EFFECT OF CREDIT RISK MANAGEMENT PRACTICES ON PERFORMANCE OF COMMERCIAL BANKS IN KITENGELA,KENYA.

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DECLARATION

DECLARATION BY THE STUDENT

I declare that this dissertation is my original work and has not been previously published or submitted elsewhere for award of a degree. I declare that this contains no material written or published by other people except where due reference is made and author duly acknowledged.

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ABSTRACT

Credit management is a major factor that influences the profitability, growth and survival of different banks. Firms mostly gain from sound credit management if the proceeds of sales surpass the total costs of credit. Actually, weak credit management is the main cause why many commercial banks fail. The target population for this study were 50 staff members from the credit department of Commercial banks.The researcher used convenience sampling in which it narrowed down to 5 Commercial banks in Kitengela which included Equity, Cooperative, Barclays, KCB and Family.The research reliedheavily on primary data. The former was gathered through self-administered questionnaires containing closed ended questions. The information was gathered and coded using descriptive statistics, specifically the mean and standard deviation to explain each variable. The data was analyzed through statistical package for social sciences (SPSS). Pie charts,frequency distribution tables, and bar charts had a great role in the presentation of results while ANOVA was used in analysing the findings. The findings indicate that Credit appraisal positively influenced performance and was insignificant, risk identification had a positive impact and was significant,risk monitoring had a negative impact and was insignificant, risk measurement had a positive and significant effect, risk control had a positive and significant effect while risk monitoring had a negatively and insignificantly influenced performance. Recommendations for the research indicate that banks can invest in other ways of improving performance such as business alignment, channel optimization, process costs, staff productivity, technology and innovation. The study concludes that the banks need a multifaceted approach in their risk management efforts that includes all the practices that were of focus to this study in order to realize the full benefits relating to risk management programs.The study suggests that a further research can be done on impact of credit risk management on financial performance of other institutions like microfinance institutions and SACCOs.

Key Words: Credit management, performance, commercial banks

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DEDICATION

I dedicate this project to my loving husband, daughter, mother and my whole entire family for all the love and support they have given me during this entire process.

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ACRONYMS AND ABBREVIATIONS

ADB- Asian Development bank

CAMEL- capital adequacy, assets, management capability, earnings, liquidity and sensitivity.

CBK- Central bank of Kenya

7Cs- character, capacity, collateral, contribution, conditions, control and common sense

GDP- Gross Domestic Product

KCB- Kenya Commercial Bank

KYC -know-your-customer threshold

NPL- Non-performing loan ratio

ROA-Return on Asset

ROE- Return on Equity

SPSS- Statistical Package for Social Sciences

UAE- United Arabs Emirates.

CHAPTER ONE

INTRODUCTION

1.1 Background of the study

Credit management is a major factor that influences the profitability, growth and survival of different banks. Firms mostly gain from sound credit management if the proceeds of sales surpass the total costs of credit (Home &Wachowicz,1998). The credit concept hasbeen in existence for decades proceeding the Second World War, and it increased significantly in Europe followed by Africa (Haron, 2004). Myers and Brealey (2003), regard this concept as an arrangement whereby the acquisition of products is done with no down payment made upon contractual agreement for later payment.

During the 19th century, loans given to customers were not re-compensated on time and this situation required an intervention. Most of the recommended steps advocated the evaluation of customers' ability to service their loan. However, the approach did not succeed due to the increased risk of default (Modourch, 1999).The credit concept has become widely appreciated by banks in the late 90s, but the default practice is still experienced even today (Modourch, 1999).

Identification of credit default on time is quite important since increased default index result in reduced liquidity rates, decreased cash flows and financial difficulty. However, reduced exposure to credit exposure translates to high debtors' level with decreased probability of bad debts,hence better financial position.A sound financial system is a key factor in the development of a nation while dismal performance could have a negative impact on the nation's financial growth (Das &Ghosh, 2007). Company's economic well-being is its power to create new resources, from everyday operations over for a given duration, and it is measured by the cash from operations and its net income.

In reducing these risks, it is imperative that a financial system has; banks with sufficient capital, shared database about borrowers,a diverse customer base,stabilized interest rates, increased bank deposits, fewer non-performing loans and more credit for borrowers. According to Sandstorm (2009), Laker (2007) and the Supervision Annual Report (2006), loan defaulters and nonperforming loans need to be reduced.

Due to high bankruptcy rates, most banks are incurring huge losses. Business practices and economic turmoil are forcing organizations to reduce payments while credit management resources are also reduced due to high expectations. Thus, credit officers are expected to search for ways of implementing best proven practices. According to Scheufler (2002), some of the pitfalls that organizations face which can be avoided include the inability of banks to spot fraudulent customers, improper estimation of current customers' contribution to bad debts, failure to plan for bankruptcies, underutilization of technology, and wasting time and resources on the evaluation of credit which has little or no impact on credit defaults.

It is quite clear that financial institutions are crucial and of immeasurable benefit to the provision of credit to customers. Credit facilitation is not only the foundation of commercial banks, but also to the developing economies; this is quite true considering that the capital markets in such nations are not as highly developed and organized (Richard et al., 2008). In Kenya lending are the dominant assets of many banking industries as they make up the lion's share of the operating capital. Kenya has a total of 44 licensed commercial banks in Kenya, three credit reference bureaus and one mortgage finance company. Out of the 44 banks, 13 are foreign while 31 are locally managed. The credit reference Bureau (CRB) in the African continent, was among the pioneer organizations to be instituted in Kenya by the Central bank of Kenya. Markedly, its establishment aimed at facilitating the sharing of borrowers' information among commercial banks as a way of facilitating credit scoring efficiently.

In 2013, higher interest rates and economic depression linked to the General election held in March forth made numerous borrowers to default on their bank loans, making the resulting in an all-time five-year high of bad loans in Kenya. A report by the Central Bank of Kenya indicates that commercial banks hold more than 70 billion Kenyan shillings worth of non-performing loans as at March. This situation emanates from pressure of the declined spending by the government and private sectors spending following the general elections. This was 14.1 per cent higher than the 61.6 billion Kenyan Shillings bad loans that the lenders held in the year 2012. However, in that year banks did not reduce their lending rates despite the clear signals from the CBK, which slowed down new lending rates, but the wider net interest margins helped them grow their profits," said VimalParmar, the head of research at Burbidge Capital. As a result, the top two Kenyan banks, Equity Bank and KCB announced a double digit growth in the

first quarter of the year. According to Ngigi (2013), KCB did announce the reduction in the Non-performing loans ratio and recoveries of non-performing loans as the key drivers of its future performance.

In 2014, the banks were thus forced to set aside additional cash as provision for defaults in loans. It required lenders to classify all the loan accounts of a borrower who defaults in clearing loans of one of their multiple loans for more than three months. Such adverse measures led to an increase in prudential provisions. Frank Ireri, the housing finance group CEO, noted that the introduction of new laws relating to the recovery process and introduction of CBK guidelines in relation to multiple mortgage facilities led to bad loans rise in the years 2013 by 30.9 per cent to 80.6 billion Kenyan Shillings, the highest in over six years, even outdoing growth in new credit advanced by lenders (Ngigi, 2014).

Every banking facility aims at operating profitably so as to earn maintain its stability while improving growth and expansion. However, for the last 20 years, they have faced a diverse set of setbacks such as the non-performing loans (NPL), and unstable cost of borrowing, political temperatures, whichimpacted the stability of financial facilities (Aduda&Gitonga, 2011). The annual supervision obtained from the Central Bank of Kenya indicates that a given part of non-performing loans which recorded an upward trajectory of 56 billion to 97 billion since 1997 to 1999. This trend inNPL continues to be a significant supervisory issue in the country. For this reason, those financial markets that record higher NPLs need to spreadtheir uncertainty and prepare portfolios that combine NPLs with performing credits, since they mostly trade in financial markets. Germany was among the leading countries in NPL trade in 2006 due to the large size and as well as the massive competition in the trade (Misati, Njoroge, Kamau&Ouma, 2010).

Boahene, Dasah and Agyei (2012), hold a similar opinion about credit creation as well as facilitation; credit creation remains the main objective of any world-wide bank through the cost of borrowing and advances, and they form a substantial percentage of the banks' assets.Similarly, Kargi (2011), holds a similar view about credit facilitation as a fundamentalsource of income for most financial institutions.In Kenya, lending is the heart-felt main element of banks; it is intricately connected to the economy's financial framework.Therefore, itrequires all policy formulators to periodically review the credit

marketwith a view for reducing shortfalls that could impede economic progression. Credit risk management can simply be termed as a well-organized strategy for controlling uncertainties by developing risk assessment methods for taming it, reducing risks, and mitigating the negative outcomes of risk while embracing some or the entire set of outcomes of the risk adopted.

However, empirical evidence and studies from other scholars show a different relation between credit management and risk. Hosna et al., (2009) observed the linkage amongNPL and capital adequacy ratios as well as profitability. The results of the study showed that the rate of NPL and capital adequacyhad an inverse relation to ROE even though the rate varied across banks. Moreover, AchouandTenghuh (2008); Kolapo et al., (2012) and Musyoki and Kadubo (2011) did the same research and found out the same linkage among profitability, credit risk measures and performance in the study.

On his part, Kithinji (2010),studied the impact of credit uncertaintyin terms of the ratio of credit and advancesalongside that of NPLcompared to total borrowings, and advances on revenue gained from assets in Kenya's financial facilities between 2004 and 2008. His research showedthatamount of credit and non-performing loans did not influence the cumulative amounts of profits gained by commercial banks. Thus, the study provides the basis for considering other variables that could greatly influence how banks perform and also a longer time-frame of the study so as to capture a real picture of the banks' performance.

Thus, weak credit management is the main cause why many commercial banks fail. According to McMenamin (1999) and Hempell (1994) research, many banks fail due to inadequacy of the bank's credit risk management systems in controlling quality. The most common approach to customer's credit selection is five C's of credit as an initial screening and risk assessment. The fundamental aim of this discourse was to determine how credit management affects performance of commercial banks.

Credit Risk Management

A sound creditcontrol is a critical activity in any organization, especially to those enterprises practicing it. It can be simply termed as a process for ensuring that clients pay for products or services delivered. Moreover, Myers and Brealey (2003), describes this phenomenon as the

collection of approaches applied by a firm in ensuring thatoptimal credit levels including its effective management.

According to Nelson(2002), this concept incorporates methods used by an entity to control its credit sales. Other terms used include, credit scoring, rating, classification and reporting. It is an aspect of financial management that is necessary for every company that offers credit services given the difficulties of giving no default risk or zero credit.

Nzotta(2004), explained that credit risk management has a fundamental impact on the fate of commercial banks as well as other credit facilities. This is sentiments emanate from the fact that the success of most depositing commercial banks depends heavily on the credit rating thus the weighing of the quality of high-risk assets.The ability to wisely and effectively controlborrowers' credit lines is one of the critical factorsofuseful credit management.Companiesmust have more intuition into a customer's credit history, financial strength, and payment patterns.

The first step in credit risk management is sales and it only stops when the final payment has been received. However, a sale is termed as a sale only after cash has being collected. It follows the principle that lending terms on goods where the borrower pays all outstanding debts including interests on schedule and within the agreed payment deadline. On the contrary, profits gained frominterestare minimized by bad debts when the borrower eventually defaults. The main objective of credit management is managing debt and financing them. This objective can be termed as safe if it guards the companies' investment in optimizing cash flows and bad debts. Scheduled laws should be appliedwhen advancing credit to many borrowers, collecting cash and setting a limit of non-repayments.

Financial Performance

The Business Dictionary defines this concept as the level of enactment of a company over a certain period, and it is expressed as the total amount of profits and losses earned during the time frame. It measures the ability of a business to use assets based on its primary mode to generate revenues.

According to Turyahebya (2013), financial performance is demarcated as the power to repay, persevere, develop and profitably respond to the environmental openings and drawbacks.

Sollenberg and Anderson (1995) agree with this. According to them, performance is measured by how the organization uses its resources to achieve its objectives. Most of the firms performing poorly do so because of poor performing assets (Hitt, 1996).

Commercial banks earn income from loans and other financial services such as fees, costs of borrowing and commissions. Other sources of income include earnings from financial assets such as gains from investments. Additionally, banks generate income from financial activities such as operating expenses and interests to account for unforeseeable losses from defaulting customers.

Effects of Credit Risk Management on Financial Performance

Credit control involves the acts of offering credit, setting the terms of the borrowing, and recovering it upon maturation. It is a role of a financial facility to manage credit regulations while minimizing financial risk and improving revenues.Graydon (2017), states that the credit management function incorporates all activities of the company aimed at customers paying invoices on time and according to the defined payment terms. Good credit management reinforces the financial performance or liquidity position, making it a critical important component of any business.

Effective credit risk management helps minimize the total credit in the hands of debtors, and reduce the risk of falling into unpaid credits. Edwards (1993),contends that if a business fails to institute measures forrecoveringitsadditional cost of late payment, including other costs such as interest charged, then its profits will be affected by any overdue account.

Most companies experience this from losses accrued from bad debts, and customers undergoing liquidation, bankruptcy, or receivership. Notably, the writing-off losses from bad debts visibly affects the income account. Also, cost of interest on delayed payment is less noticeable and may not be regarded as a cost effect. Often it is uncommonly assessed in separate records sinceit is combined with all bank charges in all activities. On the other hand, borrowing the borrowing cost emanating from late bill payments reduces the amount of interest earned by banks.However, credit managers could measure this debt cost independentlywhere the outcomescould be surprisingdue to the cost of waiting for late payments, and which could be worsecompared to cost of bad debts.

A sound credit management is about establishing and implementing a credit policy. Liquidity and insufficient working capital issues, which arecausedbyinefficient credit standards and poor credit policies present companies with numerous challenges. An effective credit policy acts as the guide for companies to communicate with and handle its first-classcustomers asassets(Pike & Neale,1999). Moreover, Scheufler (2002) is of the view that credit policy establishes an agreed collection of goals for a business and acknowledges the credit and collection function as an important supplier to the company's objectives.

Commercial banks in Kenya

According to a CBK (2013), Supervision Report as of December 2013 out of the 44 commercial banks 30 are domestically owned and 14 are foreign owned.In terms os asset holdin, foreign banks account for about 34% of the banking assets as of 2013. The Kenyan financial system is dominated by commercial banks as financial intermediaries that act as conduits between the surplus economic units and the deficit economic units (Beck, Kunt& Levine 2009). Rose (2003), discovered that a commercial bank is simply a business corporation organized for the purpose of maximizing the value of the shareholders.

Commercial banks are licensed and regulated by the provisions of the Banking Act and the regulations and prudential guidelines issued. They are dominant players in the Kenyan Banking sector and closer attention is paid to them when they are off-site or on-site to ensure they adhere to the laws and regulations. The banking industry has been earmarked as one of the Kenyan vision 2030 for economic growth through increased savings, encouragement of Foreign Direct Investment (FDI), acting as a benchmark against economy extertnal shocks as well as driving Kenya to become a leading financial centre in Eastern and Southern Africa.

According to Government of Kenya statistics (2011), there was an alarming45% annual average increase in number of economic delinquencies. Banks in Kenya lost a staggering Kshs 1.7 billion in three months from August to October 2010. Commercial banks lost Kshs761 Million in the first six months of 2010 through fraud, according to the Central Bank of Kenya (PWC, 2011). The Government of Kenya vision 2030 was within the Medium Term Plan (2008-2012) whereby some of its targets were development of a safe and reliable payments system that will ensure smooth transfer and settlement of funds between customers and banks. At he end, the use of mobile phone networks, internet, payment cards, operational resilience and security will

be pursued in order to increase trust, integrity and confidence in the ICT based payment systems (Government of Kenya, 2008). In contrast to other East African economies, Kenya has been credit for its size and diversification. Private credit Gross Domestic Product(GDP), was 23.7 in 2008, compared to a median of 12.3 % for Sub-Saharan Africa. According to Beck, Kunt and Levine (2009), Kenya is ahead of Tanzania which has 12.3 % and Uganda with 7.2%. A recent research was also done BY Diaspora Messenger (2018),indicating Kenya still leading with a GDP of 78.4 billion USD followed by Tanzania 51.6 billion USD while Uganda had 26.4 billion USD.

Commercial banks in Kitengela

Kitengela is an upcoming town containing about 11 commercial banks including Cooperative bank, Equity bank, KCB bank, Barclays bank, Consolidated bank, DTB bank, NIC bank, Family bank, National bank, Bank of Africa andJamii Bora bank.The commercial banks have lead to quick economic growth in Kitengela and has led to employment of most citizens. This is part of Kenya millineniumvision 2030. Many banks are expanding there size like NIC Bank opened 6 new branches in Kitengela as part of its ambitions to expand to reach more retail customers and grow its SME business. The new branch will offer a full array of financial products and services to target the growing business community in Kitengela and surrounding areas.

Furthermore all this commercial banks have a goal to ensure economic growth and customer satisfaction. Services have improved where clients use numbers to access customer services and tellers thus improve service delivery.

1.2 Statement of the Problem

A detailed credit risk management is the starting point for a financial facility'sfoundation and continued sustenance, while poor-quality credit causes delayed financial growth. Based on his research, Gitman (1997) portends that a relaxation of credit standards corresponds to the probability of increase in bad debts. Furthermore, lending is the heart of every industry, while loans form a part of the most valuable asset of most banks since they contribute the largest part of operating income as well as representing their greatest exposure.

Differences in the regulatory framework governing banks and non-financial brokers, the absence of independence and inefficient supervisory competence to perform the Central Bank's

scrutiny function and implementing banking laws, lack of sound government regulations contributingimmenselyto an accumulation of NPL, and the failure by financial bodies comply to the rules and regulations set out by the banking Act 2009(8) presented a great challenge to the banking infrastructure.Most banks which were collapsing in 1990s faced poor credit control risks seen in the numerous levels of NPL (Central Bank Supervision Report, 2005).

Credit risk has been affecting loan performance in a very travois way. Potential borrowers could miss the chance to clinch loansgiven that the funds couldbeheldby defaulters. This has being a major issue which has forced the CBK to set certain guidelines to all commercial banks in order to mitigate such risks by having credit reference bureaus. The purpose of credit management is to ensure the loan portfolio of institutions does not collapse in the sense that they are not able to give loans to their customers due to defaulters (Moti,Masinde&Mugenda, 2012).

In Kenya the high level of non-performing loans banking industry has been a huge hindrance to economic stability(Dinger,2009). According to a research done by Bhunia (2011), the stock of NPLs has reduced by 1.4 % to Ksh 57.5 billion by march 31st, 2012 from 58.3 billion in 2011. In the year 2010, the NPLs were Kshs. 61.5 billion (CBK Annual Report 2010). Despite reduction in NPLs in Kenya this ratio is high compared to the deposits. The banking sector gross loans and advances increased from Ksh 1.08 trillion in June 2011 to Ksh 1.29 trillion in June 2012 translating to a growth of 19.0 percent CBK Annual Report 2012. According to Azofra&Santamaria (2011), the deposit base increased by 15.9 percent from Ksh 1,219.5 billion in June 2010 to Ksh 1,412.8 billion in June 2011 mainly due to branch expansion, remittances inflows and receipts from exports.When the loans and advances transform to non-performing, banks liquidity and earnings are adversely affected.

Past studies done by other researchers have also covered widely risks and factors leading to risks of banks in the traditional banking network. In a research done by Obiero(2002), on banking regulation and its adequacy in preventing bank failures, show that out of 39 banks which failed between 1984-2002, 37.8% collapsed mainly due to poor quality of lending. This was attributable to recklessness in their lending activities and immense pressure especially in government-controlled banks to lend to politically connected individuals and institutions. According to Central Bank of Kenya (2015), monthly economic indicators, the value of gross

non-performing loans increased by 32.7% from Ksh 81.4 billion in November 2013 to Ksh 108 billion in November 2014. Similarly, the percentage of gross debts hiked from 51% in November 2013 to 5.5% in November 2014. The report furthershows the quality of the industry's loan book expressed as the ratio of the net NPL. This is why the regulatory authorities are always very concerned on the type and nature of loans approved by banks and the level of loan reserves maintained (CBK,2015).

Parrenas (2005), did a study on Americans banks in the 1980s and established that the continuous factor in the failures emanated from the inadequacy of the banks department in controlling loan quality. A further study carried out by Iqbal and Mirakhor (2007), strong risk management practices can help financial institutions reduce their risk exposure to credit risk and enhance their ability to compete well in the industry. The two studies have documented the existence of profit and show a positive link between financial institutions performance and credit risk management practices. Similarly, Achou and Tenguh (2008); Joetta (2007)studied bank performance and credit control where they found a significant linkage between financial well-being mostly expressed as profitability and credit control (loan achievements).

According to Miller and Noulas (1997), financial bodies are increasingly susceptible to high risk loans, which are accompanied by unpaid loans attracting low profits. A credit risk is significant and an expensive risk related to the banking sector since it is a direct threat to survival of an organization. It is directly linked to solvency; however, its level and intensity of loss is higher than other risks. Additionally, it results in high level of loan losses and even malfunctioning of financial institutions (Richard, 2008; Chijoriga, 2011).

Although previous researches provide crucial research findings on Credit Management, they provide no clear-cut connection between Creditriskmanagementandthe performance of Commercial Banks.This scenario exposes a glaring gap raised by empirical studies, and considering the drawbacks presented to Commercial Banks in Kenya, including NPL, it is crucial tocarry out a research on credit management. Besides, it is for banks to control credit risk to minimize losses and foresee future existence and growth.This study aims at identifying the impact of credit management on the performance of Commercial banks inKitengela.

1.3 Research Objective

General Objective

To determine the effect of credit risk managementpracticeson performance of commercial banks in Kitengela,Kenya.

Specific objective

1. To determine the outcomes of risk identification on performance of commercial banks in Kitengela, Kenya.
2. To determine the outcome of credit risk measurement on performance of commercial banks in Kitengela, Kenya.
3. To evaluate the outcomes arising from credit risk control on performance of commercial banks in Kitengela, Kenya.
4. To find out the influence of credit risk monitoring on performance of commercial banks in Kitengela, Kenya.
5. To examine the effect thatcredit appraisal had on performance of commercial banks in Kitengela, Kenya.

1.4 Research questions

1. To what level does credit risk identification affect the financial performance of commercial banks?
2. What is the impact of credit risk measurement on financial performance of commercial banks?
3. To what level does credit risk control affect the performance of commercial banks?
4. What is the influence of credit risk monitoring on financial performance of commercial banks?
5. What is the outcome of credit appraisal on performance of commercial banks in Kitengela, Kenya?

1.5 Justification of the Study

Sound credit management is of great importance to the future achievement of any banking company; since it upholds shareholder's wealth and prevents most financial institutions from going bankrupt. If it is not well managed it can actually lead to collapse of credit management in most companies. It is therefore justifiable to determine the impact of loan performance since most commercial banks in Kenya practice credit management.

1.6 Significance of the Study

The resulting outcomes of this discourse was of great importance to the following interest groups of people who may need the information in one way or the other for a given reason:

Commercial Banks

Commercial banks have the role of managing their monetary risks to cushion themselves againsttrivially high level of risk and therefore lead to slow productivity. The existence of the banking sector is of high regard given that over 85% of their liability is savings made by depositors. Financial institutions use these savings to advance credit to borrowers, which in fact is a fundamental strategy for revenue for most financial institutions. Most of these institutions look for a large clientele base to assist in diversification purposes.Despite this diversification is an extremely rare opportunity as it involves greater risk.Business risk is an important factor thus financial institutions need to develop better processes to convey better visibility in financial ability.

The main concern of this research was to ascertain how credit management affects the financial might of commercial banks.Therefore,this research sought to fill this gap by examining how credit management impacts the financial growth of commercial banks.

Legal and Regulatory Framework

This study had great importance to the legal and regulatory framework. It would also be of great importance to investors who seek to know where best to invest. The research is also a great benefit to the oversight board and senior management. Such research findings would help in addressing the existing knowledge gap in literature of linkage credit management and the well-being of commercial banks.

1.7 Scope of the Study

The specific context of the investigation is commercial banks in Kenya. This study was limited to Commercial banks in Kitengela. It narrowed down to risk control, risk identification, credit appraisal, risk measurement and risk monitoring.

Time scope

The research was conducted for a period of 8 months where time was set to schedule dates to meet each particular bank one at a time.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This section reviewed empirical literature, theoretical overview and summary of literature review. It developed theories related to the research which explained the prevailing research disparity on consequences of credit control on commercial banks in Kenya and its conceptual framework.

2.2Theoretical Literature Review

According to Kombo and Tromp (2009), a theory is a pure cluster of various proven general propositions, which are correct, which are applied as principles of elaboration and prediction for a given set of phenomena. A theoretical framework is commonly used by scientists when performing research studies to formulate a theory. In this chapter the discussion was based on 4 basic theories shifting theory of Liquidity, financial distress theory, tax credit theory and credit risk theory.

Shiftability Theory of Liquidity

The shiftability theory argued that banks can protect themselves against huge withdrawal charges by holding a credit instrument, as a kind of liquidity reserve acting a secondary market for the product already exists (Moulton, 1915). The basis of this theory is that banks liquidity can only be maintained if they hold assets that can be shifted or sold to investors for cash. Furthermore, assets can be shifted to the Central Bank to attain cash without any material loss perhaps when necessity arises in order to solve liquidity problems (Ngwu,2006). Therefore, a bank's liquidity can only be maintained if it at all times it has assets readily available for resale and for as long as Central Bank is openly willing to acquire the asset offered at a discounted price. This proposition recognizes that large assets held by banks are a perfect cradle for liquidity.

Dodds(1982), describes liquidity management as a theory that involves activities of collecting money from savers and creditors while finding the best combination of finances for a particular fund. The general view is that at the time of distress, a bank could have difficulties establishing liquidity given that the market confidence could be severely affected by the credit rating of an institution. However, for a bank that is doing well the liabilities becomes an

important source of liquidity. The analysis thus gives out clear information on the effect of liquidity on performance of commercial banks.

According to a research done by Casu, Girardone andMalyneux, (2006) as quoted by Botoe (2012), there is a massive disconnect in the Shiftability theory just like the one which made it necessary to abandon the commercial loan theory. It stated that at the time of a generalized distress, secondary reserve assets, which provide liquidity, lose effectiveness due to market scarcity. Critics argue that the theory rules out the fact that during actual depression, the shares and debentures cannot be shifted to other lenders by the banks.

The role of Central bank as lender of last resort thus gained momentum and therefore liqidity was left to rest with the Central bank.The shiftability theory thus surived these realization that the idea of final liduidity in bank loans rests with shiftability to the Federal Reserve banks. Under it, the liqidity apprehensions were thus returned to the loan portfolio,where maintenance of quality assets could meet the test of intrinsic soundness (Allen and Gali,2004).

This theory directly relates with credit risk control and credit risk measurement variableswhere banks can control the level at which they offer credit and has difference levels to measure the amount at which a certain person qualifies for a particular credit. Credit lending is used by banks as a way of gaining profit through interest that are paid in alliance with the credit borrowed.

Thus, commercial banks can use this theory to practice the concept of bank of other banks that is to preserve a certain amount of the cash received at Central Bank in crises where lenders do not refund loans to avoid gaining huge losses.

Financial Distress Theory

In their research, Baldwin and Scott (1983) argued that when a firm’s business degenerates to the level of inability to satisfy its financial duties, then it could be described as having attained a state of financial distress. Some of the first indicators of this state include violation of debt repayment and reduction of dividends payouts. The main factor used in identifying firm’s distress is the failure to satisfy its contractual debt duties.

Nevertheless, extensive financial distress effects occur well prior to defaults in payment. Companies enter into this situation due to poor management, decline in its abilities and economic

distress (Wruck, 1990). Moreover, Boritz (1991), describes it as the process in which the first step is an incubation period featuring several severe economic conditions and mismanagement, which commits costly errors. For instance, the commercial banks' ability to provide depositors and loan to borrowers may constitute a liquidity risk. Loan portfolio management is quite an important determinant of the firms' liquidity.

This theory presents the consequences of credit management on the monetary ability of a company. This model offers a non-biased perspective to credit management and originates from liquidity and credit risk facing a firm. The financial distress theory proposes a neutral platform to undertake an incisive empirical analysis of this rapport within the commercial banks.

According to a research done by Brigham and Ehrhardt (2008), on financial management, weight on the cost of debt they found out that as debt increases bankruptcy also increases. Those holding on debt, preferring a higher promising return in the event of a higher bankruptcy risk, which in effect hikes the pre-tax cost of debt. Therefore, loan borrowers are going to have to dig more into their pockets which becomes hard and thus leads to loan defaults and reduction in repaying the dividends to shareholders in banks.

Tan (2012) studied the impact of financial distress on a company's performance based on a regression analysis, while relying on financial leverage as a proxy for the distress. According to the research financially distressed companies underperform. This means that a company's underperforms when faced with financial distress.

Based on a further research done by Irungu (2013) as quoted by Njeri (2013), on how financial distress affects performance of commercial banks, they discovered that banks loan risks continue to rise despite profits. According to Irungu (2013), profit of Commercial banks in Kenya rose by a fifth in 2012 and non-performing loans (NPLs) increased by 13.33 per cent to 61.6 billion shillings. Despite the rise in profit, banks should take precautions when lending money as NPLs could easily lead banks to financial distress leading to failure just like in the past.

This theory is in conjuction with credit appraisal and identification as one of the variables under the study. Banks need to be aware of the steps to take to avoid going into financial distress such as the 5Cs of credit appraisal. The banks can use certain indicators to identify when the

bank is about to go into financial distress. Some of the factors would include huge withdrawals and high rate of loan defaulters.

Comercial loan theory and Liqidity

Adam Smith provided the first systematic exposition of the doctrine of Wealth of Nations (1776). Commercial loan theory is an asset managemet kind of theory that emphasized on liquidity, the otrine that held that banks should restrict their earning assets to “real” bills of exchange and short-term, self-liquadating advances for commercial prposes. Thus, it argued that individual banking organizations could maintain the liquidity necessary to met the requirements of deposit withdrawals on demand.Under some modified criteria this basic doctrine came to be known in the U.S. as the commercial loan theory of credit.

The commercial loan theory came obsolete because of its conceptual flaws and its impracticality. A critic underlying assumption of the theory held that short term commercial loans were desirable because they would be repaid with some income resulting from the commercial financed by the loan. It was realized that this assumption would certainly not hold during a general financial crisis even if bank loan portfolios did confirm to theoretical standards, or in most commercial transactions the purchaser of goods sold by the original borrower had to depend to a significant extent on bank credit. Without continued general credit availability, therefore, even short-term loans backing transactions involving real goods would turn illiquid.

According to Casu (2006), firm adherence to the orthodox doctrine was practically impossible if banks were to play a role in the nation’s economic development. Moreover, the practice of continually renewing short-term loans for the purpose of supporting log term capital proects proved unacceptable. The failure or inability of banks to tailor loan arrangements to the specific conditions encountered with longer-term issues in fact contributed immensely to the demise of the practice.

Portfolio theory

Portfolio theory of investment tries to maximize portfolio expected return for a given amount of portfolio risk or equivalently minimize risk for a given level of expected return, by carefully choosing the proportions of various assets. Portfolio theory was developed in 1950s and was

considered and was considered an important advancement in the mathematical modelling of finance.

However, many theories and practical critisms have been developed against it. This include the fact that financial returns do not follow a Gaussian distribution or indeed any symmetric distribution and those correlations between asset classes (Micheal, Sproul 1998). Although, portfolio theory is widely used in the finance industry and several of it authors won the Nobel prize for the theory, in recent years the basic portfolio theory have been widely challenged by fields such as behavioural economics.

This theory relates to credit appraisal the first objective where banks can use this theory in making investment decisions such as trading in forex market and local investment bonds like Akiba bond.

2.3Empirical Literature Review

Financial performance refers to the financial estimates of the outcomes of a company's policies and operations over a given period. A well-performing and profitable banking industry should withstand adverse shocks and positively influence the stability of the financial system (Bernnardo et al., 2007). Besides, commercial banks have a critical contribution to the economic performance of any nation. Their intermediation function enables them to mobilize resources, which is an important part of the efficient resources allocation in countries for productive activities.

According to Nelson (2002), the most considered external factor for loan defaults is the national economic downturn. The study postulates that the absence of an aggressive debt collection policy plays a critical bank-specific element that contributes to non-performing debt issue in Kenya (Nelson, 2002). The objective of the study focused on investigating the actions taken by bank managers to eliminate the challenge while examining the success levels of such initiatives. It used a sample of 30 managers drawn from the top ten largest banks, and it showed that the leading external factor is the national economic downturn. On the other hand, non-disclosure of vital information by clients during the loan application process is the most crucial customer-specific factor. Also, the study discovered that most financial institutions which failed

in Kenya since 1986 were caused by NPLs. Finally, it concluded that the absence of an elaborate debt collection policy could be as perceived as the primary bank-specific issue that contributed to the NPL challenge in the country.

Valsmakis (2005), conducted research about risk revenue or funds arising from debtors' late and defaulting of credit payment. It hoped to determine if the risk of non-payment could lead to a failure to pay. Consequently, he established that loan risk comprises the loss of revenue emanating from industry's inability to collect expected interest earnings and the principal arising from defaulted loans. Markedly, credit risk comes from the possibility that the anticipated income from advances and securities taken might not be fully paid. His conclusion shows that credit risk is regarded as the most dangerous risks facing a company.

Also, Waweru and Kalani (2009) conducted an inquiry into commercial bank turmoil in Kenya. Their study showed most NPLs in Kenyan banks emanated from national economic downturn, diminished consumer purchasing power, and legal issues. However, such findings were a complete opposite of the observations made by Waweru and Kalani (2010) considering the area of study and methodologies.

On his part, Muasya (2009) examined the impacts of NPL on the financial health of the banking sector in Kenya during a world financial turmoil. His findings confirmed that non-performing debts have an impact on Kenya's commercial banks. An additional analysis of specific banks whose assets surpass the kshs 25 billion mark showed that the impacts are negative, but the intensity of non-performing debts for slightly over half of the analyzed banks were not as severe to profitability and interest income. Moreover, the asset quality of the banking industry recorded an increased growth marked by 7.17%.

Bhattarai(2016), did a research on commercial banks performance and made a conclusion that NPL ratio had adverse effect on performance of banks while the cost of a loan had a positive impact on the overall financial health of banks.

According to Mugenda (2008), there are other factors outside the bank that may cause it to fail, and they include deregulation and insufficient information.

Non-performing Loans

A loan is said to be non-performing and thus the chances of it being repaid in full are always expected to be somewhat lower. According to Ahmad and Ariff(2007), a NPL is the portion of loan values which are in default beginning three months and over. However, when the debtor resumes paying the loan, it turns back to a re-performing loan despite him or her having missed all the payments. Institution holding non-performing debts may decide to dispose them at a fee so as to rid of risky assets. Sales of non-performing loans should be regarded with utmost care due to their numerous implications, such as those touching on the firm's profit and loss, and tax factors (Akkizidis, 2008).

According to a research done by Muasya (2009), as an MBA to the University of Nairobi about the effect of NPL on the financial performance of the banking sector, it was concluded that commercial banks are adversely affected by the escalating levels of non-performing loans made through provisioning as well as suspended interest.Muasya (2009), explains that most of the other factors include understaffing and incompetent staff among others, which account for the years between 2004 and 2008. The study used a sample of 13 banks is to demonstrate how the elements impact the financial health of banks, which was measured by using the pre-tax profit of the 13 sampled financial institutions.It used a single regression equation strategy to examine the effects of non- performing loans on the stability of the financial industry. A subsequent test implicating all the variables was conducted, followed by the final one comprising only NPLs interest revenues as per the provisions of the research framework. The results of the research showed that commercial banks could record negative implications from the rising levels of non-performing loans from provisioning made and interest from expense.

Effect of Credit Appraisal on Performance of Commercial Banks

Credit appraisal includes procedures for requesting loans and requirements listed in the credit policy files of banks to help loan personnel in advancing credit to customers. This one of the critical stages in loan processing since it evaluates data related to the financial strength and credit scoring of the client. The factors that are considered in loan approval include; the background of the applicant, the reason for the application, the amount of loan required, the borrowers' amount and source of his contribution, terms of repayment for the borrower, the borrowers' proposed

security, the location of the borrower's business, and financial and technical appropriateness of the proposed credit (ADB Desk Dairy, 2008).

There are 7Cs relevant to the credit appraisal model in enabling financial companies achieve the know-your-customer threshold (KYC). The importance of doing this is to reduce the level risk of default that banks have to deal with during the credit management process. The 7Cs are: character, capacity, collateral, contribution, conditions, control and common sense (MacDonald, 2006).The above factors should be considered jointly when any loan appraisal process is being undertaken. A good report on each of these factors reduces the risk of defaults in loan repayment.The use of the 7Cs model in credit appraisal enables banks to monitor their level of exposure with respect to existing and potential customers hence reducing the number of non-performing advances.

DrShukla and Kagoyire (2016),did a research that aimed at establishing the extent to which Equity bank relied on customerto appraise Credit Management. The investigation followed a descriptive cross-sectional approach. The target studygroup for the research was 57 staff from credit department of Equity bank. They collected data through questionnaires that was later tabulated and analyzed using SPSS, The study revealed that Commercial banks in Rwanda rely on customer appraisal in Credit Management moderately. Additionally, it discovered that customer appraisal is a plausible tool for loan andsome elements of collateral are crucial during such appraisals, that failure to consider the customer's ability to repay the loan results in default, and that client appraisal factors the character of the customer seeking credits services. Finally, it found that Rwanda's commercial banks' personnel was competent to handle customer appraisal.

On their part, Waweru and Kalani (2009) explored the banking crisis in Kenya. The results of their research showed that the major cause of NPL in the country emanate from national economic downturn, diminished consumer purchasing power, and legal obstacles. It further acknowledged the similarity between loan delinquency and non-performing loans. Despite this, the research differs from that of Waweru and Kalani (2010) considering the area of study and the methodologies used. Besides the primary task of commercial banks in providing credit, evidence alludes to the credit rationing extension even to those who have appealing credit scores. Globally, only about 1.5 percent of MSEs have access to loans from Commercial banks

in the country (international centre for economic growth 1999). This situation begs the question of how the remaining majority satisfy their working and investment requirements.

Mohammad (2008), also conducted research on risk management in the Bangladesh banking industry. The driving force of his research was to understand the role of credit risk on non-performing loans. He discovered that the fundamental cause of the issuelaid in the accumulation of non-performing loans over an extended duration. According to him, it is only a significant lowering of the NPL ratio of the nation that could prevent it from losing a competitive edgein the ever-increasing globalization of the banking service happening in the world today. Given their two-decade long experience in dealing with problems of NPL, there are plenty of information about the cause and solutions to the challenge. Consequently, the researcher concluded that it is imperative that lenders, policy makers, and borrowers to borrow heavily from the past experience and act accordingly.

Njiru (2017), did a research that sought to investigate effects of credit appraisal on financial health of commercial banks. From the aforementioned, commercial banks apply various credit appraisals and mostly a combination at a go. The mostly used method as per the respondents is referencing with CRB (91%) followed closely by the use of 5Cs of credit at 87%. The customer past credit history has been applied in many commercial banks since 77% of the respondents felt that way. The credit scoring model, however, was not as popular as the other techniques. Only 54% of the respondents believe this method is applied in their institution. The wide and consistent use the aforementioned techniques is expected to enhance the loan performance to a great extent.

Effects of Risk Measurement on Performance of Commercial Banks

Risk measurement is the evaluation of the likelihood and extent (Magnitude) of a risk (Benard, 2018). Several researchescontribute to this area of study; Mohd and Salina (2010) conducted research to find the link between financial execution and risk administration in the Malaysian Islamic banks.As a way of measuring the risk administration practices, the authors evaluated five issues affecting bank supervision practices as stated by the Basel Committee. These five components examined in the research include; the environment of the firm's risk environment, the firm's policies and procedures, procedures for measuring risks, risk mitigation, the company's risk monitoring and the business's internal control. The listed elements intricately

connected to Return on Asset (ROA) and Return on Equity (ROE). The researchintimated that those Islamic banks that recorded higher ROA and ROE showed improved risk management strategies. However, the study's center of focus was only on the 5 independent variables, which functioned as the only measures of risk management for determining financial performance. The study focused on additional measures in a strategy that helped reduce the error term.

In Kenya,Kithinji (2010) analyzed the profitability and credit risk control of Kenyan commercial banks. His research aimed at evaluating the level of credit risk control to profitability of Commercial banks in the country.He gathered credit data, amounts of loans, and the amounts of profit for the period between 2004 and 2008 for testing.A regression analysis for the study observed the absence of a connection between the studied variables, such as profits, credit levels, and the level of advance. As a result, the research concluded that the profitability levels of commercial banks had no relation to the credit levels and advances, and hence, the remaining variables impacted the profit levels. The findings of this study, therefore, bring out a glaring knowledge gap given that it focused on the credit risk control in financial health in commercial banks.

Ogilo(2012), also conducted an investigation into the effects of credit risk control on financial health of Kenyan commercial banks. Its aim was to establish whether there is a relationship between credit risk control factors using CAMEL indicators and profitability of these banks.The researcher relied primarily on secondary data obtained from CBK publications. He proceeded to perform multiple regression analysis in the data analysis section. The investigation discovered a profound influence of the components of CAMEL on the profitability levels of commercial banks. Besides this finding, the study also identified that asset quality, capital adequacy, liquidity, and management efficiency also depicted a weak connection to the financial performance while earnings depicted a robust relationship with financial well-being. The research also intimated that CAMEL model is an ideal proxy for risk management strategies.

According to a research done by Njoroge (2013), about the strategic risk control strategies used by AAR Insurance they spotted the reputation risk as the primary factor confronting the organization. The primary research design employed in the study was case study. The investigation targeted a population comprising 40 senior management and middle personnel at AAR Insurance Kenya Limited. They were mainly drawn from various departments including

finance, underwriting, and operation.As part of the call to action, the study recommended the Board tocontinue holding on to the ownership and extending the risk agenda across the business. Also, it recommended the company to focus the emerging risk types such as operational risks, reputation, and IT security at the same time keeping an eye on the conventional risks including credit and market risks.

Ongore and Kusa (2013), also expended their research on the determinants of profitability of Kenyan Commercial banks. They used multiple linear regression models and Generalized Least Square on panel data in determining the estimates of parameters.The results of the analysis indicated that the decisions of the board of management determined the profitability of commercial banks, whereas the macroeconomic factors had little contribution. Similarly, they derived a weak connection between financial well-being and risk control. However, the empirical review did not bring out a clear relationship between risk control and profitability. All in all, study aimed at determining the connection between risk control and profitability among Kenyan insurance companies.

Muteti (2014), conducted a research to establish the relationship between financial well-being and financial risk administration of business banks in Kenya. His target population for this study includedKenya's Commercial banks totaling 43 as at December 2013, which was the entire population for the investigation. The author analyzed data using SPSS after which inferential statistics sufficed to complement a multiple regression model used for the analysis. On the other hand, profitability was estimated using the ratio of ROA. Notably, the independent variables were: the bank's loan risk, its cost of borrowing risk, the foreign exchange uncertainty, the uncertainty of the bank's liquidity, capital management, the size of the bank, and its deposits. The outcomes of the research showed that the credit risk, uncertainties of the cost of borrowing, foreign exchange uncertainties, the risk of liquidity, risk of capital control, the size of the bank and its deposits had a significant influence on the profitability of the Kenyan business banks. Its main focus was on ROA as the tool for measuring profitability. Additionally, it paid much of the attention on financial risks as independent variables as well as the measures used to mitigate risks and the connection to profitability of banks.

Effect of Risk Identification on Performance of Commercial Banks

This refers to a vigorous process of detecting situations and trying to characterize it. According to Barton (2002), this is a procedure of deliberately analyzing, reviewing and anticipating possible risks. It is fundamental to establish the risk function in the entire corporation. Besides, identifying risk is vital in any effective risk control system. In the attempt to manage risks, banks' management must understand the type of risks they face. One of the primary factors during the entire process is to account for all risks. For this reason, there are numerous strategies for successfully identifying risks. According to Kromschroder and Luck (1998), the initial approach to organizing the deployment of risk control formula is to spot the important observation part within and without the organization. Later, the firm's functional units and personnel should take up responsibilities for identifying potential risks. For example, the financial department ought to identify foreign rate risks and interest rate risks. Some other approaches that can be used in risk identification include scenario analysis in risk Corporation. A company can identify severity and a risk's frequency by mapping risks in a process that could help the firm to refrain from low severity and low frequency. Instead, it could divert its focus more on highly severe and low frequency risks.

It is quite important that an organization establishes the risk control function throughout its operations except for the parent company. However, its subsidiaries have to identify these risks and evaluate them. Risk mapping and scenario analysis are also other approaches used to identify risks. A company can identify severity and a risk's frequency by mapping risks in a process that could help the firm to refrain from low severity and low frequency.Instead, it could divert its focus more on highly severe and low frequency risks.The process of identifying risks involves ranking components based on the severity levels, the magnitude of its impact, and dollar effects (Barton, 2002). Accordingly, this initiative aims at sorting risks, according to the level of importance and assisting managers to develop risk management for effective resource allocation.

Al-Tamimi (2002), sought to find out the relation of risk identification to commercial banks practice of risk management and discovered that commercial banks in the UAE faced credit risk. The research discovered that the analysis of financial statement and inspection by managers are the fundamental methods used to identify risks.Other fundamental strategies used to manage risks include credit score, establishment of standards, risk rating, the analysis of credit

worthiness, and collateral. According to a recently-done research by Al-Tamimi and Al-Mazrooei (2007) about risk management in Commercial banks of the UAE and foreign banks revealed that they encountered risks of foreign exchange, operational risk, and operating risk.

The process of identifying risks has a significantly positive influence on risk management practices. Some of the works whose focus targeted risk mitigation and risk identification for the cases of banks include those of Haron and Hin Hock (2007), which mainly targeted credit and market risks. Haron (2007) specifically trained his efforts on operational risk. On the other hand, Haron and Hin Hock (2007) paid undivided attention to inherent risk; such as the loan and market uncertaintyexposures experienced in financial bodies. Further, they discuss the idea of displaced commercial uncertaintywhich matters most for financial institutions.In their conclusion, they indicated that certain risks could be regarded as inherent for the efficient operations of a conventional bank.Risk exposures are different for every bank and are complicated than the typical financial institutions. However, the tenets of risk management and credit form the foundation of the ongoing process of establishing prudent standards at the same time filling the regulatory gaps in the finance section.

Effect of risk control on Performance of Commercial Banks

Some of the key Credit controls are delinquency management, credit committees, and product design (Churchill and Coster, 2001). Based on a recent research done by DrShukla and Kagoyire(2016),to examine the impacts of credit risk management on profitability in Equity bank in Rwanda, it was discovered that the amount of interest charged has an impact on how loans perform in the Commercial Banks. The research further showed that the involvement of credit committees in decision making loans are crucial in reducing credit risk or default. Additionally, the regular use of credit checks enhance credit control, while imposing fines on late payment prompts customers to pay their loans. In addition, using customer loan application forms is a useful strategy for improving credit control and monitoring, whereas flexible repayment periods enhance loan repayment. Finally, the study showed that the regular use of credit checks is successful in credit management.

Accordingly,Muasya (2013) studied the connection between credit risk control strategies and losses of loans among commercial banks in Kenya. His investigation employed a descriptive research design. Research findings indicated that a substantial percentage of commercial banks

in the country did not institute credit risk control information systems for efficient monitoring, measuring, and identifying, and controlling risk. However, he found that most of the banks management acknowledged the need for sharing information among them as a means for mitigating the risks.It concluded that credit risk control strategies are a common concept among most commercial banks in the country, whereas most of their management were pleased with government laws related to credit risk management, such as the establishment of the Credit Information Sharing Act. Further, it found that there is a significant adverse connection between credit risk control approaches and credit losses in Kenya's commercial banks.

Wanjohi (2013), analyzed the effect of adequate internal control on fianacial performance of commercial banks.The researcher used descriptive research design. The data was collected using both primary and seconday data. Descriptive statistics was used to analyse the data.Overall, for the Kenyan banks, the best financial risk management practice was Adequate Internal Controls Practice which obtained the highest mean of 90 per cent. This indicates it greatly affects financial performance.

Effect of Risk Monitoring on Performance of Commercial Banks

Risk monitoring process is an important process after identification. The risk control feedback loop implicates the senior personnel and management in the identification of risks and therefore, they must evaluate, process, and create ideal operational systems, procedures, and policies. In his study, Rouse (2009) postulates that some of the ways of facilitating control and monitoring process include audited accounts, visits, interviews, internal records, and management accounts.These initiatives minimize the probability incurring NPL since they ensure a proper usage of credit for the designated purpose, early identification of warning signs, and other problems that relate to the conduct of the customer's business and which could affect the profitability of the facility.They are also handy in cultivating compliance with the terms of credit and other conditions that enable the lending facility to develop rapport with the borrower about the problems and prospects of his business.

Through the monitoring and control process, a lending decision can be made on proper credit risk evaluation and examination of credit worthiness of debtors. Though previous information of good performance and integrity it offers guidelines to project statistics in performance, in which they cannot guarantee future performance. Norton and Andenas (2007)

did a research and discovered that a credit advanced on the precincts of proper analysis could flop because the debtor might fail to meet the obligations as defined by the terms and conditions governing the loan contract. Lenders are thus advised to have proper follow up and monitoring aspects which are essential. This includes; monitoring compliance with the set credit rules, overseeing the proper use of the advance loan, ensuring the continued viability of operations for continued performance, identifying deviations from the guidelines of the decision, and assessing the performance of the credit regularly (Leply, 2007).

Basically, there are three basic structures for following up a loan. These include legal, financial, and physical follow ups. The legal follow-up, according to McManus (2010), aims at ensuring that the business exists and operates as well as the collateral status of the properties. It also ensures that the declared financial data and quality of goods are correct while ensuring that other records conform to financial data. Also, it confirms the labor situation, availability of raw materials, check of a change of management set up, assess undue turnover of important operating staff, and record any marketing difficulties.On the other hand, the financial follow up is important for verifying that the reason for taking credit continues to apply as regards the borrower’s environment and operation as well as if the end use matches the borrowing motive (Leply, 2007).

The importance of the legal follow up is that it makes sure that the legal resort provided tothe financial institution is kept alive always. It involves actions of obtaining the correct documentation through registration and follow up of insurances to keep them alive (Rose, 2010).Among particular details relating to legal follow up are establishing if contracts are availability of raw materials properly executed by the right people, including the proper completion of documents, timely acquisition of revival letters, timely update of loan/mortgage contracts, and the examination of laws, the regulatory directives, and third party claims (Koch & MacDonald, 2007)

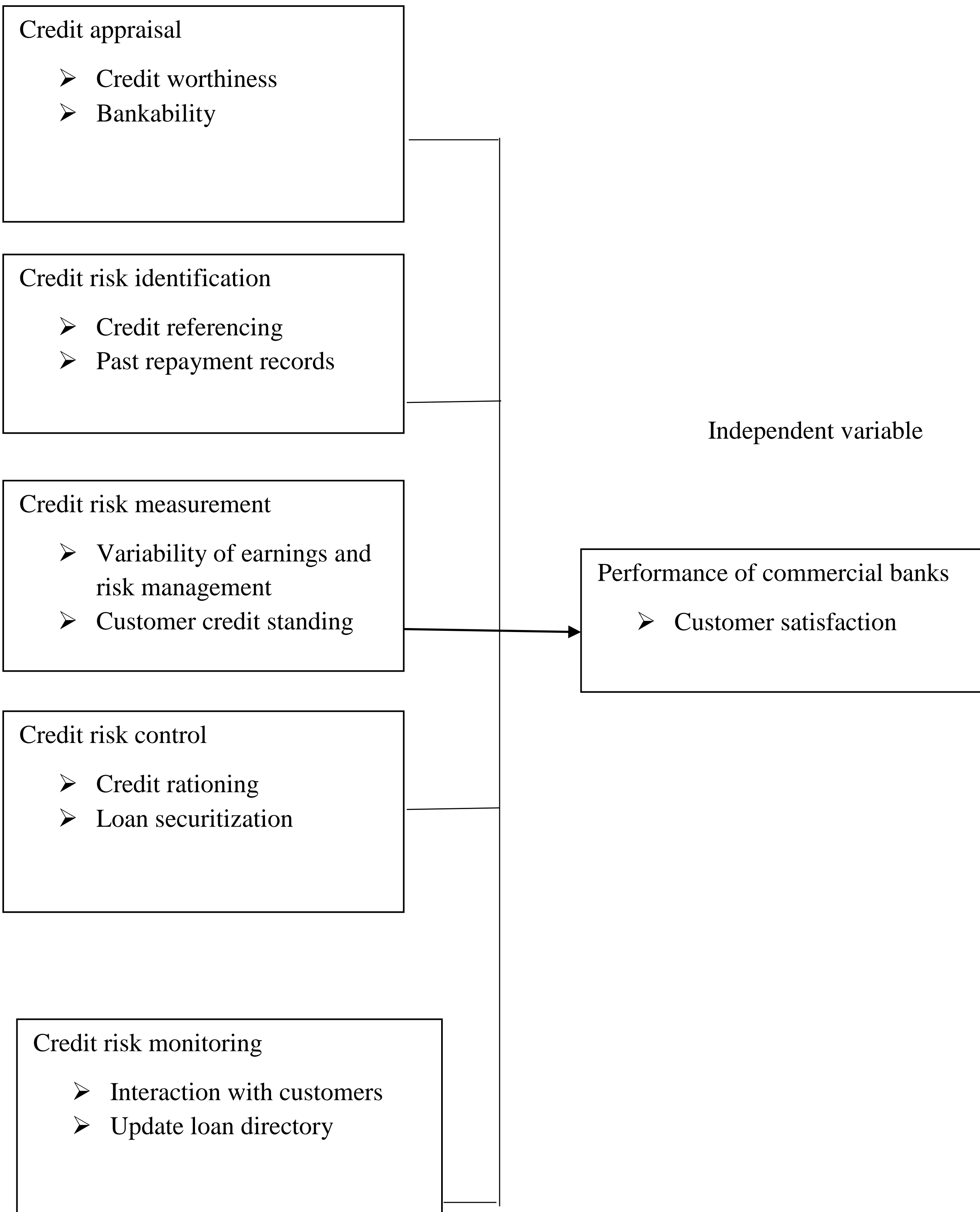
The formulation and Implementation of systems, procedures and policies into the internal control process requires the participation of line staff. This step ensures that they provide feedback about the ability of the bank to control risk with little or no operational challenges. Further, the manager and the committee need to periodically access the results for evaluation.

Markedly, policy manuals, such as the credit manual, contain most of the risk management guidelines in most banks. (CBK,2010)

2.4Conceptual Framework

Smith (2004) defines a conceptual framework as a research tool envisioned to support a researcher development of awareness and understanding of a state under scrutiny to communicate it. When clearly expressed, it has a wide range of usefulness as a tool to help a scholar in making meaning of subsequent findings. A conceptual framework establishes an ideal platform for negotiating and testing the agenda. Also, it forms the basis for examining, reforming, and reviewing a hypothesis while it explains the probable linkage among the variables (Smith, 2004).

Figure 1:Conceptual Framework



Source: Author, 2018

2.5 Operationalization and measurement of variables

Table 1

Operationalization of variable

Variable	Measurement
Credit appraisal ➢ Credit worthiness ➢ Bankability	Using a 5-pointLikert Scale where 1 represents strongly agree, 2-disagree, 3-neutral, 4-agree and 5 strongly agree.
Risk identification ➢ Credit referencing ➢ Past repayment records	CRB credit scoring Measured using a 5-point Likert scale where 1 represents strongly agree, 2-disagree, 3-neutral, 4-agree and 5 strongly agree.
Risk measurement ➢ Variability of earnings and risk management ➢ Customer credit standing	Using a 5-point Likert Scale where 1 represents strongly agree, 2-disagree, 3-neutral, 4-agree and 5 strongly agree.
Risk control ➢ Credit rationing ➢ Loan securitization	5-point Likert scale of ratio 1 to 5 where 1 represents not at all, 2- least extent, 3-moderate, 4-great extent and 5 very great extent
Risk monitoring ➢ Interaction with customers ➢ Update loan directory	Likert scale of ratio 1 to 5 where 1 represents not at all, 2- least extent, 3-moderate, 4-great extent and 5 very great extent.
Performance of banks ➢ Customer satisfaction	Likert scale of ratio 1 to 5 where 1 represents not at all, 2- least extent, 3-moderate, 4-great extent and 5 very great extent.

Source: Author, 2018

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This part examines the research design, target study group, data gathering instrument, data gathering procedure, data analysis and processing, and measurement of study variables. It further analyses the various processes and approaches to be used when gathering and processing data.

3.2 Research design

Orodho (2008), explains that a research design is the plan, scheme, or outline for formulating answers to issues under study. The research will be conducted using descriptive research design. According to Creswell (2008), the descriptive method of study is used to obtain data about the already existing condition. Consequently, the emphasis will be in describing instead of judging and interpreting. To this effect, the approach is more suitable for this research as it is fast and efficient considering the financial factor.

3.3 Target population

Borg and Crall (2009), define this concept as a conventional study of the whole set of real or hypothetical individuals, objects, or events from which a researcher generalizes the result. Consequently, this study's target population will be 50 staff members from Commercial banks in Kitengela. The target population was 50 because Kitengela is a small town having fewer banks and so are the members of staff.

3.4 Sample size and sample procedure

The researcher will use conveience sampling in which it will narrow down to 5 Commercial banks in Kitengela which include Equity, Cooperative, Barclays, KCB and Family bank.

3.5 Data and data collection techniques

The data was gathered through self-administered questionnaires containing closed ended questions. The research relied heavily on primary data. By definition, a questionnaire is a tool used in survey, and it has self-administered questions (Manheim & Richard, 1995).These instruments were administered through several approaches such as drop-and-pick-later strategy

as well as through emails sent to intended respondents. The study also relied on, a 5-point Likert scale to determine the effects of credit management on performance of commercial banks in Kenya. Evidently, the close ended questions facilitated the collection of quantitative and qualitative data. On the other hand, the questionnaires had two sections, where the first one contained general information about interviewees. On the second section, questions about the impacts of credit management practices on financial ability of commercial banks were asked. As a way of increasing response rate, telephone calls were used to help make follow ups.

3.6 Reliability and validity tests

Content validity was used as a measure of the degree to which data collected using a particular instrument represents a specific domain or content of a particular concept. According to Mugenda and Mugenda (1999) the usual procedure in evaluatingthe content validity of a measure is to use the professional expert in a particular field.

The researcher also sought expert opinion in the field of study especially the researchers supervisor and lecturers in the school of business, this enhanced the validity of the study. Reliability refers to the consistency of measurement and it was enhanced through a pilot study. The sample of the pretest was a total of 5 Commercial banks and the pretest was included in the final outcome.

3.7Data analysis

This concept refers to the process of systematically gathering, putting together, arranging and organizing information into units that are easy to manage, synthesizing it, analyzing patterns, and making sense of important information. The respondent answers were rated on a five Likert scale. In this proposed model, each observed response (from 1 to 5) had a common and partially underlying factor.

The information was gathered and coded using descriptive statistics, specifically the mean and standard deviation to explain each variable. The statistical tool for the analysis was the statistical package for social sciences (SPSS) version 23. Pie charts, frequency distribution tables, and bar charts had a great role in the presentation of results. The research used the following regression model:

$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_{5+}\ \varepsilon$……………………………………(i)

Where;

Y= the dependent variable (Performance of Commercial banks)

α - Is a constant; the concept explaining the firms performance given and it's the Y value when all the predictor values (X_1, X_2, X_3, X_4, X_5) are zero

β_1, β_2, β_3, β_4, β_5 – Are constants regression coefficients representing the condition of the independent variables to the dependent variables.

X_1 – Credit appraisal. An increase in the credit appraisal unit resulted in a corresponding unit increase in performance.

X_2 – Risk identification. An increase in the risk identification unit resulted in a corresponding unit increase in performance.

X_3 – Risk measurement. An increase in the risk measurement unit resulted in a corresponding unit increase in performance.

X_4 – Risk control. An increase in the risk management unit resulted in a corresponding unit increase in performance.

X_5- Risk monitoring. An increase in the risk monitoring unit resulted in a corresponding unit increase in performance.

Ɛ - (Extraneous) Error term denoted a variation in the performance due to the other factors that are not included.

Diagnostic testing

The researcher carried out diagnostic tests in order to find out if there would be problems arising due to violations of the regression model. The study used the following diagnostic tests; multicollinearity, serial correlation and heteroscedasticity.

Multicollinearity test

Multicollinearityis when we have high correlation between the independent variables in the study. Brooks(2008), states that an idependent variable becomes the exact combination of other independent variables, the model cannot be estimated since it is in a perfect collinearity position.

The test was thus conducted using tests of correlations and it showed a weak negative correlation indicating there was no multicollinearity.

Serial correlation test

The test that was used to check for autocorrelation in the data was Durbin Watson(DW) test to check that the residuals of the model were not auto correlated since independence of the residuals is one of the basic hypothesis of regression analysis.

Heteroskedasticity test

Homoskedasicity is an assumption that the errors terms in the regression models have a constant variance. On the other hand heteroscedasticity is an assumption of linear regression that accounts for errors in the regression equation. The linear regression assumes that the error term is homoscedastic which means that its contant variance. The data was tested using Glejser LM test to detect any case of heteroscedasticity.

CHAPTER FOUR
DATA ANALYSIS, FINDINGS AND DISCUSSION

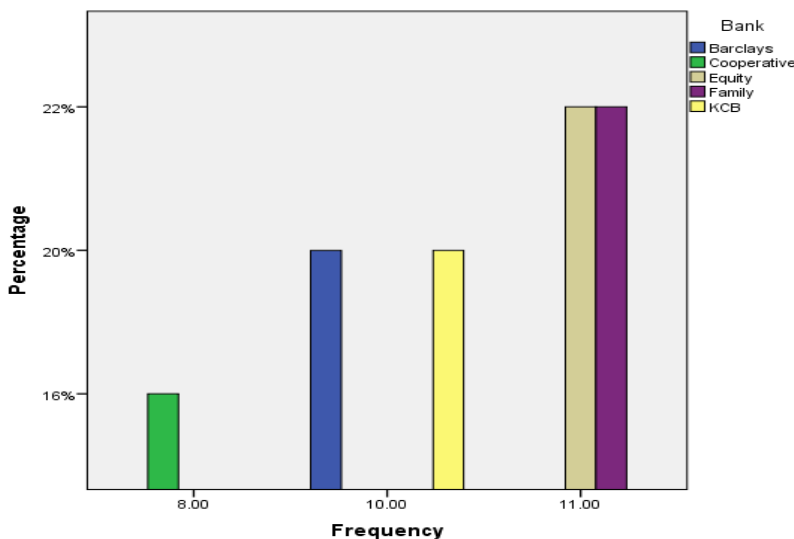
4.0 Introduction

This chapter shows how data was analyzed including the results and findings of the study questions regarding the respondents. This study used a Likert scale in collecting and analyzing financial risk management, where a scale of 5 points were used in computing the means and standard deviations. The findings were then presented in tables and suitable explanations were given in prose. The results of financial performance for the banks were presented in a table and a brief explanation was given. To measure the effects of financial risk management regression analysis was used. This chapter concludes with a brief interpretation of the findings.

4.1 Response Rate

A response rate represents the number of people who participated in the study and it is presented in the form of percentage. This study had a sample size of 5 commercial banks in Kitengela. From the results 75 % participated in the study and only 25% who failed to do so. According to Mugenda and Mugenda (1999), a response of 50 % is adequate for analysis and reporting, a response rate of 60% is good while, a response rate of 60 % is good while a response rate of 70% and above is excellent.

Figure 2: Commercial banks in Kitengela



Source: Author, 2018.

According to figure 2; 16% of the response rate was from Cooperative, 20% Barclays which was similar to KCB, 22% from Family bank which was also similar to Equity bank.

4.2 Demographic information

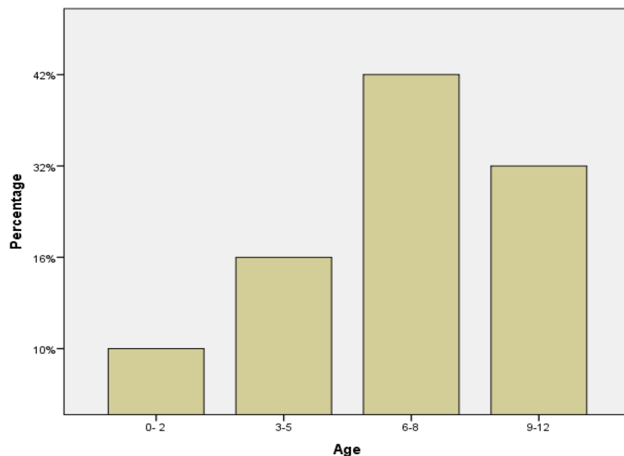
Work experience

This table shows the number of years a person has been working on the bank. The respondents were asked to indicate the number of years they had worked. The responses are provided in table 3.

Table 2
Work experience

		Frequency	**Percent**	**Valid Percent**	**Cumulative Percent**
Valid	0-2	7	14.0	14.0	14.0
	3-5	10	20.0	20.0	34.0
	6-8	13	26.0	26.0	60.0
	9 and above	20	40.0	40.0	100.0
	Total	**50**	**100.0**	**100.0**	

Figure 3:Work experience



***Source: Author, 2018*.**

Table 2 and figure 3 above show that 10%, of the people have been working in the bank for a period of 2 years and below, 16% had been operating in the bank for 3-5 years, 42% worked for a period of 6-8 years and 32% also worked for 9-12 years. These findings indicate that majority

of the staff at the commercial banks had worked for a period of 6-8 years while minority had been operating from 2 years and below.

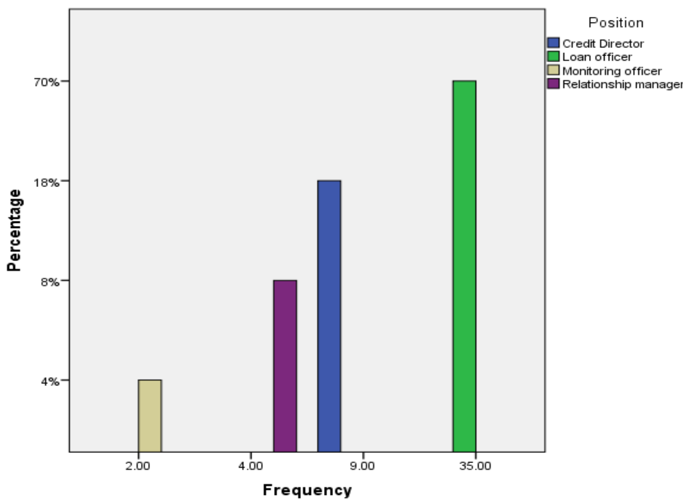
4.3 Designation of respondents

This table shows the position held by each person who was able to fill the questionnaire.

Table 3
Designation of respondents

	Frequency	Percent	Valid Percent	Cumulative Percent
Loan officer	37	74.0	74.0	74.0
Relationship manager	6	12.0	12.0	86.0
Monitoring officer	3	6.0	6.0	92.0
Credit manager	4	8.0	8.0	100.0
Total	**50**	**100.0**	**100.0**	

Figure 4: Designation of respondents



Source: Author,2018.

According to the table 3 and figure 4;70% who filled the questionnaires were loan officers, 8% were relationship managers, 4% were monitoring officer and finally 18% were credit officers. This indicates that majority of the people who were given the questionnaire were loan officers

who are the main persons' concernedwithloanissuance and thus had vast information on the impact of credit risk management on performance of commercial banks.

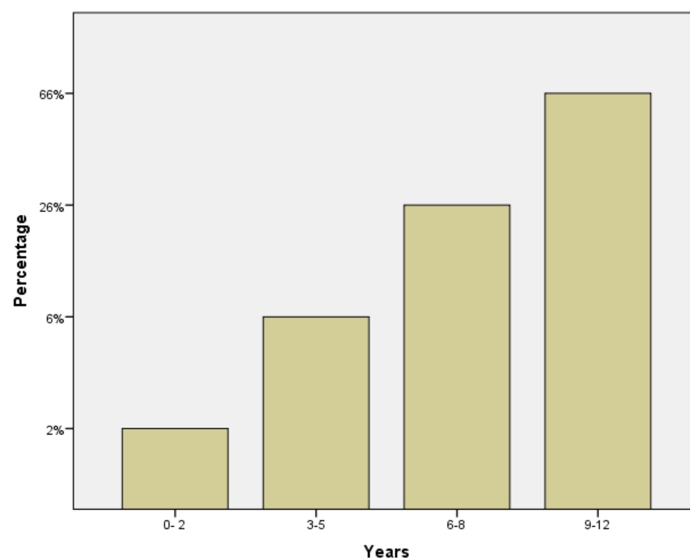
4.4Number of years of operation

This table shows the number of years one has been operating in the bank.

Table 4
Years of operation

	Frequency	Percent	Valid Percent	Cumulative Percent
6-8	7	14.0	14.0	14.0
9 and above	43	86.0	86.0	100.0
Total	50	100.0	100.0	

Figure 5 :Years of operation



Source: Author, 2018.

According to table 4 and figure 4.4, 2% stated that the bank had operated for a period of 2 years and below,6% showed that the bank had been in operation for 3-5 years, 26% stated that the bank had operated for 6-8 years and 66% indicated that the banks had been in operation for a period of 9 years and above. These findings indicate that majority of the commercial banks had

been operational for a long time and thus had a lot of information on the impact of credit risk management practices in their companies.

4.3Substantive tests

Multicollinearity test

Table 5
Correlation Matrix

		Y	X_1	X_2	X_3	X_4	X_5
Pearson Correlation	Y	1	.110	.625	.387	.361	-.085
	X_1	.110	1	-.057	.092	-.072	-.077
	X_2	.625	-.057	1	.118	.130	-.089
	X_3	.387	.092	.118	1	.191	.134
	X_4	.361	-.072	.130	.191	1	.212
	X_5	-.085	-.077	-.089	.134	.212	1

Source: Author, 2018.

From the matrix above, it can be seen that the level of relationship between performance and the independent variables, high level of correlation are discouraged as it results to a problem of multicollinearity. All the variables such as credit appraisal(X_1), risk identification(X_2), risk measurement(X_3), risk control(X_4) and risk monitoring(X_5)were not strongly correlated. This indicates that there was no multicollinearity in any of the explanatory variables.

Regression analysis

In this section the research shows regression results. Regression were used to determine the performance of commercial banks in relation to credit appraisal,riskidentification,risk measurement, risk control and risk monitoring. The model is represented by:

$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_{5+} \varepsilon$……………(ii)

Table 6
Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	1.812	.496		3.654	.001
Credit appraisal	.079	.062	.126	1.265	.212
Risk identification	.343	.062	.554	5.502	.000
Risk measurment	.110	.041	.274	2.691	.010
Risk control	.122	.046	.271	2.626	.012
Risk monitoring	-.058	.049	-.121	-1.178	.245

a. Dependent Variable: performance

Source: Author, 2018

Using the values of the coefficient (b) from the regression coefficient, the established equation takes the form of:

Performance= 0.079 credit appraisal + 0.343 risk identification + 0.110 risk measurement + 0.122 risk control - 0.058 risk monitoring

The results show that all the independent variables have a positive impact on performance except risk monitoring which has a negative impact and is insignificant (risk monitoring -0.058). The results indicate applying Credit appraisal results to 0.079change in performance while risk identification results into 0.343 change in performance, risk measurement results into 0.11 change in performance, risk control results into 0.122 change in performance and risk monitoring results into -0.058 change in performance. The results further indicate that risk identification,risk measurement and risk control are significant since the p-value is less than 0.05 (p-value< 0.05) while credit appraisal and risk monitoring whichare insignificant as the p-value is greater than 0.05(p-value> 0.05).

Table 4.17:Goodness of fit and serial correlation

The Durbin-Watson test was used to check residuals of the models that were not auto correlated since independence of the residuals is one of the basic hypotheses of regression analysis.Being that the DW statistics were close to the threshold of 2 at 2.175, it can be noted that there was no autocorrelation.

Table 7
Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
					R Square Change	F Change	df1	df2	Sig. F Change	
1	.758[a]	.575	.526	.22999	.575	11.892	5	44	.000	2.175

a. Predictors: (Constant), credit appraisal, risk identification, risk measurement, risk control, risk monitoring

b. Dependent Variable: performance

Source: Author, 2018

The table 7 above talks about the Goodness of fit. The model satisfies the requirement for Goodness of fit since the $R^2$is 57.5% with >30% being the benchmark. This shows the independent variables explain 57.5% of the variables in the research while 42.5% is explained by other variables not inclusive in the model. The model is also significant as the p-value is less than 0.05.

Analysis of variance (Anova)

Table 8
ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
	Regression	3.145	5	.629	11.892	.000[b]
1	Residual	2.327	44	.053		
		5.473	49			

a. Dependent Variable: performance

b. Predictors: (Constant), credit appraisal, risk identification, risk measurement, risk control, risk monitoring

Source: Author, 2018

Table 8 illustrates the Analysis of Variance (ANOVA) which assesses the overall significance of the model. The regression results the model is significant at 0.0 which is actually less than 0.05.

4.4 Diagnostic tests

Heteroskedasticity test

Glesjer test

Table 9

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.142	.278		.511	.612
	Credit appraisal	.008	.035	.035	.242	.810
	Risk identification	-.005	.035	-.023	-.154	.878
	Risk measurement	.024	.023	.154	1.038	.305
	Risk control	-.049	.026	-.284	-1.898	.064
	Risk monitoring	.028	.028	.152	1.024	.311

Dependent Variable: Absut

Source: Author, 2018

Interpretation of Test Results Output Glesjer

Based on output coefficients the obtained value of Sig. credit appraisal 0.810, risk identification 0.878, risk measurement 0.305, risk control 0.064 and risk monitoring 0.311 > 0.05, it can be concluded that there is no heteroscedasticity problem.

Figure 6:Prediction of residuals

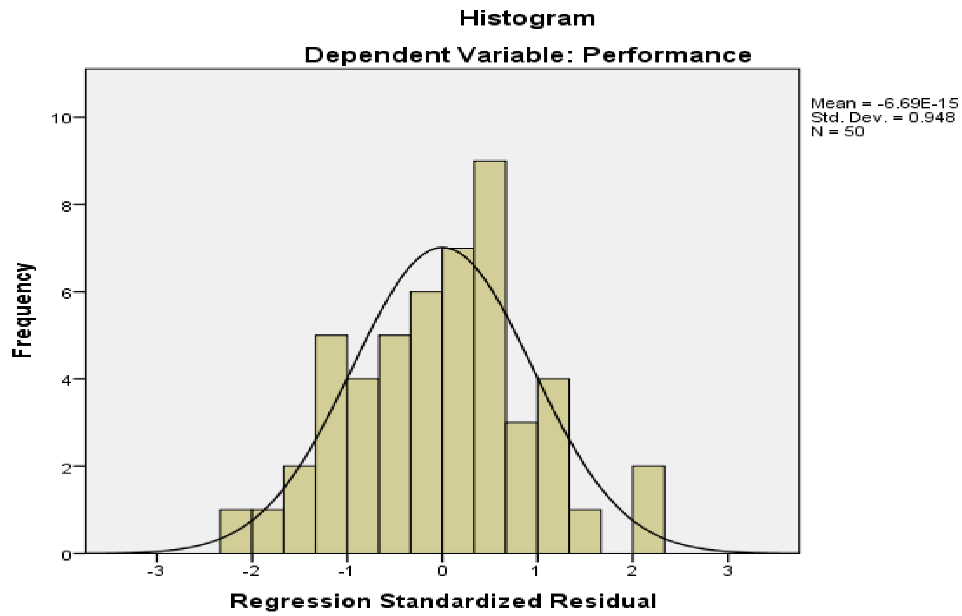
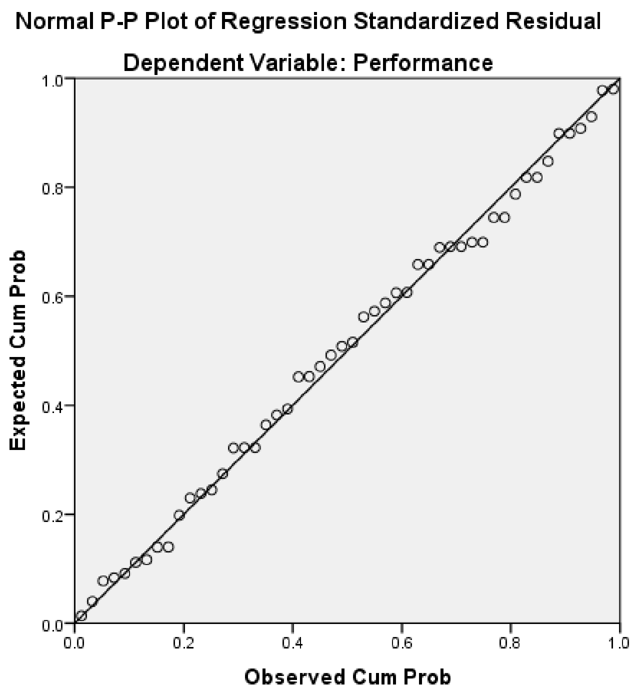


Figure 7 : PP- Plots for the residuals



Source: Author, 2018

The figures show that residuals are normally distributed along the estimated model.

4.5 Findings

Findings for Main objective: Performance of Commercial Banks

Customer satisfaction is used under performance of commercial banks as the main dependent variable.

The table below indicates the extent to which the following process of credit appraisal is applied at the bank. Ii is tick appropriately on a scale of 1-5. 1- Strongly Disagree, 2- Disagree, 3- Uncertain, 4- Agree and 5- Strongly agree.

Table 10: Customer Satisfaction

	Strongly Disagree	Disagree	Uncertain	Agree	Strongly agree	N	Mean	Standard deviation
Customer's grievances are generally low	0	0	14	24	12	50	3.96	0.727
Customer satisfaction ratings are high	2	3	0	29	16	50	4.14	0.857
They are numerous cases of repeat loan applicants	0	0	0	20	30	50	4.60	0.495
Individual customers operate many other accounts with the bank	0	0	0	31	19	50	4.38	0.49
Customer are always positive about new products offered by the bank	0	0	0	33	17	50	4.34	0.479
Bank always gets new customers through positive word of mouth received from previous clients	0	0	0	29	21	50	4.42	0.499

The results show that customer's grievances are generally low indicating that customer satisfaction rate is high. Therefore leading to numerous cases of repeat loan applicants. Due to such individual customers begin to open many other accounts within the bank. This actually indicates that the customers are positive about new products offered by the bank. The customers acting like marketing agents to the bank by referring other clients to use certain bank products. According to the research the highest mean was 4.60. Repeat loan applicants had the highest mean where staff indicated that there is great extent at which customers come back.

Credit Appraisal

Table 11: Competent personnel

	Strongly disagree	Disagree	Uncertain	Agree	Strongly agree	N	Mean	Standard deviation
Staff members from the loans department are co-operative and helpful to all clients.	0	0	1	18	31	50	4.60	0.535
Special help is accorded to friends and families of loan officers giving them a biased access to loan facilities.	43	6	0	1	0	50	1.18	0.523
Loan officers require further training to enhance their professionalism in regards to their customer relations.	1	3	0	33	13	50	4.08	0.829

The findings indicate that staff members from the loans department are generally cooperative and helpful to all clients without favoring a particular person due to ethnic background or blood relationship. The research further show that loan officers require further training in order to bond with other team members and enhance the unity of team members. According to the researcher, the highest mean was 4.60 where a big number indicated that staff are cooperative and helpful to clients.

Table 12: Capacity to Repay Loan

	Strongly disagree	Disagree	Uncertain	Agree	Strongly agree	N	Mean	Standard Deviation
The bank operates a well-structured policy on credit risk management.	1	0	2	19	28	50	4.46	0.762
Before providing loans, the bank performs a credit risk analysis on borrowers.	0	0	1	23	26	50	4.5	0.544
A credit scoring model is applied in credit assessment on borrowers.	0	0	1	28	21	50	4.44	0.535

Further analysis into the research also showed the extent to which capacity to repay a loan affects performance of commercial banks. From the findings 2 % of the population were not certain whether the bank operates a well-structured policy on credit risk management while 98% were clear on the particular fact. A mean of 4.46 was obtained for this study indicating a high level of agreement to that particular finding. Furthermore, 2% of the population were not sure whether the bank performs a credit analysis on borrowers before providing loans while 98% were certain that it performs the credit analysis procedure. A different mean of 4.5 was obtained indicating that a great percentage of the persons were quite clear on the analysis on borrowers. Research indicates that 98% of the population agreed to applying credit scoring in credit assessment on borrowers. A particular mean of 4.44 was discovered from that research.

Risk Identification

Table 13: Credit Referencing

	Strongly disagree	Disagree	Uncertain	Agree	Strongly agree	N	Mean	Standard deviation
The bank is in close contact with the CRB for assistance regarding lending decisions to borrowers.	0	0	1	20	29	50	4.56	0.541
Subsequent approvals on loans and their appraisals are performed on the basis of the credit history	1	0	0	28	21	50	4.36	0.693
Credit referencing assists in mitigating credit risks for banks books of financial performance	0	0	1	26	23	50	4.44	0.541

According to the researcher the bank is always in close contact with the CRB for assistance regarding lending decision to borrowers. Furthermore, loan approval is always based on credit history of the person. Although banks cannot solve all such problems and thus it uses credit referencing in order to mitigate the credit risk. According to the research credit referencing is a component of risk identification which influences the performance of commercial banks. The study indicates that 98 % of the population agreed that the bank is always in close contact with the CRB regarding lending decisions to borrowers. A mean of 4.56 was obtained from that particular research which shows that a great number of persons confirm to CRB usage during loan approval. The research further indicates that 98% of the personnel agreed that subsequent approvals of loans and their appraisals are performed on the basis of credit history. A certain mean of 4.36 was also obtained for this particular research indicating a higher mean which shows that the bank highly uses credit history on approval basis.

Table 14:past repayment record

	Strongly disagree	Disagree	Uncertain	Agree	Strongly agree	N	Mean	Standard deviation
The Bank uses the CRB to improve approval of loan to customers.	0	0	0	32	18	50	4.36	0.485
Payment records of customers will enhance measures to improve banks' book of accounts	0	0	6	27	17	50	4.22	0.468

The researcher further shows that the bank uses CRB in order to improve approval of loan to customers. According to the research a customer will enhance certain measures to improve banks' book of accounts. Further investigations into the findings indicate that 100% of the researchers affirm that the bank uses CRB to enhance chances of a client will get a loan or not. A mean of 4.36 was obtained from that research indicating the extent at which CRB referencing will influence loan approval. However, from the study 12% were not sure on whether payment records of customers enhance measures to improve banks' book of accounts but 88% were certain that it enhances banks' accounting books. A higher mean of 4.22 was also obtained from the study affirming that particular research. According to the research CRB referencing is applied in loan approval and thus improve a banks' book financial institutions.

Risk Measurement

Table 15: Variability Of Earnings And Risk Management

	Strongly disagree	Disagree	Uncertain	Agree	Strongly agree	N	Mean	Standard deviation
The CAMEL framework is used in identifying relative and future risks.	0	1	20	17	12	50	3.8	0.833
The bank dictates the loan size limits that one qualifies for on the basis of their financial history.	0	0	3	24	23	50	4.4	0.606
The use of a credit committee reduces the chance of default.	3	0	4	28	15	50	4.04	0.968

According to the data obtained from variability of earnings and risk management all as components under risk measurement which indicate that it does have an influence on performance. Findings indicate that 2% of the officers disagree to the use of CAMEL framework while 40% were uncertain and 58% do agree with that particular research. A mean of 3.8 was obtained which showed that the extent of usage of the CAMEL framework. Furthermore, 6% of the population were not clear whether the bank dictates the loan size limits that one qualifies for on the basis of their financial history while 94% do affirm to that particular finding. A great mean of 4.44 was also obtained indicating that a big percentage agree to the fact that bank dictates loan size limit that one qualifies. There was a variation on the level at which credit committee reduces the chances of default 6% disagreed, 8% were uncertain while 86% agreed to its usage. The mean for the particular variable was 4.04 which indicates the use of credit committee greatly reduces the chances of default.

Table 16: Customer Credit Rating

	Strongly disagree	Disagree	Uncertain	Agree	Strongly agree	N	Mean	Standard deviation
Borrower's credit ratings reduce the bank's exposure to risks.	0	1	1	37	11	50	4.16	0.548
Consistency in applying credit rating improves loan performance.	0	0	0	31	19	50	4.38	0.49

According to the researcher a borrower's credit rating reduce the bank's exposure to risks. The bank can further improve by having a consistent credit rating which will thus improve loan performance. The highest mean was 4.38 indicating a big number were certain that consistency in applying credit improves loan performance.

The research also indicates the influence of customer credit rating on performance of commercial banks. A mean of 4.16 was obtained for the particular research which shows the high percentage of bank exposure to credit ratings. On the other hand, 100% of credit officers agree that consistency in applying credit rating improves loan performance. A mean of 4.38 was obtained on this research.

Risk Control

Table 17: Credit Rationing

	Strongly disagree	Disagree	Uncertain	Agree	Strongly agree	N	Mean	Standard deviation
Credit control affects the level of credit rationing	1	1	5	34	9	50	3.98	0.742
Credit rationing influences the amount of loan approved visa vis the loan applied.	0	1	4	34	11	50	4.1	0.614
Lack of proper assessments to a borrower's loan repayment capability leads defaults.	0	0	0	27	23	50	4.46	0.543

Risk control has a great influence on the performance of commercial banks where credit control affects the level of credit rationing. Credit rationing also influences the amount of loan approved visa vis the loan applied. Therefore, a lack of proper assessment to a borrower's loan repayment capability leads to default. The highest mean of the data was 4.46 indicating that lack of proper assesmentsnegatively impacts on repayment capability.

It has been noted that risk control influences the performance of commercial banks. Credit rationing as a component of risk control also influences performance. According to the research credit control affects the level of credit rationing. A mean of 3.98 was obtained for the

research. Furthermore, they also had different views on the level at which credit rationing influences the amount of loan approved visa vis the loan applied. A mean of 4.1 was obtained for the research which indicates that improper assessment on borrower's loan leads to default.

Table 18: Loan Securitization

	Strongly disagree	Disagree	Uncertain	Agree	Strongly agree	N	Mean	Standard deviation
Loan securitization enables the bank to improve its financial performance	0	1	3	33	13	50	4.16	0.618
Loan securitization determines the profit earned by investors	1	4	3	32	10	50	3.92	0.877
Any client is allowed to invest in securitized loans.	0	4	4	21	21	50	4.18	0.896

The researcher shows how loan securitization enables the bank to improve its financial performance thus determining the profit earned by investors. According to the study any client is allowed to invest in securitized loan. According to the research findings loan securitization enables the bank to improve its financial performance. A mean of 4.16 was obtained from the research indicating that a huge number of credit officers agreed that securitization greatly improves performance. Therefore, improved financial performance leads to increased profits. A mean of 3.92 was gathered from the analysis showing the great extent at which loan officers

agreed to such findings. The mean obtained was 4.18 which indicates the majority opinion is that any client is allowed to invest in securitized loans.

Risk Monitoring

Table 19: Interaction with Customers

	Strongly disagree	Disagree	Uncertain	Agree	Strongly agree	N	Mean	Standard deviation
Bank loan officers interact with their customers prior to giving them loans.	0	2	2	22	24	50	4.36	0.749
Most customers are not aware of the legal terms and conditions of a loan.	0	8	0	17	25	50	4.18	1.063
Interaction with bank staff provides borrowers with crucial information regarding their suitability for the loan applied.	0	2	0	26	22	50	4.36	0.693

The prior interaction with customs before offering loans gives them a glimpse about the legal issues related to the loan. However, most customers are not aware of the legal terms and contains pertaining a loan although interaction with bank staff provides borrowers crucial information regarding the suitability for the loan applied. A higher mean was experienced in both question 1 and 2 indicatingthat there is a client to customer relation prior to giving loans.

Risk monitoring is a factor which influences the performance of commercial banks. Interaction with customers is a semi-variable under risk monitoring and is thus shown to influence performance.. A mean of 4.36 was obtained which indicates that majority of the loan officers agreed that a relationship of customer-to-client was large. A mean of 4.18 was obtained from the research indicating the great extent at which customers lack knowledge on loans.

Table 20: Upload Loan Directory

	Strongly disagree	Disagree	Uncertain	Agree	Strongly agree	N	Mean	Standard deviation
The bank uploads a borrower's loan directory to have up to date information regarding their financial status.	1	0	0	30	19	50	4.32	0.683
Updated customer data enables the bank to easily make assessments regarding loan issuance.	1	0	0	27	22	50	4.38	0.697

The study indicates that the bank always uploads a borrower's loan directory to have up to date information regarding their financial status. The updated customer data enables the bank to easily

make assessments regarding loan issuance. To a great extent loan officers agree that the bank always uploads a borrower's loan directory. The highest mean was 4.38 while the highest standard deviation was 0.697.

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the summary, recommendations and limitations of the research. This chapter is separated into three different sections. The first chapter represents the summary followed closely by recommendations and finally limitations of the research.

5.2 Summary of findings

The main objective of the study was to ascertain effects of credit risk management on performance of selected commercial banks. The specific objectives included examining the effect that credit appraisal had on the performance of commercial banks, evaluating the outcomes arising from credit risk control on the performance of commercial banks, determining the outcomes of risk identification on the performance of commercial banks,determining the outcome of credit risk measurement on the performance of commercial banks and finding out the influence of credit risk monitoring on the performance of commercial banks. The study distributed a questionnaire which assisted to examine the effect of credit risk management on performance of selected commercial banks in Kitengela. The study used descriptive research design. The sample size was 5 commercial banks in Kitengela. Data was gathered and analyzed from credit officers and other staff in credit department. The data was analyzed using SPSS 23.

Findings on Effect of Credit Appraisal on Performance of commercial banks

The study found that Credit appraisal positively influenced performance of commercial banks with a coefficient of 0.079 and was insignificant. Credit appraisal was insignificant since the p-value was more than the benchmark of 0.05(0.212>0.05).

Findings on Effect of risk identification on performance of commercial banks

The study found out that risk identification had a positive and significant effect on performance of commercial banks. This is so because it had a coefficient of 0.343. Ceteris paribus, a unit increase in risk identification across time and between banks leads to 0.343increase in financial performance on average.

Findings on Effect of risk measurement on performance of commercial banks

The study found out that the coefficient for risk measurement was 0.110 which positively influenced performance and significantly influenced financial performance of commercial banks in Kenya. A unit increase in risk measurement across time and between commercial banks leads to 0.110 increase in financial performance on average.

Findings on Effect of risk control on performance of commercial banks

The findings also deduced that risk control positively and significantly influenced the financial performance of commercial banks as it had a coefficient of 0.0122. This means that ceteris paribus, a unit increase in risk control across time and between commercial banks leads to 0.0122increase in financial performance on average.

Findings on Effect of risk monitoring on performance of commercial banks

The study found that risk monitoring negatively influenced performance of commercial banks with a coefficient of -0.058 and was insignificant. Risk monitoring was insignificant since the p-value was more than the benchmark of 0.05(0.058>0.05).

5.2 Conclusion

The study shows that almost some of the variables significantly affected performance while others insignificantlyaffected it hence the conclusion of this research is that the banks need a multifaceted approach in their risk management efforts that includes all the practices that were of focus to this study in order to realize the full benefits relating to risk management programs.

The study also revealed that most commercial banks turned to CRB referencing in order to approve loans. Risk management significantly contributes to performance

Credit risk management significantly contributes to performance of commercial banks even with the adoption of risk management practices. The study, therefore, concludes that there is a strong relationship between credit risk management practices and performance of Kenyan commercial banks.

5.3Recommendations

Effect of risk identification on performance of commercial banks

The findings show that risk identification significantly affects financial performance of commercial banks. Commercial banks must use risk identification to mitigate the level of credit risks. The banks need enhance their process and indicate any other terms which are also key to a loan process such as existing financial status and current employment status that is are you permanently employed or on contract and how many years have you worked in that place.

The findings also indicate that the bank uses credit referencing to mitigate risks. The banks need to enhance the mitigation strategies by using other methods such as risk avoidance, risk acceptance, risk limitation and risk transference in relation to the type of risk.

Effect of risk measurement on performance of commercial banks

According to the research risk measurement improves performance of commercial banks. CAMEL framework is used in identifying relative and future risks. The banks are expected to improve this and use up to date methods such as the Internal Capital Adequacy Assessment Process (ICAAP) to review its own funds together with its risk in order to establish appropriate measures based on up-to-date risk analyses

Effect of risk control on performance of commercial banks

From the risk control positively influences the performance of commercial banks. The commercial banks need to increase risk control measures to reduce the level of credit risk. The commercial banks can invest in other ways of improving performance such business realignment, channel optimization, process costs, staff productivity, technology and innovation.

5.4 Limitations of the study

The study faced limitations with respect to cooperation of some of the banks.. Obtaining data from commercial banks was a great challenge and the management in some few commercial banks were not cooperative luckily the researcher managed to obtain the data from the credit officers of all the 5 commercial banks.

The researchalso faced challenges of time frame within which the data was to be collected from the respondents.Theconstraint limiting the study from collecting information for the study particularly was where the respondents delayed in filling the questionnaire and required a constant reminder. The receipt of this could have led to improvement in the conclusions drawn in the study.

The study faced challenges of uncooperativeness from some of the respondents due to the sensitivity of the information required. The researcher overcame this by explaining to the respondents that the information they provided was to be held confidential and was only for academic purpose only.

5.5 Suggestions for further research

The research was based on effects of credit risk management on financial performance of commercial banks in Kenya. The study suggests that a further research can be done on impact of credit risk management on financial performance of other institutions like microfinance institutions and SACCOs.

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LETTER OF RECOMMENDATION

APPENDIX 1: QUESTIONNAIRE
Part A: General information

1. Name of Bank

Equity Bank ☐ Cooperative Bank ☐ Barclays bank ☐

Family bank ☐ KCB bank ☐

2. Number of years you have worked in the bank

Less than 2 years ☐ 3-5 years ☐

5-7 years ☐ 7-10 years ☐

3. Current position in the bank

Loan Officer ☐ Relationship Manager ☐

Monitoring Officer ☐ Credit Director/ Credit Manager ☐

Other (Please Specify): ___________

4. Number of years the bank has been operating

Less than 2 years ☐ 3-5 years ☐

5-7 years ☐ 7 years and above ☐

5. Type of loan products offered by the Bank

Normal loan ☐ Instant loan ☐ Development loan ☐

School fees loan ☐ Emergency loan ☐

Others(Specify): ___________

PERFORMANCE OF COMMERCIAL BANKS

CUSTOMER SATISFACTION

Kindly indicate the extent to which the following process of credit appraisal is applied at your bank. Please tick appropriately on a scale of 1-5. 1- Strongly Disagree, 2- Disagree, 3- Uncertain, 4- Agree and 5- Strongly agree.

	Strongly Disagree	Disagree	Uncertain	Agree	Strongly agree
Customer's grievances are generally low					
Customer satisfaction ratings are high					
They are numerous cases of repeat loan applicants					
Individual customers operate many other accounts with the bank					
Customer are always positive about new products offered by the bank					
Bank always gets new customers through positive word of mouth received from previous clients					

PART B: EFFECT OF CREDIT APRAISSAL ON PERFORMANCE OF COMMERCIAL BANKS

COMPETENT PERSONNEL

Kindly indicate the extent to which the following process of credit appraisal is applied at your bank. Please tick appropriately on a scale of 1-5. 1- Strongly Disagree, 2- Disagree, 3- Uncertain, 4- Agree and 5- Strongly agree.

	Strongly Disagree	Disagree	Uncertain	Agree	Strongly agree
Staff members from the loans department are co-operative and helpful to all clients.					
Special help is accorded to friends and families of loan officers giving them a biased access to loan facilities.					
Loan officers require further training to enhance their professionalism in regards to their customer relations.					

CAPACITY TO REPAY LOAN

	Strongly Disagree	Disagree	Uncertain	Agree	Strongly agree
The bank operates a well-structured policy on credit risk management.					
Before providing loans, the bank performs a credit risk analysis on borrowers.					
A credit scoring model is applied in credit assessment on borrowers.					

PART C: EFFECT OF RISK IDENTIFICATION ON PERFORMANCE OF COMMERCIAL BANKS

CREDIT REFERENCING

	Strongly Disagree	Disagree	Uncertain	Agree	Strongly agree
The bank is in close contact with the CRB for assistance regarding lending decisions to borrowers.					
Subsequent approvals on loans and their appraisals are performed on the basis of the credit history					
Credit referencing assists in mitigating credit risks for banks books of financial performance					

PAST REPAYMENT RECORDS

	Strongly Disagree	Disagree	Uncertain	Agree	Strongly agree
The Bank uses the CRB to improve approval of loan to customers.					
Payment records of customers will enhance measures to improve banks' book of accounts					

PART D: EFFECT OF RISK MEASUREMENT ON PERFORMANCE OF COMMERCIAL BANKS

VARIABILITY OF EARNINGS AND RISK MANAGEMENT

	Strongly Disagree	Disagree	Uncertain	Agree	Strongly agree
The CAMEL framework is used in identifying relative and future risks.					
The bank dictates the loan size limits that one qualifies for on the basis of their financial history.					
The use of a credit committee reduces the chance of default.					

CUSTOMER CREDIT RATING

	Strongly Disagree	Disagree	Uncertain	Agree	Strongly agree
Borrower's credit ratings reduce the bank's exposure to risks.					
Consistency in applying credit rating improves loan performance.					

PART D: EFFECT OF RISK CONTROL ON PERFORMANCE OF COMMERCIAL BANKS

CREDIT RATIONING

	Strongly Disagree	Disagree	Uncertain	Agree	Strongly agree
Credit control affects the level of credit rationing					
Credit rationing influences the amount of loan approved visa vis the loan applied.					
Lack of proper assessments to a borrower's loan repayment capability leads defaults.					

LOAN SECURITIZATION

	Strongly Disagree	Disagree	Uncertain	Agree	Strongly agree
Loan securitization enables the bank to improve its financial performance					
Loan securitization determines the profit earned by investors					
Any client is allowed to invest in securitized loans.					

PART E: EFFECT OF RISK MONITORING ON PERORMANCE OF COMMERCIAL BANKS

INTERACTION WITH CUSTOMERS

	Strongly Disagree	Disagree	Uncertain	Agree	Strongly agree
Bank loan officers interact with their customers prior to giving them loans.					
Most customers are not aware of the legal terms and conditions of a loan.					
Interaction with bank staff provides borrowers with crucial information regarding their suitability for the loan applied.					

UPDATE LOAN DIRECTORY

	Strongly Disagree	Disagree	Uncertain	Agree	Strongly agree
The bank uploads a borrower's loan directory to have up to date information regarding their financial status.					
Updated customer data enables the bank to easily make assessments regarding loan issuance.					