The Influence of Credit Management on Loans Portfolio Performance of Commercial Banks in Kenya.

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Abstract

Banking sector is a key source of funding for most businesses. Improved loans portfolio management leads to high performance of banking institutions. Commercial banks use various avenues to generate their income. Credit management is one of the sensitive areas of management of banking institutions which deals with credit. Credit management gives assurance that loan borrowers will pay back the money lend to them by commercial banks. It is a vital component of the banking practice management function. A banking institution with proper credit management policy will enable it to improve its efficiency. Thus, this study sought to ascertain influence of credit management on loans portifolio performance of commercial banks in Kenya. Descriptive research design was used and data was collected from eleven commercial banks headquarters in Nairobi. The study was based on census approach as it focused on all the eleven commercial banks listed on NSE, Kenya. For each commercial bank listed, 5 respondents were sought, thus providing 55 respondents. Study employed both secondary and primary data. Instruments used to collect data were questionnaires and Central Bank of Kenya finanial reports websites, journals of Kenya bankers association and commercial banks of kenya accounts published annually. Data was analyzed using applied descriptive statstics, correlations and regression by use of Statistical Package for Social Sciences(SPSS). The aggregate mean score of credit management and loans portifolio performance of commercial banks was 4.07, and a strong correlation of r= .623. The conclusion from the findings indicated that employing proper credit management has a significant and positive influence on loans portifolio performance of commercial banks. The study recommended that commercial banks adopt sound policies reviews, carry out proper client appraisals, exercise delinquency credit management, and have in place a well-functioning Credit Management department.

Key words: *Credit Management, Performance, Loans Portfolio, commercial banks in Kenya .*

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1.0 Introduction

Loans advancement within banking industry is considered one of their most significant functions. Banks derive their main revenue from issuance of loans, and managing of loan portfolios affects bank performance (Giesecke, 2014). Loan growth is defined as the variation in a banks' loan portfolio. Any growth in a banks' loan book, is perceived as a vital measure of management performance that indicates good bank credit policies (Araga, 2011). Regularly, banks ease the credit level standards with an intention of attaining higher market shares. Such decisions may lead to a problem in adverse selection and a substantial increase in non-performing loans caused by various risks such as issuance of unsecured loans.

Undeniably, the large number of unrecoverable loans is the key reason of bank non-performance (Araga, 2011). It is very important to monitor repayment characteristics of customers to help determine future issuance of loans. Banks have been embracing evaluation of respective risk portfolios applying the laid down standards (Basel II, 2006). The obligation of the bank is to hold capital and measure against nonpayment risk which is incremental to any non-payment risk held in bank's value at-risk model. Incremental nonpayment risk levy was integrated in trading book capital system in reaction to growing amount of disclosure in banks. Embracing new technology in capturing and monitoring loans portfolio performance improves on default risks.Basel II (2006) goal was to encourage bankers to increase their risk management ability, including how organizations price products, create reserves for losses and regulate their operations. Conventionally, functional proficiency is determined by banks using indicators of profitability, namely, return on investment, yield on assets and return on equity.

Further, financial institutions apply operational ratios; namely, total operating expenses per output unit and monetary output per staff member (Giesecke, 2014). The Principal objective for portifolio loan performance in Canada is directed to regulate risk strategies that are associated with banks actions on lending. Weak strategic or tactical decisions made concerning funding criterions, loans portifolio innovation of loan products, or physical and demographic opportunities in place can threaten the future of the bank (Booth, 2009).

"Employing proper credit management practices has a positive and significant influence on loans portfolio performance of commercial banks in Kenya"

In South Africa, funds managers are swift in advising banks where to invest and how to collect loan debts cheaply (Humphrey, 2015). Locally Kenya continues to experience banking hitches that have led to collapse of many banking institutions. Waweru and Kalani (2009) observe that the core of the financial performance of many financial institutions was lending. Lending practices thus signify discretion actions that banking institutions undertake before issuing loans to clients. As concerns this study, these practices include Know Your Customer (KYC) procedures, interest rates, partnership with credit reference bureau and credit policy principles.

Statement of the Problem

Extension of credit by banks to customers is the chief source of revenue for commercial banks. The interest realized from credit product in banking pointers to the effectiveness or ineffectiveness of the banking system. Nevertheless, chances of non payment of borrowed loan commitments have been on the increase in commercial banks, predominantly for unsecured loans. This has led to adoption of credit risk management as a crucial practice for all financial institutions (Geitangi, 2015). Loan defaulting by borrowers is a big blow to financial institutions. Some of the defaulted banks have closed down and others put under receivership by Central Bank of Kenya, while other banks have merged to survive in the market, with Commercial Bank of Africa (CBA) and (NIC Group plc) as good examples of such mergers (Oballa, 2017).

This has had a negative impact on the image of banks to customers. Credit management is recognized as a significant process in all financial institutions (Gatuhu, 2013). Thus, the study was carried out to establish the effect of management of credit on loan portfolio performance of Kenyan commercial banks. In order for researcher to examine the association between management of credit of loans portifolio and perfomance of commercial banks in Kenya, researcherset out to test the hypothesis that there is no imparative association betweent management of credit and portifolio loans performance of Kenyan comercial banks.

Purpose of the study

To ascertain the influence of credit management on loans portfolio performance of commercial banks in Kenya.

Hypothesis of the study

HO_1: No significant association existed between management of credit and loans portfolio performance of Kenyan commercial banks.

Theoretical Review

The study was guided by information asymmetry theory that was formulated by Akerlof et al. (2002). Information Asymmetry Theory is concerned with choices in transactions where one partner is better placed with information as compared to the opponent. The outcome creates imbalance of power in transactions and this results to market failure. This means that it is not easy for everyone to access the information, much as it is not possible for everyone to be aware of what is happening. High information asymmetry influences money lenders' will to give credits.

Extra risk arises with uncertaity in organization level performance, and more variability in investment opportunity. High percentage of associated monitoring charges is transferred to borrowers through increased interest rates with high cost of data collection which in turn leads other borrowers to limit use of lines Where monitoring is imperfect, lenders are not able to eliminate information asymmetry; hence, bank credit can be restricted for opaque companies (Jin & Leslie, 2003). Although lenders try to put restrictions and to monitor borrowers against engaging into behaviours that might hinder them from paying loans, enforcement becomes very expensive. The theory relates to the study in that credit valuation process is sometimes done using inaccurate information and it negatively influence bank performance.

Empirical Review

Empirical review gives evidence of similar studies on credit management on loans portfolio performance in banks. Gatuhu (2013) did investigate the influence of credit management on financial performance of microfinance institutions employing descriptive survey design on a population of 59 MFIs in Kenya. The study established that appraisal of clients, control of credit risk and policy on credit collection influences financial performance of microfinance institutions. However, this study was done on an MFI and not on the commercial banks.

An empirical study by Salem and Jamil (2021) investigated the impact of credit risk management on financial performance of United Arab Emirates commercial banks, the target population being 16 commercial banks. Their study employed use of secondary data. The study concluded that the ratio of non-performing loans cost income ratios have a negative significant effect on commercial banks in United Arab Emirates. Sujeewa (2015) researched on impact of credit management on the performance of commercial banks in Sri Lanka. The findings of the study revealed that non-performing loans and provisions had adverse impact on the bank profitability. In Europe, Muhamet and Sahiti (2016) carried out a study on the effect of credit risk management on banks profitability in Kosovo.

The study revealed that a higher risk asset ratio would result in marginal decline in profitability, while non-performing loans had a significant effect on profitability of banks. These studies were carried out in countries; however, the present study targetted commercial banks in Kenya. The researcher therefore, pursued in establishing influence of credit management on loans portifolio perfomance of Kenyan commercial banks. In order to test association between credit management and loans portfolio perfomancce of commercial banks, the study purposed to perform hypothesis testing that that thre is no imperative association between management of credit and loans portfolio performance of Kenyan commercial banks.

2.0 Materials and Methods

Descriptive research design was adopted in this research permitted holistic explanation of the phenomena under investigation, thus guaranteeing minimal bias during data collection and lesser mistakes when interpreting data collected Saunders et al. (2019). This study was based on census approach since it involved the entire commercial banks listed on the NSE, Kenya. For each commercial bank listed, 5 respondents were sought. This provided 55 respondents. A survey was employed to gather primary data from respondents. Questionnaires were distributed to senior loan officers (branch managersloan portfolio managers, operational managers,business banking supervisors and credit managers) of 11 listed commercial banks in Kenya. Audited financial statements from listed commercial banks of Kenya and CBK was used as Secondary data for the time frame 2016 to 2019. The collection of data was done using data collection guide.

Pre-testing of data collection tool was done in order to detect any weakness in the design of the instruments to be used (Cooper & Schindler, 2014). The pilot study was done using 5 respondents that were selected from unlisted banks (Credit Bank and Ecobank) . The respondents in the pilot study were required to evaluate the items of the statement for clarity, relevance and meaning. On the basis of their outcomes, the tool was accordingly adjusted before going for data collection. Analysis of quantitatative data was carried out by employing inferential and descriptive analysis with aid of SPSS 21.0. Validity was attained through engaging supervisors who gave their opinions as experts after checking the questionaires against the study objectives.

Evaluation was done by employing analysis of multiple regression to establish significance of predictor variable on predicted variable. Regression model focused on describing and evaluating the relationship that exists between one variable and another. Multiple linear regression was employed in establishing association between credit management and loans portfolio perfomance based on the regression model presented below:

$Y= \beta_0+ \beta_1 X_1$
Y= Bank loans Portfolio Performance
β_0 = Is the regression constant or intercept,
$X_{1=}$ Credit Management.

3.0 Results and Discussion

Response rate and reliability

Out of the 55 questionnaires issued (35) 64% response was received. As per Mugenda & Mugenda (2009) 50 % response rate is satisfactory for analysis, 60% response rate is good whereas 70% response rate and above is exceptional. The response rate of 70% was adequate to come up with a conclusion of the study. The reliability analysis of credit management was 0.781. Computed Cronbach alpha Coefficient Value of above 0.7 was deemed to be acceptable as a test of reliability (Garson, 2012). Outcome showed that the variable tested achieved adequate and recommended computed coefficient alpha value of above 0.7, which proved that the instrument was reliable.

Demographic Analysis

Male respondents were majority at (22) 62.9 %, while female were (13) 37.1 %. These results show a balanced gender representation in the banking sector. It is equitably balanced with a slight favour in the men representation. Findings indicated a positive development in gender involvement whereby according to the constitution of Kenya (2010), all public organizations are required to adhere to one-third gender rule.

On working experience, (11) 31.5 % had an experience of between 21 – 25 years which was the highest, (6) 17.1% had worked for between 16 – 20 years, and (5)14.3% had worked for between 11 – 15 years, which was equal to those who had worked for between 6 –10 years. Cumulatively (33) 94.3% of the workers had banking experience of more than 5 years, giving the researcher confidence in competency of respondents. workers who had worked for a lengthy period of time in an institution are believed to have internalized procedures and have more knowledge on a research problem under consideration.

Descriptive statistics of credit management and loan portfolio outcomes of Kenyan commercial banks.

Credit management is among the sensitive areas of concentration in financial firms that deal with credit and need to be given a lot of attention. An institution with proper credit management policy will have improve efficiency. The degree of agreement on statement relating to credit management on loan portfolio performance of comercial banks in Kenya are given in Table 1 below.

Table 1

Credit Management and Loans Portifolio Performance of Commercial Banks

Statement	N	Agree		Undecided		Disagree	
		F	%	F	%	F	%
Loans Policies of Commercial Banks are reviewed to reduce default risks.	35	27	77.1%	7	20 %	1	2.9 %
All clients are appraised as per the loan policies and requirements.	35	31	88.5 %	3	8.6 %	1	2.9 %
Loan delinquency is well managed through credit management system.	35	32	91.4 %	2	5.7 %	1	2.9 %
There are credit committees in place for loans processes and approval.	35	32	91.4 %	2	5.7 %	1	2.9%
There are variety of loan products to satisfy different qualities of borrowers.	35	33	94.3 %	2	5.7 %	0	0%

Researcher set to ascertain the influence of Credit Management on loan Portfoli**o** performance of comercial banks in Kenya. (27) 77.1 % of research participants agreed that Loans Policies of commercial banks in kenya were reviewed to reduce default risks. (7) 20% were undecided, while (1) 2.9% disagreed. Further (31) 88.5% of respondents agreed that all clients are appraised as per the loan policies and requirements, (3) 8.6% were undecided, while (1) 2.9% disagreed. On whether Loan delinquency was well managed through credit management system, many respondents (32) 91.4% were affirmative that indeed loan delinquency was well managed through credit management system, while a lesser proportion of (2)5.7 % were neutral, and (1) 2.9% disagreed. The findings are supported with empirical study by Gatuhu (2013) who investigated the influence of credit management on financial perfomance of Microfinance institutions in Kenya. His study established that appraisal of clients, control of credit risk and policy on credit collection had a strong relationship, and therefore influenced financial performance of MFIs.

Participants were asked whether there were credit committees in place for loans processes. (32) 91.4 % of the respondents, which was a significant proportion, agreed that there are credit committees in place for loans processes and approval, while (2) 5.7 % were neutral, and (1) 2.9% disagreed. Research participants indicated that there are varieties of loan products to satisfy different borrowers. Cumulatively, (33) 94.3 % of participants agreed that there are varieties of loan products to satisfy different borrowers, while (2) 5.7 % were neutral. The results are in agreement with a study done by Mutua (2016) who sought to evaluate the influence of credit risk management on financial performance in SACCOs in the county of Kitui. His study indicated a postive and strong association between monitoring of credit and financial performance of SACCOs.

Correlation analysis

The analysis of Pearson correlation was employed to determine the nature and strength of the independent variable and dependent variable which were tested at 95% significance level. Using results from the correspondence, the researcher computed correlation results in Table 2 below.

Table 2

Pearson correlation coefficient between Credit Management and Loans Portifolio Performance of Commercial Banks

Construct		Credit Management	Bank Performance
Credit	Pearson correlation	1	
Management	Sig.(2-tailed)		
Bank	Pearson correlation	.908**	1
Performance	Sig.(2-tailed)	.001	
	N	35	35

** Correlation is significant at 0.05 level (2-tailed)

The findings in table 2 above represent correlation coefficients of the research variables. It is thus clear that a relationship exists between explanatory variable (credit management) and the explained variable (performance of comercial banks), which was positive and significant at 95% confidence level. The correlation analysis shows that credit management had a positive correlation coefficient of 0.623 with a p-value of less than 0.05. According to the analysis, there is proof of existence of a strong correlation between explanatory and explained variables.

Regression analysis

Table 3

Model Summary

Model	R	R Square	Adjusted R Square	Std Error of Estimate	Durbin watson
1	.908 [a]	.824	.813	.1073	1.836

The model explains the proportion of percentage change in the explained variable (performance of commercial banks) as explicated by explanatory variable. Coefficient of determination was used to describe the suitability of the model if it was a good predictor. The results indicate that independent variable (credit management) explained variations in performance of commercial banks by 81.3%, as indicated by Adjusted R^2 of . 813; and this shows the model is a very good predictor. The Durbin Watson value for the model was 1.836 indicating that statistically the two variables were not correlated in any significant way, and this guaranteed the independence of errors and boosted accuracy of the regression model.

Table 4

ANOVA on Credit Management and Loans Portifolio Performance of Commercial Banks

Model	Sum of Squares	Df	Mean Square	F	Sig
Regression	.262	1	.262	43.67	.001
Residual	.183	33	.006		
Total	.445	34			

a. Dependent Variable; Loan Performance Of Commercial Banks

b. Predictor: (constant) credit Management

The outcome of the findings in the table above shows a level of significance of .001. This confirms that the model of regression used is a vital predictor of the relationship of credit management on loan portfolio performance of commercial banks.

Regression diagnostic tests were applied to test fundamental assumptions with regard to multiple linear regression. Normality was established employing skewness (-1.052), and kurtosis (1.040). Linearity was confirmed using the pearson coeficient of correlation (r=0.623), while Multicollinearity was tested through Tolerance (.353) and Variance inflation factor (2.827).

Table 5

Regression weight table *on Credit Management and Loans Portifolio Performance of Commercial Banks*

Model		Unstandardized Coefficients		Standardized Coefficients	T	sig
		B	Std error	Beta		
1	(Constant)	4.636	.461		2.810	.041
	Credit Managemnt	.496	.172	.361	2.715	.029

The results of the multiple regression analysis on direct relationships of explanatory variable (credit management) and explained variable (performance of comercial banks) are summarized in table 3 above.

Regression equation obtained from the output:

$Y = 4.636 + 0.496 X_1$

Credit management and loan portfolio performance of commercial banks in Kenya

The objective of this study was to ascetain the influence of credit management on loans portfolio performance of commercial banks in Kenya. A null hypothesis $H0_1$ was formulated with assumption that no substantial association existed between credit management and loans portfolio performance of commercial banks. Findings from table 4 showed the F value of 43.67 which was significant (p= .001) at 95%.

This indicated that credit management is significant in predicting loan portfolio performance in commercial banks. At P<0.05 level of significance the null hypothesis was rejected. This implies that credit management bears significant relationship on loans portfolio performance in Kenyan commercial banks. In the study, the statistics confirmed the existence of a significant and strong correlation between credit management and loan portfolio performance of commercial banks in Kenya.

4.0 Conclusions

The purpose of the study was to ascertain whether employing credit management practices influences loans Portfolio performance of commercial banks in Kenya. Conclusions drawn from the outcome reveals that there is need to have a competent credit committees, policies on reducing default risks, and a diversified loan products scheme to satisfy different categories of clients. Thus, the study revealed that employing proper credit management practices has a positive and significant influence on loans portfolio performance of commercial banks in Kenya.

5.0 Recommendation

To attain effective and efficient loans portfolio performance of Kenyan commercial banks, the commercial banks must employ good credit management practices. The commercial banks should ensure they adopt sound loan policies, carry out proper client appraisal, exercise delinquency management and have a credit committee for a well-functioning credit management department, and appoint committed and competent members of staff to the credit committee.

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