of supporting the credit functions since the cost of capital will increase in relation to added risk as capital is outstanding for long period in the events of today payments.

The dilemma of credit management of varying the level of consumer credit or loans the trade-off between profitability and liquidity or solvency of any commercial bank which affects its survival.

Kansiime Elderd (1996), the influence of credit on performance is either way: first credit earns financial institutions interest that contributes to its profitability and on the other hand, the borrowers benefit by way of achieving a

financial boost in business but which depends on the commercial bank's innovations, exhibited or manifested on the credit policy as well as outreach, by way of branch coverage.

As a major element in the struggle of the rural poor to achieve an economic break-through of the vicious of poverty, the provision of micro credit constitute the primary function of commercial banks and micro credit institutions in Kenya.

However, a good credit policy which ignores saving mobilization affects negatively the financial viability of the financial institutions or intermediary. It is beneficial to focus on what the policy does to the performance of the financial system and therefore performance in the commercial bank should be measured by number of people who have regular access to financial services, costs of *financial transactions quality of services provided*, proxy being the repayment rates and having mobilization.

It is therefore true that the success of commercial banks depends on financial self sustainability and substantial outreach to the targeted population rather than credit policy since financial self sustainability is achieved when the returns on Equity, net of any subsidy received equals the excess on opportunity costs of funds.

2.6 Functions of credit management policy in the Economy.

2.6.1 Reducing the rate of defaulters

According to Gerald O. Hatler (1991) all debts instruments carry some degree of risk; risk management is an integral part of investment portfolio management and the overall management of funds. Banks must take great care in evaluating what levels of risk are inherent in the various assets they acquire and the liabilities they assume. They must make sure that they are compensated with earnings proportionate to the risks they accept, and they must balance the levels of risk that exist within and among their various

portfolios. Risk is much more difficult to measure, however, because its key character is uncertain. Thus credit and interest rate risk are the basic types of risk in bank investments and loans.

Credit risk is the possibility that the borrower of a loan or the issuer of the security may be unable to meet interest and principal payments when they fall due. This failure of borrowers to carry out their financial obligations to their lenders are pledged by contract is called default. A borrower ma is unable to perform up to expectation for a variety of reasons, many of which are not always predictable. Hence anything that affects the borrower's financial position may contribute to credit risk.

According to Meir Kohn (1991), Defaulting is to fail to pay off the amount owed when the loan mature. There is a risk of loss that adheres to generals in general. The lending bank cannot tell in advance which loans will turn bad or will cause trouble, but know from experience that loans of different classes offer varying possibilities for risk. Credit management policy helps to reduce this risk by reducing the rate of defaulters through monitoring loan given. A good credit policy enables that loaned amount is paid back by all clients in the right time.

2.6.2 Maintains liquidity.

According to Dr. P.K.Srivistava (2000), liquidity is the word that the banker uses to describe his ability to satisfy demand for cash in exchange for deposits. The bankers should attach great significance to his obligation to pay his depositor's money, on demand, because his inability to do so, may lead to the public loosing confidence in the bank.

According to Gerald O Hatler(1991) liquidity is the ability to obtain needed cash quickly and at a reasonable cost since funds may be unpredictable and uncontrollable, banks must maintain adequate liquidity to ensure that cash or access to it ,can be obtained on short notice and with little or no loss of

transactions to cover emergency needs of funds, to satisfy the customers demand for loans, and to provide flexibility in taking advantage especially favorable investment opportunities. A bank with too little liquidity is able to fix and rearrange its mix of assets and liabilities to respond to changing business conditions. A bank with little liquidity may be forced to obtain needed funds at a high cost or may find it difficult to obtain needed funds at any reasonable cost. A bank with excess liquidity also pays a penalty for failing to manage its liquidity position efficiently because the cost of liquidity is usually lower earnings.

2.6.3 Maintains a favorable spread

According to Eugene F Brigham and Joel F.Houston (1999), spread income comes when the cost of funds does not exceed the interest rate earned on the loan portfolio. When loan is given to clients, he /she pay it back with interest and the institution earns interest income. Credit policy enables the bank to acquire interest expense thus making profit.

According to Gerald O Hatler (199), spread management focuses on maintaining an adequate spread between a bank's interest expense on liabilities and its interest rate fluctuations. Thus spread management attempt to reduce the bank's exposure to cyclical rates and to mobilize earnings over the long term.

CHAPTER THREE:

RESEARCH METHODOLOGY

3.0 Introductions

For the effectiveness of the research, research design, data collection and analysis was used to arrange the information in such a way that enabled the researcher to come up with the reliable recommendations and conclusions. The following is the methodology which was employed starting with the research design, study population, sampling design, research instruments and analysis of data.

3.1 Research design

The research design was a case study of Equity bank, Kisumu branch Kenya. In this study a cross sectional-survey was done. Qualitative design was used to collect information from the respondents on the attitude and opinion in relation to the effects of credit policy on the performance of commercial banks. On the other hand, qualitative design technique was used to collect numerical data. Therefore the researcher used both the primary and secondary data and in this case, primary data was obtained using questionnaires and interview, while secondary data was gathered from the internet, magazines, textbooks and journals.

3.2 The study population

The study was conducted only in Kisumu branch out of other branches countrywide. Equity bank Kisumu branch has a population of 40 workers who are both male and female, and are divided in the various departments. The researcher used simple random sampling technique. Respondents were identified depending on their willingness and availability during the study exercise. The various employees in the bank formed samples where respondents were selected randomly.

3.3 Sample design and size

3.3.1Sampling design

Random sampling technique was used in picking the employees on which the data was to be collected. Thus respondents were then randomly selected from staff in Equity bank Kisumu branch. Sampling design was preferred in the process so as to achieve maximum precision. Equity bank senior management and other staff were also interviewed.

3.3.2 Sample size

Considering time and other constraints of the study, the researcher selected 20 respondents who were randomly selected from the study population of 40, each department being represented. These considered representation of the study population consistent with the research questions in chapter one. The willingness of managers to give information and respondents positions in Equity bank was the major factors considered in selecting the respondents' sample.

3.4 Data source, collection and analysis

3.4.1Data source

To achieve the research objectives both primary and secondary data was used on the study.

The main primary data source was in depth from questionnaires which were administered to Equity bank staffs. Secondary data sources were obtained from monographs (text book), annual reports of commercial bank of Kenya and quarterly reports, Equity bank new letters, Equity bank director's reports and audited accounts, credit registers. Journals and other publications to provide a yardstick against response from primary data gathered in order to deliver meaningful objective interpretation of the efficiency of the existing credit policy on the performance of the bank.

3.4.2 Data collection methods and instruments

3.4.2.1 Questionnaires method

Data was collected by use of structured questionnaires designed by the researcher. The questionnaires were sent to the department heads, staff and other subordinate staff. This technique was used because all the respondents are literate. The major advantage of this method includes; free from biased information and enough time for the respondent to consider his/her points carefully than in an interview.

3.4.2.2 Interviewing method

The personal interview were carried out by the researcher as a follow up of the researcher as a follow up of the questionnaires so that the interviewee is aided in the areas of difficulty and seek an in depth discussion and explanation on matters on the questionnaires.

3.4.3 Data processing and Analysts

Data collection was edited analyzed using percentages in chapter four, tables and graphs and sample statistics modules like the central tendency, frequency distribution to assess the effects of credit management function on the performance of commercial banks. Quantitative data analysis was performed in relation to research question.

Statistical findings will be interpreted in light of the objectives of study and conclusion will be made based on the literature review to attach more meaning.

CHAPTER FOUR:

PRESENTATION, ANALYSIS AND INTERPRETATION

4.0 Introduction

This chapter discusses the research questions in view of the research objectives to assess the roles credit policy in the performance of commercial banks so as to improve our understanding of the salient issues of the subject matter in line with survey finding and literature reviewed. In the presentation of finding, tables and figures have been used; frequencies/ percentages have also been used to describe findings. Thus the discussions of findings have been organized under the heading of existence and use of credit policy and its effects on performance of commercial banks.

4.1 Bio data

4.1.1 Respondents Designations

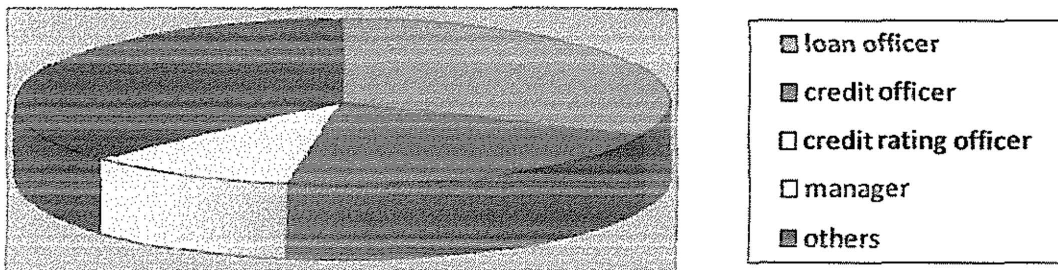
In this study the researcher sought to understand who the respondents were by designation. The tables 1 below present a diagrammatic presentation of the same. In the category of others, it include people working in the finance, accounting, administration, legal departments in Equity bank

Table 1 Classification of the respondents by designation

Designation	Designation	Designation
Loan officer	6	30
Credit officer	4	20
Credit rating officer	2	10
Manager	1	5
Others	7	35
Total	20	100

Source: primary data

Figure 1 Classification of the respondents by designation



Source: primary data

From the above analysis, it is easily deduced that the highest number of respondents from the management were 6 loan officers representing 30% of the

total respondents. There were 4 credit officers representing 20% of the respondents. Only 2 credit rating officers representing 10% responded to the questionnaire. Others have 35% which include staffs working with support function of Equity bank and have relevant information of the study.

4.1.2 Respondents by Age Sex and education level.

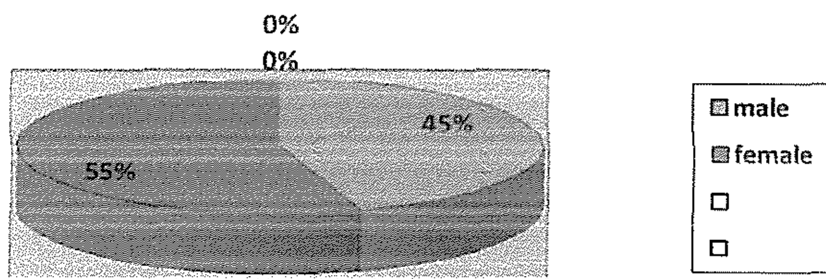
The researcher sought to analyze the respondents by age, sex and education as in the table below.

Table 2. Respondents by sex categories

Sex	Frequency	percentages
Male	11	55%
Female	9	45%
Total	20	100%

Source: primary data

figure 2: respondents by sex categories



Source: primary data

There were 11 males representing 55% and 9 female representing 45% of the respondents, thus males were the highest. This showed that Equity bank

employees more males and the number of people seeking for loan in the bank are males thus this has been indicated in the study.

Table 3: Respondents by age groups

Age group	Frequency	Percentage
18 - 25 years	5	25%
26 - 33 years	9	45%
34 - 41 years	2	10%
42 - 49 years	2	10%
Over 50 years	2	10%
Total	20	100%

Source: primary data

figure3: respondents by age group

Source: primary data

The researcher was also interested to find out the ages of the respondents by grouping them hence the majority of the respondents were from age group of 26% - 33 years who were 9 constituting of 45%. There were also age groups of 18 – 25 years which were only 5 representing 25% of the respondents. The age

grouping of 34 - 41 years .42 - 49 years and over 50 years were only 2 each consisting of 10% each.

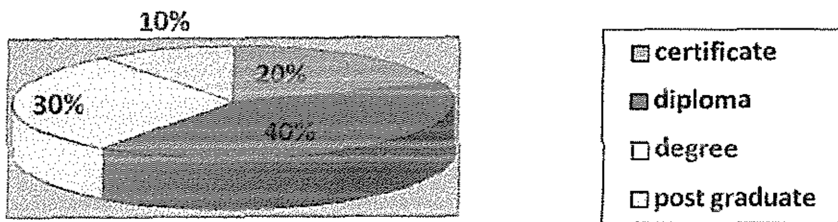
Table 4. Respondents by education level

education level	**frequency**	**percentage**
Certificate	4	20%
Diploma	8	40%
Degree	6	30%
Post graduate	2	10%
Total	20	100%

Source: primary data

From the above analysis, there were 8 respondents who had diploma in education level representing 40% while degree level had 6 respondent consisting of 30% of the graduate thus it was regrettable to note that only 30% of graduate responded to the study as compared to the diploma that had 40% of respondents to the study. This was as a result that most of the senior management staff were busy in relation to the lower staffs. There were 4 respondents in certificate level representing 20% while post graduate level had 10% respectively.

figure4:respondents by level of education



Primary data

The researcher was also interested to find out how much time the respondents have spent working with the Equity bank so as to effectively interpret their views in relation to the performance of the Equity bank.

Table 4 Respondents' length of service

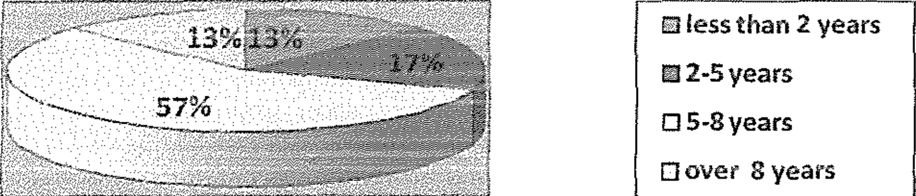
Period in service	Frequency	Percentage
Less than 2 years	4	20%
2- 5 years	8	40%
5 -8 years	6	30%
over 8 years	2	10%
Total	20	100%

Source: primary data

From the above illustration, it is evident that the largest proportion of the respondents had worked with the company for a period of 2-5 years with a frequency of 8 representing 40% of the respondents. This therefore proves that their views are largely based on past personal experiences with the bank over the period of 5 – 8 years which had 6 of the respondents constituting of 30% of the respondents thus this shows that the respondents of 40% have a fairly

sound knowledge on the operations if the bank. There were 4 respondents who had taken less than two years in the service in the equity bank which represent 20% of the respondents. The researcher also fund out that there were only 2 respondents who had worked in equity bank for over years representing 10% ofthe respondents

figure 5: respondents by length of service



Source: primary data

4.2 Credit policy in Equity data

The performance of any commercial bank depends on its existing credit policy at any given time period. Equity bank has written credit policies, procedures and directives that are guided by the bank's mission and strategies plan. These are used to guide the credit decision made and define the target markets of the bank.

From the above table, 19 of the respondents strongly agreed that equity bank has written policy guidelines that guided them in their credit decisions and this represents 90% of the respondents in the research while 5% of the respondents disagree that Equity bank has a written credit policy.

Source: primary data

The management in equity bank reviews the credit policy, procedures and directives as shown in the figure 7 below.

4.2.1 Credit policy review

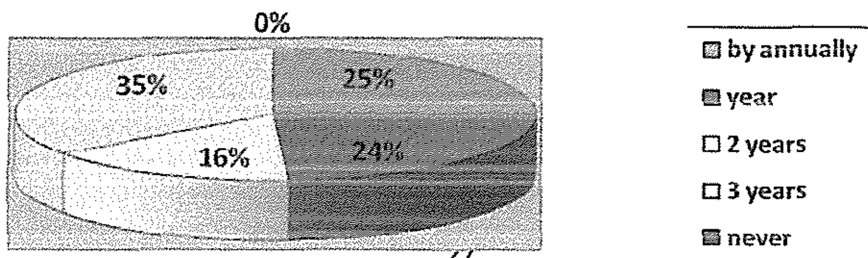
The researcher was also interested to find out how credit policies are reviewed and how effective they are to the Equity bank.

Managers and head of departments review the bank's credit policies, procedures and directives periodically with 8 respondents agreeing that the management reviewed their credit policy at least once year representing 40% of the respondents. The issues taken into consideration in the credit policies and procedures are shown in table 8 above.

The response of credit supervisors on the question of extent of applicability of market definition was also examined. All credit supervisors interviewed strongly agreed that a bank had a policy on credit write off. 7 respondents agreed that the credit policy was reviewed by annually and this representing 35% of the respondents.40% agreed that the credit policy was reviewed every year.

12 respondents strongly agreed that credit policy was reviewed every two years while about 10% agreed the policy was reviewed every 3 years.

figure of the credit policy



12 respondents also agreed that equity Bank use procedures and directive for all loan applicants thus this representing 60% of the respondents and 7 respondents also agreed that equity bank use procedures for all loan applicants but only 1 of the respondent disagreed with this.

10 respondents strongly agreed that before borrowers are given loans, their outstanding and liabilities are checked to determine appropriate line of credit prior to granting additional credit and this representing 50% of the respondents

Table 7: Summary of credit policy respondents

response	frequency	percentage
strongly agree	18	95%
agree	1	5%
neither agree nor disagree	1	5%
disagree	0	0%
strongly disagree	0	0%
total	20	100%

Source: Primary data

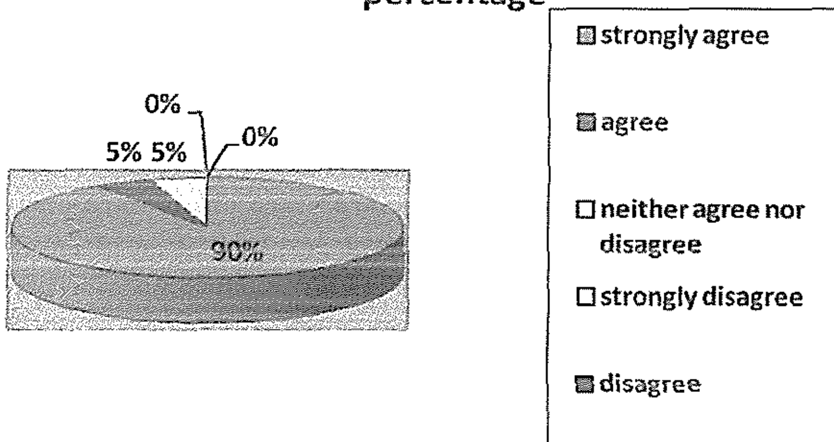
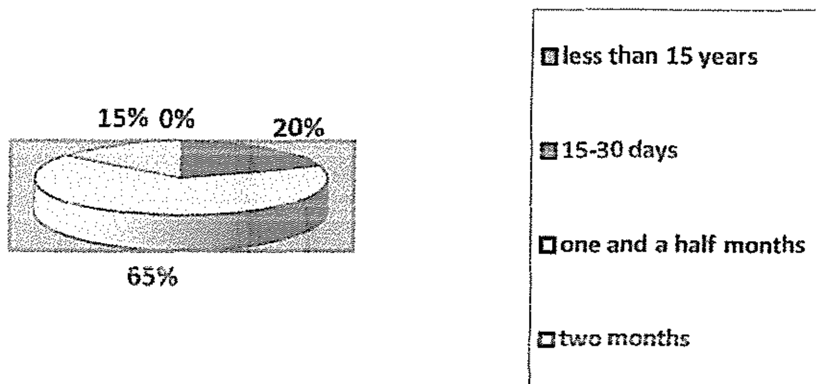


Table 9 response approval of loan facilities.

Response	Frequency	%-age
Less than 15 days	1	5%
15 - 30 days	15	75%
One and a half Months	4	20%
Two months	0	0%
More than two months	0	0%
Total	20	100%

Source: primary data

There are some clients who need less amount of loan from the bank and have all requirements that the bank need thus 5% of the respondents agreed that it takes less than 15 days for such clients to secure loans from banks. While 4 of the respondents agreed that it takes one and a half months' for a client to secure a loan from equity bank and this represent 20% of the respondents.



Source: primary data

4.3 Credit rating

The bank uses a credit rating system in assessment of the clients' credit worthiness these rates are assigned by the credit officers, their supervisors and sometimes by the head of credit section or the general managers. The credit rates are assigned to rate the credit worthiness of the respondent credit chart.

Table 10: response on credit rating in Equity bank

ıse	**Agree**		**Strongly agree**		**Neither agree nor disagree**		**Strongly disagree**		**disagree**		
rating	F	%	F	%	F	%	F	%	F	%	Total
your bank use a ı of credit rating in ting of clients ation for credit ?	7	35%	13	65 %	0	0%	0	0%	0	0%	100 %
credit ratings of ; often reviewed?	6	30%	10	50 %	1	5%	2	10%	1	5%	100 %
the performance of equity bank been ve between the ls of 2003-2007?	11	55%	9	45 %	0	0%	0	0%	0	0%	100 %
there some factors lead to non-ents/bad debts in y bank?	12	60%	7	35 %	0	0%	0	0%	1	5%	100 %

Key:

F- Frequency

%- Percentage

At supervision level, the respondents agreed that the bank uses credit rating policy. This shows the supervisors involvement in the bank's and the bank's use of credit rating system. All respondents agreed hat the bank use a credit rating system in assessment of the client's credit worthiness.

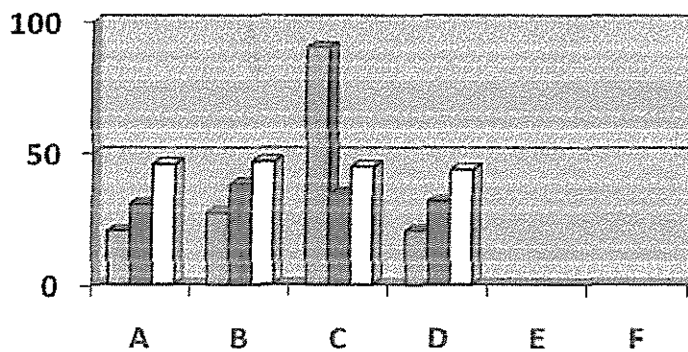
13 of the respondents strongly agreed that Equity bank use credit policy system in evaluating of clients" application for credit facility thus this represents 65% of the respondents. This makes the bank to effectively choose their clients who can pay back the loans given by the bank. 7 of the respondents agreed that Equity bank use rating system to its clients hence this represents 36% of the respondents.

The researcher also wanted to know if the credit rating of clients is often reviewed thus 50% of the respondents strongly agreed that Equity bank reviews its credit rating policy while 30% of the respondents agreed that the bank reviews its credit rating policy, however, 15% of the respondents disagreed that Equity bank does not review its credit rating policy. The researcher wanted to know it there were some factors n that leads to non-payments/ bad debts in Equity bank , hence 12 of the respondents agreed that Equity bank faces some problems and this representing 60% of the respondents.

The respondents considered several factors as the cause of bad debts namely:

Improper appraisal, conmen, poor supervision, political influence, and weak legal system diversion of funds, non-compliance and poor payment thus this is shown in figure 9 below

figure 9: challenges in monitoring respondents'%



Source: primary data

KEY

A- poor communication

B- large portfolio of clients

C- clients change of premises

D- hostile clients

E- transport

F- accessibility of clients

4.3.1 Response on factors on assessment of credit facility

The researcher was interested in knowing how important are the below factors important in application for a credit facility.

Table 11: importance factors used in assessment of credit facility

Response	IV		I		FI		HI		NI		Total
Credit limit summary	9	45%	8	40%	1	5%	1	5%	1	5%	100%
Purpose of the credit	12	60%	6	30%	1	5%	1	5%	0	0%	100%
Collateral/security	14	70%	6	30%	0	0%	0	0%	0	0%	100%
Capacity of customer to pay	12	60%	8	40%	0	0%	0	0%	0	0%	100%
Character of the management	3	15%	6	30%	5	25%	2	10 %	4	20 %	100%
Financial assets of the company	9	45%	2	10%	4	20%	4	20 %	1	5%	100%
Financial projection	8	40%	4	20%	2	10%	5	25 %	1	5%	100%
Owner level of dependence	8	40%	9	45%	1	5%	1	5%	1	5%	100%

Source: primary data

Key: VI – Very important I – Important **FI** – Fairly important **HI** – Hardly Important, **NL** – Not important **F** – Frequency

There are some important factors that Equity bank has to take into consideration before granting loans to their clients thus the researcher wanted to know how important these factors are. There were 12 respondents representing 60% of the respondents who agreed that the purpose of the credit is very important before clients acquire the loan, the clients have to state the reasons why they need the loan.

35 of the respondents representing 70% agreed that collateral or security is very important for the bank to check before granting loans to clients, thus this will give the bank the assurance that the clients will pay the loans. The bank has also to check on the capacity of the customer to pay the loan, thus 100% of the respondents agreed that this is important since the bank has to know whether the clients are capable of paying the loan. The researcher also wanted o know if the character of the management is an important factor when one is applying for loan hence 15% of the respondents agreed that it is important while 25% of the respondents fairly agreed that it is important. However, 20% of the respondents said that character of the management is not important when a client applies for loan.

9 of the respondents representing 45% agreed that financial assets of the company is very important factor in evaluating an application for the credit facility while 5% of the respondents said that financial assets of the company is not important in evaluating an application for the credit facility. Owner level of independence is also important since this will prove to the bank that the clients has the capacity to pay for the credit when given thus 40% and 45% of the respondents agreed that it is very important and important respectively in evaluating an application for the credit facility.

4.3.2 Response on credit recovery approach.

Table 12: Effectiveness of credit recovery approaches

Response	HE		FE		NE		NR		Total
	F	%	F	%	F	%	F	%	%
Continuous supervision to ensure purposeful use of the loan.	6	30	6	30	8	40	0	0	100
Continuous customer sensitization about their financial obligations	10	50	8	40	1	5	1	5	100
Reminder on phone letters and physical customer contacts	14	70	6	30	0	0	0	0	100
Use of court bailiffs and mortgage of collateral	12	60	8	40	0	0	0	0	100
Visiting clients whenever need be	11	55	6	35	1	5	1	5	100
Auctioning clients property	13	65	7	30	1	5	0	0	100
Reference to guarantors	10	50	8	40	1	5	1	5	100
Warning to the customers	13	65	7	35	0	0	0	0	100

Source: primary data

Key

High effective **(HE)**, fairly effective **(FE)**, not effective **(NE)**, non response **(NR)**, frequency **(F)**

In the evaluation on credit recovery approaches, the researcher wanted to find out effectiveness is the above table. 30% of the respondents agreed that

six months to one year for them to repay their loans 12 respondents representing 60% of the respondents strongly disagreed while 40% of the respondents disagreed that second time borrowers are given that long duration to repay their loan.

40% strongly disagreed that the third time borrowers given long time i.e. more than one year for them to repay their loans while 55% of the respondents disagreed that the time borrowers are given that long duration to repay their loans. The respondents agreed that Equity bank treat their clients equally and this depends on he amount of loan a customer applies for hence all customers are equal.

Table 114: effectiveness of the policy to the client of the clients

Response	Agreed		Strongly agreed		Neither agreed nor disagreed		Strongly disagreed		Disagreed		
	F	%	F	%	F	%	F	%	F	%	Total
Are there some weakness in the policy, which might results to low repayment rate from the borrowers due to its strict terms and conditions?	4	20%	8	40%	0	0%	5	25%	3	15%	**100%**
Does the policy limit the borrowers' capacity from securing a loan?	8	40%	10	50%	0	0%	1	5%	1	5%	**100%**
Does the policy establish guidelines for loans to the clients and determine the repayments terms?	9	45%	10	50%	0	0%	0	0%	1	5%	**100%**
Does Equity bank check and evaluate collateral before giving its clients loans	9	45%	11	55%	0	0%	0	0%	0	0%	**100%**

Source: primary data

The researcher wanted to know whether the above information are important to the clients thus 40% strongly agreed that there some weaknesses in the policy, which might result to low repayment rate from the borrowers due to its strict terms and conditions.25% of the respondents strongly disagreed with that, 15% also disagreed with it.

The researcher also inquired whether the policy limits the borrowers' capacity from securing a loan hence 10 respondents representing 50% of the respondents strongly agreed with this and also 40% of the respondents agreed, however, 5% of the respondents strongly disagreed that the policy limit the borrowers' capacity from securing a loan.

55% of the respondents strongly agreed that Equity bank checks and evaluate collateral from clients before giving them loans. 45% of the respondents also agreed with it. This will help the equity bank to know the amount of money they will give to their clients' proportionally to their collateral.

4.5 Effects of credit policy on the bank's performance.

Table 15: Response of the clients on the bank's credit policy

Response	**Frequency**	**Percentage**
The policy encourages clients to borrow.	8	40%
The policy discourages clients from borrowing	0	0%
High repayment rates due to the structures of the guidelines in the policy	9	45%
Low repayment rate due to some weakness in the policy\	3	15%
Total	**20**	**100%**

Source: primary data

From the table above, results of the survey and interviews conducted indicated that 9 respondents representing 45% of the respondents agreed that the highest majority of the respondents took pride in the bank's credit policy considering the high repayment rates, due to strictness of the guideline in the policy and the clients also find the bank's credit policy bearable.

8 respondents representing 40% of the respondents revealed that the policy encourages the clients to borrow. This was due to the facts that loan processing takes less days, 3 respondents representing 15% of the respondents agreed that at times there are low repayment rates due to some weakness in the policy.

CHAPTER FIVE:

SUMMARYCONCLUSION & RECOMMENDATION

5.0 INTRODUCTION

This chapter presents the summary of findings, conclusion, recommendation for future research in line with study objectives and research questions

5.1 Summaries of main findings of the study

5.1.1 Length of service.

Finding indicated that those who have worked with equity bank for a long time have worked for periods between 2-5 years which is 40% of the respondents as shown in table 5. This therefore proves that their views and findings are largely based on the past personal experiences with the bank.

5.1.2 Credit rating.

The credit rating process is carried out in commercial bank Equity bank does this to assess the clients' credit worthiness before giving them loans. These rates are assigned by credit officers, credit supervisions and head of departments where they do the assessment of credit rates. It was noted that the credit rating process has a significant effects on the bank. This implies that if the credit rating is effective carried out, the performance of commercial banks would be enhanced.

Credit policy

The performance of any commercial bank depends on its existing credit policy at any given time thus Equity bank has written credit policies, procedures and directive that are guided by the bank's mission and strategic plan, (Table 6). These are used to guide the credit decision made and define the target markets of the bank. It was noted that credit policies are reviewed after every two years in the bank (table 8).

5.1.4 Credit evaluation

Credit evaluation looks at the depth analysis in a client application. It is the duration it takes a customer to access the funds from the time an application on credit facility is tendered in from the bank (Table 9). 75% of the respondents agreed that it takes 15-30 days for credit application to be approved from Equity bank and this is seen when a customer has met all the requirements needed by the bank.

5.1.5 Credit recovery approach

Credit recovery approach is the process through which equity bank recovers its loan that is principals and interests given to its clients (table 12).equity bank use court bailiffs and mortgages as securities while giving loans, hence when clients fail to repay principal the equity bank will auction the clients property. However the bank has to remind the client on phone, letters and physical contact before auctioning the customer's property.

5.1.6 Duration given to borrowers

Equity bank treats its customers equally whether he's a first time borrower, second or third time borrower. When a clients wants a loan from the bank and has met all the requirements needed by the equity bank then the bank will treat him like any other client who has been borrowing from the bank (table 12).the only difference depends on the amount one takes from the bank: those who take large amounts of loans, their interests rate and time paying back their principal and interest are different from those who take small amount of loan. Thus the higher the amount of loan the lower the amount of interest rate and the longer the duration for payback the loan butt the lower the amount of loan the shorter the paying back period and the higher the interest rate

5.2 conclusions

It is evidently true that the good performance of Equity bank was mainly contributed by the credit control measures as a result f well established credit policy screening mechanism in place before credit is extended to clients. It's

evident from this study that indigenous commercial banks in Kenya use all the elements of credit policy management process, but are not comprehensively using the aspects of the various elements of the process in the management of their credit function.

There is a significant and positive relationship between the elements of credit policy management and the performance of Equity bank thus these finding reveal that the credit policy management in the bank has a strong impact of the quality of the bank's loan portfolio and thus the performance of the bank.

An overall credit policy management must include an evaluation of the credit risk management policies and practices of the bank. This evaluation determines the adequacy of financial information received from a borrower, which must be used by banks as a basis for the extension of the credit and the periodic assessment of inherently changing risk. Hence credit policy should define target market risk acceptance criteria, credit origination and maintenance procedure, and guidelines for portfolio managements.

5.3 Recommendations

From the research study, it was noted that equity bank takes a fairly long time to review its credit policies. This should not be the case, the economic conditions changes much regularly and therefore the bank is prone to making losses due obsolete policies.

The time taken to approve loans at equity bank according to 75% of the respondents is 15-30 days. This is fairly a reasonable duration. However they are not very keen in assessing the credit worthiness of the customer and therefore end up giving loans to people who end up as defaulters and the bank ends up making losses.

According to the study, only 10% of the bank staff at Kisumu Branch work as credit rating officers. This is the allowed number compared to the number of

clients they handle. Equity therefore should increase the staff that works in that department to ensure effectiveness and efficiency.

According to the research, most of the people working in the credit department are people who have not stayed with the bank for a long time. The argument they have is that credit department is not very sensitive since cash is not involved. This is a wrong perception because these inexperienced staff ends up misinterpreting the policies and making wrong assumptions and thus putting the bank profitability objective of the bank.

5.4 Issues for further research.

The study assessed the effect of credit policy on the performance of commercial banks in Kenya using Equity bank as a case study. This was in regard is to Equity bank past experience of credit function in line with its performances. The whole exercise of credit risk management depended on the discretion of management in controlling the level of loan portfolios. Thus its however advisable that a study on other bank outside the credit policy could provide further information on the factors that may influence the performance of commercial banks more so in Equity bank of Kenya. Further research can be done on other financial institutions apart from Equity bank that deal with giving out loans and have credit policies since Equity bank is just part of financial institutions. This leads to easy comparison and make research done earlier more realistic.

5.5 Limitations of the study

A number of limitations was experienced during the research some of which include;- Literature ; there was limited data on research variables in the text books and even the little that was sometimes hard to understand in that it was a bit complicated to be related to the study (secondary data). Such literature problem was solved by hard work and much research many in libraries.

Time ; time allocation for research was not enough to allow one to exhaustively obtain all the information and data required for all the necessary conclusion to be made. Time problem was overcome by dedication that was to say the research sending most of the time doing research work.

Cooperation; there was lack of proper cooperation from the staff of the bank. This is because they considered most of their information secrets of the bank and giving them out would be making them vulnerable to their competitors.

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Appendices

Appendix 1: research instruments

A.QUESTIONNAIRES

QUESTIONNAIRES TO THE MANAGEMENT

Dear sir/madam

I humbly ask you to participate in this research on the effects of credit policy on the performance of commercial banks in Kenya, taking Equity bank, Kisii branch as the case in point. The study is purely for academic purposes, thus it will not be disclosed in any way for any other causes. It is a partial requirement for the award of bachelor's degree in business administration at Kampala international university to the researcher.

Instructions: please help by answering the following questions as honestly as possible . please tick where appropriate on the provided spaces

Questions	Agree	Strongly agree	neither agree nor disagreed	Strongly disagree	Disagree
Credit policy					
8. Does your organization have a written credit policy?					
9. Are credit policies, procedures and directives realistic to the performance of Equity bank?					
10. Do you always use procedures and directive for all loan applicants? 11. Are borrowers outstanding liabilities checked to determine appropriate line of credit prior to granting additional credit?					
12. Does the credit policy encourage clients to borrow?					
13. Does Equity bank conduct review on its credit policy?					
14. Does your bank use a system of credit rating in evaluation of clients' application for credit facility?					
15. Are credit rating of clients often reviewed?					
16. Has the performance of the Equity bank been between the periods of 2003 – 2007 been effective?					
17. Are there some factors that lead to non-payments/bad debts in Equity bank?					

Section B INTERVIEW GUIDE

1. Does your organization have a written credit policy?
2. Are credit policies, procedures and directives realistic to the performance of equity bank?
3. Do you always use procedures and directive for all loan applicants? Are borrows outstanding liabilities checked to determine appropriate line of credit prior to granting additional credit?
4. Does the credit policy encourage clients to borrow?
5. Does Equity bank conduct review on its credit policy?
6. Does your bank use a system of credit rating in evaluation of clients' application for credit facility?
7. Is credit rating of clients often reviewed?
8. Has the performance of the equity bank been between the periods of 2003-2007 been effective?
9. Are there some factors that lead to non-payments/bad debts in equity bank?

Section c

How clear are the policies, procedures and directives in the following areas?

Question	Very clear	Clea r	Fairly clear	Not clear	Not include d
Credit terms.					
18. In defining duties and responsibilities of credit officers, credit supervisors and credit committees					
19. in defining acceptance types of loans?					
20. In setting guidelines for categorizing loans					
21. In establishing maximum financial information required at the inception of credit.					
22. Establishing leading authority of committees, individuals or officers.					
23. Credit analysis and credit information					
24. Establishing limits and guidelines for loans to bank officers and directors					
25.Establishing maximum maturities for the various loans					
26.Establishing geographical limits for loans					
27. Establishing limits and guidelines for loans to any related interests.					
28. In submission and processing of credit application.					

Section D

In evaluation an application for a credit facility, how important are the following?

Criteria	Very important	important	Fairly important	Hardly important	Not important
29.Purpose of credit					
30. Collateral / security					
31. Capacity of customer to pay					
32.Character of management					
33. Financial assets of the company.					
34. Credit limit summary					
35. Credit approval memo					
36. Financial projection					
37.Owner level of dependence					