

CREDIT CARDS AND PERFORMANCE OF COMMERCIAL BANKS PORTFOLIO IN KENYA

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ABSTRACT

The use of credit card as an investment option to commercial banks has gained popularity over the years. Kenya's growing middle class have preferred the utility of credit cards to hard currency as a safe way of making purchases and executing business transactions. This trend has increased competition among commercial banks as they position themselves for business investment which has now raised concerns about the effects of credit card on performance of commercial bank portfolio. This study sought to determine the effects of credit cards on performance of commercial banks portfolio in Kenya and particularly in Migori town. The study sought to determine the relationship between adoption of credit cards and credit card holders' satisfaction and to establish whether adoption of credit cards has improved commercial banks revenue. The study adopted descriptive design. Open and closed questionnaires were distributed to six (6) commercial bank managers who were selected through purposive sampling and 120 credit card holders. The data was analysed by use of Pearson product moment correlation coefficient, simple regression analysis and chi-square. The results showed that credit cards have contributed positively to satisfaction of credit card holders and adoption of credit cards improved commercial banks revenue. The study recommends that there is need for commercial banks to widen their credit card market so as to benefit more from usage of credit cards so as to improve their returns.

Key words: Credit cards, performance, portfolio

1.1 INTRODUCTION

The usage of credit card as an alternative form of making payments and obtaining cash which has gained prominence in the banking sector today dates back to early times. However, according to Price water

house Coopers Report (2011) credit risk is a major risk for any bank. With increased competition for lending and as banks expand their retail networks; there is heightened risk of banks relaxing their credit approval and appraisal procedures, thereby increasing risk. The report adds that credit risk is largely attributed to customer default, inconsistent credit stress test standards across the industry. Portfolio risk from loans skewed in favour of particular industry sectors also contribute to increased credit risk. (www.pwc.com/ke retrieved on 23/2/2011)

Central Bank of Kenya report of 2010-2011 revealed that commercial banks' lending rates declined marginally from 14.39 percent in June 2009 to 13.88 percent in May 2011, reflecting the higher risk perception by commercial banks, the interest rate spread rose from 9.94 percent in June 2010 to 10.23 percent in June 2011. In addition, the Kenya consumer price index (CPI) rose by 14.49 percent from 105.6 in June 2010 to 120.9 in June 2011. Taking into account price changes throughout the year, the index rose on average by 6.88 percent by June 2011 compared with an annual average increase of 5.43 percent in June 2010. The rise in overall inflation in the year to June 2011 largely reflected an increase in prices of food and fuel. The annual average inflation rose to 6.9 percent in June 2011 from a low of 3.9 percent in January 2011 and 5.4 percent in June 2010.

Kolari (1997) added that commercial banks will tend to specialize in a particular credit area to take advantage of management expertise. Likewise, for reduction of risk and consequent improvement of the profitability index of small business lending, banks can diversify into other loan areas. In this way losses in one area of lending can be offset by gains in other areas, which tend to smooth profits and reduce risk.

1.2 STATEMENT OF THE PROBLEM

The performance of credit cards portfolio is influenced by complex interaction between several factors like credit risk, credit limit utilization, customer satisfaction and revenue generation. Cohen (2005) stated that the force that affects the economy in the developed countries is the purchases done with credit cards when compared to individual saving which can also be true for developing countries. A number of studies like Nash (1993) found out that credit card lending specialization gives higher and more volatile returns than achieved by banks with conventional product mixes. Few studies have examined credit cards effect on performance of commercial banks based on customer satisfaction and bank revenue. Therefore this study sought to evaluate the effects of credit cards on performance of commercial bank portfolio in Kenya.

1.3 OBJECTIVE

To establish the effects of credit cards on performance of commercial banks portfolio in Kenya.

1.4. METHODOLOGY

The study employed a descriptive design. The purpose of descriptive design, according to Ezeani (1998), is to collect detailed and factual information that describes existing phenomenon. There are six commercial banks in the town and all were involved in data collection thus the bank managers were all interviewed. The sample size of 120 credit card holders was drawn from the bank records. A sample of 120 was in conformity with Roscoe's (1975) rule of thumb which indicated that sample size between 30 and 500 was sufficient. The researcher designed a questionnaire for the credit card holders which sought their opinion on satisfaction with the use of credit card. The questionnaires were randomly distributed to credit card holders who were asked to indicate the extent to which they agree or disagree with the statement. The Five-Point Likert's scale having the ratings strongly agree (5), agree (4), undecided (3), disagreed (2), and strongly disagreed (1) were used to seek their opinion. Product Moment Correlation Coefficient was used to show the strength of association between credit cards usage and customer satisfaction at 5% level of confidence. Linear regression analysis was used to establish the relationship of commercial bank portfolio

and credit cards in terms of customer satisfaction, and chi-square was employed to gauge bank managers' opinion on contribution of credit cards to generate bank revenue.

1.5. RESULTS AND DISCUSSION

Customer satisfaction and revenue associated with credit cards were used as variables to establish the effects of credit cards on performance of commercial banks. According to Oliver (1981), customer satisfaction entails the full meeting of customer expectation of certain products and services. Indeed, recent research in accounting advocates using customer satisfaction and loyalty as useful non-financial measures of firm performance so that good corporate governance will be the outcome (Smith & Wright, 2004). Since most banks and financial organizations offer similar products and services, customer satisfaction has become an important asset of measuring performance particularly for the banking and finance industry (Khondaker, Saifuddin & Zaman, 2011). On the other hand, bank revenue can as well be used to measure performance of bank portfolio (Revell, 1980).

The first objective of the study was to determine the relationship between adoption of credit cards and credit card holders' satisfaction. Consequently, the researcher tested the following hypothesis:

H₀₁: There is no significant relationship between the adoption of credit cards and credit card holders' satisfaction.

H_{a1}: There is significant relationship between the adoption of credit cards and credit card holders' satisfaction.

The researcher used benefits associated with credit cards like making purchases without necessarily having cash, getting money when salaries delay and negotiated credit limits to gauge the respondents on their satisfaction with credit card services. The findings revealed (**Table 1**) that 58% of the respondents were of the opinion that credit cards have improved credit card holders' satisfaction, 39 or 33% strongly agree while 11 or 9% disagreed and none respondent on the opinion undecided or strongly disagreed. Therefore, the agree opinion having the higher percentage showed that the adoption of credit cards has improved credit card holders' satisfaction. The respondents who agreed argued that statements were sent regularly, they were always served promptly whenever the card was presented, the credit card holders were able to make purchases when lacked cash, they were also happy that credit cards offered flexible repayment. The findings were supported by a study by Feinberg (1996) who found out that credit cards served the customers satisfactorily since in the event that a customer's wallet or purse was stolen, credit cards offered more protections and recourse than cash hence reduce cash based crimes. On the other hand, credit holders who were dissatisfied argued that the use of credit card for repayment could be expensive due to hidden monthly charges and when one defaults, credit card attracts more charges. Lastly, credit card required maximum discipline or else one go into bad debt.

The SPSS output for the data on credit cards and credit card holder's satisfaction based on the benefits associated with credit cards shown in table 1 revealed that there was an association between the adoption of credit cards and credit card holder's satisfaction. Commercial banks issuance of credit cards as a means of payment and access to cash has improved the customer's satisfaction. The Pearson Correlation Coefficient (r) was 0.733 or 73% (**table 2**) showed that there was a strong and positive relationship between the adoption of credit cards and credit card holders' satisfaction. The study therefore concludes that commercial banks provide services that customers are deriving satisfaction with particular reference to the use of credit cards thereby evaluating the performance of bank portfolio on convenience and comfort it provides to them as customers.

The statistical tools used in analyzing the model of this research work were given thus: the coefficient of correlation (r) shows the degree or extent of relationship between the dependent variable and the independent variable. The value of 0.733 in table 2 shows the existence of a positive relationship between these variables. It equally reveals a good degree of dependency of the dependent variable to the independent variable. The coefficient of determination (R^2) explains the proportion of the total variation in the dependent variable that is attributed to the variations in the independent variable. From table 3, it was revealed that about 59.8% (0.598) of the variations in the dependable variable are attributed to variations in the independent variable. It thus indicates that only 59.8% of credit card holders' satisfaction is explained by the use of credit cards. The Adjusted Co-efficient of Determination ($R^2_{Adjusted}$) which shows the actual variation in the dependent variable attributed to the independent variable. **Table 3** revealed that the adjusted co-efficient of variation is 0.464 which implies that the actual variation is 0.464% as against the 46.4% suggested by normal R^2 .

From table 4, the model connecting contribution of credit cards (independent variable) and customer satisfaction (dependent variable) is $Y = -20.4 + 14.8X$. The co-efficient of adoption of credit cards by bank customers extended 14.8 indicating that use of credit card contributes positively to satisfaction of credit card holders. This indicates that 77.3% of the variation in the dependent variable is explained by the regression equation. The study therefore concludes that the null hypothesis is rejected and the alternative hypothesis accepted.

The second objective of the study was to establish the effect of credit cards on improvement of commercial banks revenue. The study hypothesized thus:

H_{02} : Adoption of credit card does not improve commercial banks revenue.

H_{a2} : Adoption of credit card improves commercial banks revenue.

The chi-square test was employed by the researcher to test the significance of the responses of commercial bank managers on whether credit cards have improved banks revenue. The chi-square test was performed by defining the numbers in categories and observing the number of cases falling into each category and knowing the expected number of cases falling in each category. The formula used was:

$$Z^2 = \frac{(O_i - E_i)^2}{E_i}$$

Where $Z^2 = \text{chi - square}$

O_i = Number of observed case in category i

E_i = Number of expected cases in category i

K = Number of category

From table 5, Z^2 (Chi-square) value calculated is 12.833 and the degree of freedom $k-1$, $5-1 = 4$. Using the statistical table to find the value of $Z^2_{\frac{\alpha}{2}}$ at 0.05 confidence level, the result is = 9.4877. Since the value calculated is greater than the value tabulated ($12.833 > 9.4877$) at 5% confidence level, the null hypothesis is rejected and the alternative which stated that 'Adoption of credit card improves commercial banks revenue' is accepted. The findings were in line with Cohen (2005) who found out that the force that affects the economy was the purchase done with credit cards when compared to individual saving thereby promoting banks investment. Another support of the findings was Ausubel (1991) who did an empirical study of credit card market and found out that abnormally high profits existed in the banking industry in spite of its seemingly competitive structure with over 6,000 card issuers. In addition, Manning (2000) further found out that banks were eager to distribute as many cards as possible because of the huge profits associated with credit card business.

The respondents identified sources of revenue as interchange fee (transaction amount) and finance charges (interest charged, late fee, annual fee, over limit fee and cash advance fee). However, the

commercial banks experience dormant credit cards. The respondents stated that dormant credit cards affects the banks' portfolio by lowering commission charged on credit card usage, withholds banks money and at times ends up in bad debt to the bank. The dormant credit cards as well enabled the bank to lose interest that should have been accrued to the bank when credit card is used since it doesn't generate income in terms of renewal fees.

The findings of the study revealed a positive correlation usage of credit cards and bank portfolio. This implied a marginal change in the diversification of banks portfolio and overall adoption of credit cards in the Kenyan banking industry will result to customer satisfaction, proportionate increase in banks revenue and subsequent portfolio improvement. This is confirmed by the level of regression co-efficient hence findings of the study revealed a positive correlation between credit cards transactions and banks portfolio in Kenya.

1.6.3 Conclusions

The banking industry plays a pivotal role in supporting economic development through financial services (Dube, et al 2009). Commercial banks in Kenya have embraced credit cards as a way of diversifying their loaning facilities. Similarly, credit card acceptance depends on bank service quality, customer preferences and satisfaction. Based on the summary of the major findings, the study concludes that the adoption of credit card as an investment by commercial banks has a strong effect on the overall banking performance in relation to customer satisfaction and revenue generation. Credit cards add fortune to the commercial banks through profitability enhancement. On customer satisfaction, credit card serves the customers well as they access credit and limit insecurity associated with cash payments.

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TABLES

Table 1 Credit Cards and Satisfaction of Credit Card holders

Response	Number of Respondents	Percentage
Strongly Agree	39	33
Agree	70	58
Undecided	-	-
Disagreed	11	9
Strongly Disagreed	-	-
Total	120	100

Table 2 Correlations

	X (Credit Card)	Y (Credit Card holder Satisfaction)
X (Credit Card)	1	.733(**)
Sig. (2-tailed)	.125	
	N	120
		120

**Correlation is significant at 0.01level (2-tailed).

Table 3 Model Summary of Regression Results

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.733(a)	.598	.464	22.148

a Predictors: (Constant), X (Credit card)

Table 4 The Regression Model

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
B	Std. Error	Beta			
(Constant)	-20.4	23.229		-0.878	.444
Credit card	14 .8	7.004	.773	2.113	.025

a Dependent Variable: Credit Card holder Satisfaction

Table 5 Chi-Square Table on Credit Cards and Improvement of Commercial Banks Revenue

Respondents View	O _i	E _i	O _i -E _i	(O _i - E _i) ²	$\frac{(O_i - E_i)^2}{E_i}$
Strongly Agree	4	1.2	2.8	7.84	6.533
Agree	2	1.2	1.8	3.24	2.7
Undecided	0	1.2	-1.2	1.44	1.2
Disagree	0	1.2	-1.2	1.44	1.2
Strongly disagree	0	1.2	-1.2	1.44	1.2
	6	6	0	15.4	12.833