



Research Paper

Assessing the effect of credit risk control practices on lending performance of commercial banks in Kenya

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Abstract

The study assesses the effect of credit risk control practices on the lending performance of commercial banks in Kenya. Credit risk is among the most significant challenges facing Kenya commercial banks, and it has an impact on their lending performance. We measure commercial banks' lending performance by examining whether there is an increase or decrease in the number of loan applications that are approved and funded. Primary data was collected from 42 commercial banks in Kenya with a focus on branches in Nairobi County and logistic regression was used for estimation of parameters. Results indicated that proper loan usage, assessment and review of loan applications, and adherence to set credit guidelines and policies were statistically significant in predicting lending performance. In addition, the level of education of credit officers and years of lending experience among staff were also found to affect lending performance in commercial banks. It recommended that a framework that binds the borrowers from diverting funded loans to other uses be developed and that the strengthening of loans application assessment and review through the use of modern technology.

Keywords: Credit risk, Control practices, Lending performance, Commercial banks

GEL Classifications: G32, E43, E44

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I. Introduction

Commercial banks' primary function is lending, as indicated by the number of loans that make up their assets and the annual significant increase in loans issued to borrowers in both the private and public sectors of the economy (Kihuro&Iraya, 2018). As a result, most commercial banks' primary activity is lending. Consequently, a bank's loan portfolio is its most valuable asset and source of revenue (Lai, 2015). Loans are considered the most important assets of banks because of their enormous contribution to the financial health of banks through interest revenue gains (Sujeewa, 2015). Guidelines that explicitly specify conditions of credit facilities and the management of the portfolio thereof, including loan origination, appraisal, supervision, and collection, characterize a competent credit risk control management system. Borrower screening is a practice that has been frequently recommended when lending. The recommendation has mainly been implemented in the banking industry in the form of credit risk assessment. As a result, obtaining reliable information from potential borrowers is critical for effective screening (Bodie, 1999).

Commercial banks play the role of intermediation by receiving customer deposits and lending money to borrowers. As a result, they are subject to a variety of risks, which might affect their lending performance directly or indirectly (Olweny&Shipho, 2011; Sufian& Chong, 2008). The provision of credit is the main activity of banks, and it is from this that they earn profit. As a result, credit risk is one of the bank's main challenges, and it has an impact on their lending performance. According to Boahene, Dasah, and Agyei (2012), credit quality is a key measure of a bank's financial soundness and health. Because lending is a bank's primary source of revenue, weak credit risk management plays a significant role in bank failures. The Basel Committee

on Banking Supervision (2000) stated that liberal credit standards for borrowers and counterparties, as well as poor loan portfolio risk management, continue to be major causes of serious difficulties among banks.

Credit risk in lending has a long history that dates back to the 2008-2009 global financial crisis, often known as the great recession. The fundamental cause of the financial crisis was deregulation in the financial industry. The housing market bubble was fueled by an excess of mortgage-backed securities (MBS) that packaged high-risk loans together. Unprecedented levels of defaulted loans came from reckless lending; when the losses were totaled up, several financial institutions failed, demanding a government bailout (Mukhtarov, Yuksel, & Mammadov, 2018). The exposures to credit risk in the banking industry have turned the lending sour, interest rate positions adopted and derivative exposures that may have been assumed to cushion balance sheet risk do not seem to be adequate (Olusanya, Oyebo&Ohadebere, 2012).

Kenya's economy increased at a 5.7 percent annual rate between 2015 and 2019, making it one of the fastest-growing economies in Sub-Saharan Africa. As a result, it is a preferred investment destination in the region. The country's economic performance has been supported by a stable macroeconomic climate, great investor confidence, and a robust services industry. As a result, the government repealed the Central Bank of Kenya's interest rate ceiling with effect from 2019, reducing credit risk and protecting Kenya's commercial banks from crises. Despite the removal of interest rate caps, lending performance has remained unchanged, with the majority of SMEs unable to obtain loans (Credit officers survey, 2021).

Further, to enhance the credit risk control in financial instructions, from January 1, 2018, the International Financial Reporting Standard (IFRS 9) on Financial Instruments came into effect. The International Financial Reporting Standards (IFRS 9) provided a new technique for calculating provisions for projected losses on loans extended by lending institutions. As a result, the expected credit losses must be recognized at all times, and the amount of expected credit losses must be updated at each reporting date to reflect changes in the credit risk of financial instruments. With this implementation, the majority of banks have adopted a strict credit risk assessment, ensuring that credit facilities are adequately secured and that alternative repayment options are available (UNCTAD, 2019).

However, commercial banks are still struggling to implement IFRS 9 standards, particularly with the requirement of introducing an effective interest rate into the model, which is complicated and time-consuming due to the need for automation. In addition, as a result of the strict risk profiling and credit assessment requirements, growth in loan book is very minimal, resulting in a negative impact on the bank's profitability. Further, the lack of sufficient historical data for assessing and re-modeling the IFRS 9 assumptions and parameters, such as Probability of Default (PD) and Loss Given Default (LGD), has exacerbated the problem (CBK, 2018).

The majority of commercial banks in Kenya are rebranding amongst other reasons, to regain their lost credit market share which has been occasioned by credit risk issues (Gathigia, 2016). To stay afloat in the wake of the banking industry's credit risk challenges, rebranding is taking place in terms of structures, product design, and service delivery (Haneef, Riaz, Ramzan, Rana, Ishaq, & Karim, 2012). Nevertheless, the credit risk challenges have been amplified by the COVID-19 health pandemic which has turned out to be an economic challenge in terms of non-performing loans from across all the sectors. As result, there is increased default in the personal loan portfolio which has resulted from job losses, and the COVID-19 pandemic has exacerbated the situation as all sectors of the economy have been hit hard. The non-performing loans are expected to rise, while banks are expected to intensify their credit recovery efforts (Credit Officers Survey, 2021).

We hypothesize that lending performance has not improved due to ineffective credit risk control practices implementation by the commercial banks in Kenya. Therefore, the objective of this paper is to assess the effect of credit risk control practices on the lending performance of commercial banks in Kenya. Particularly, we measure the lending performance of commercial banks by the increase or decrease in the number of loan applications that are approved and funded. Further, the paper assesses the credit risk control practices that include whether loan granted by banks is used according to the loan agreement, assessment, and reviews of all the loans applications, loans classification, provision of allowances on how to absorb anticipated loss as required by IFRS 9, update by borrowers on the changes in their financial capability and adherence to the set credit guidelines. The level of education and years of experience are used as control variables. Further, we provide policy recommendations that could enhance lending in the banking industry.

II. Literature review

Theoretical review

This study is based on the dynamic theory of lending standards (2020). According to this theory, tighter lending requirements lead to the rejection of unproductive loan applications. Furthermore, the assumption is that identifying unsuccessful loan applicants, even those previously rejected by other banks, is not easy for banks. These arguments require a dynamic strategic complementarity between banks, resulting in lending criteria that are more persistent than business cycles themselves. In addition, the theory creates negative externalities of

strict lending criteria, meaning that lending requirements need to be tightened especially after negative shocks to reduce credit risk. As a result, markets, where borrowers are likely to shop for loans from several lenders, include markets where borrowers already have ties with several lenders where borrowers need to roll over loans and this raises the likelihood of looking for loans after rejection.

As such, the banks are obligated even with prior relationships with the borrower, to assess and review all the applications and ensure a proper measure of credit risk controls are in place. Furthermore, when applying lending standards, this theory encourages lenders to rely on costly private information. In Kenya, various credit reference bureaus (CRB) provide this information through credit score is primarily based on credit report information through a CRB report. Banks use credit scores to evaluate the potential risk posed by funding a loan to borrowers but more needs to be done to ensure that the borrowers' good score in the CRB report has very few chances of turning to NPL once the loan application is approved and funded.

Empirical literature

For the period 2002 to 2011, Kurawa and Garba (2014) examined the effect of credit risk management on the profitability of six Nigerian banks. The findings revealed a positive and substantial association between credit risk and the profitability of banks. Further, Kithinji (2010) established that risk control in commercial banks is meant to control approved decisions that are not well examined and result in cases of default in loan repayments and non-performing loans, a considerable extension of credit, and directed lending. To minimize the negative effects, policies have focused on banks' officers assessing and reviewing all loans applications that are brought to the banks before lending is approved. This activity takes care of the commercial banks and by extension tended to highly concentrate on collateral as the main security for loans which at times makes the banks assume other forms of mitigating risk.

According to Mumbi and Omwaga (2017), credit policies have a substantial impact on commercial bank financial performance, and rigorous adherence to credit standards will save the bank from non-performing loans and improve lending performance. As a result, commercial banks must strictly comply with all lending guidelines to reduce credit risk and improve lending. In Nigeria, Uwuigbe, Uwuigbe, and Oyewo (2015) investigated the effects of credit risk management on bank performance. For the period 2007-2011, a sample of ten banks was used. To estimate the coefficients of the variables, the study used a panel linear regression model. Nonperforming loans and bad debt ratios have a significant and adverse effect on bank performance, according to the findings.

Using data for five years from 2009 to 2013, Kodithuwakku (2015) examined the relationship between credit risk and performance of eight commercial banks in Sri Lanka. The return on asset (ROA) was employed as a performance proxy, and credit risk indicators in provision to total loan, loan provision to non-performing loans were used. Non-performing loans and provisions have a negative impact on the financial performance of the institutions, according to regression results. Moreover, Nelson and Schwedt (2006) postulate that credit control management has gained prominence within the banking industry with banks now classifying, all loans issued to enhance control. Moreover, banks are moving away from the old book-and-hold lending practice and adopting a more active strategy, buoyed by the development of new technologies that leverage the best mix of assets in light of the prevailing credit environment, market conditions, and business opportunities. Much more so today than in the past, banks can manage and control obligor and portfolio concentrations, maturities, and loan sizes, and address or even eliminate problem assets before they create losses many of which also stress test their portfolios on business line bases to inform their overall management.

On the other hand, Derban (2010) conducted a study and found that credit controls in commercial banks have been improved by having policies that allow the commercial banks to absorb any anticipated loss from the clients who default in payments. This is in line with IFRS 9 which came into effect in 2018 to strengthen market discipline. The importance of IFRS 9, does so by making it possible to, among others, numerically establish critical elements of explaining the risk of default, assess the significance of the elements, improve the pricing of default risk, allow identification of risky loan applicants, and possess capabilities to calculate reserves needed to meet expected future loan losses. Aykut (2016) examined how credit and market risk affected the performance of public listed Turkish banks. The results revealed that credit risk is inverse and foreign exchange has a direct effect on banking sector profitability when using a generalized autoregressive conditional heteroscedastic technique for weekly data obtained between 18th January 2002 and 30th October 2015.

A study by Kani (2017) examined the influence of credit risk on banking performance in West African Economic and Monetary Union member states (WAEMU). Over the course of nine years, 20 banks were studied (2007- 2015). The study revealed a negative and significant effect of credit risk on bank performance as assessed by ROA using individual-specific effects models. Similarly, the study of Heffernan (2009) indicated that when managing credit risk, clear established credit control, new credit approval, and credit extension processes are very important for setting credit lines appropriate to borrowers in commercial banks. In addition, the purpose of the loan, which specifies how the funds will be utilized, is one of the factors examined in credit

scoring before a loan is accepted and disbursed, according to the findings Maluni (2009). Importantly, current, and potential exposures change both with the passage of time and dynamism of variables making Further, controlling of borrowers crucial while the processes involved including approvals by credit authorities on new credits, renewals, and alteration of terms such as credit restructuring must be fully documented and recorded.

Alshatti (2015) used data from 2005 to 2013 to investigate the impact of credit risk management on the financial performance of 13 Jordanian commercial banks. The findings revealed that credit risk management has a strong positive influence on bank performance. In their study on credit scoring, Aveny, Brevoort, Kenneth, and Canner (2009) found that borrowers do not submit financial reports for evaluation of their business. This was in contrast with the fact that the banks granted credit without conditions requiring the borrower to submit regular reports on how the financed business is performing. Aveny, et.al (2009) while noting that banks would, absent of current financial reports that show exposure details, continue to depend on assessments of actual risk opined that it is insufficient to have a general overview of the correlations between the various types of loans instead proposing the use of exact statistical measures of the links to all other types of loans in the credit portfolio.

Okere, Isiaka, and Ogunlowore (2018) investigated the impact of risk management on the financial performance of ten Nigerian banks. The findings revealed that there is a significant and positive relationship between risk management and bank financial performance. In addition, Messai, and Jouini (2013) asserted that non-performing loans affect how banks set interest rates and this constitutes a problem for those who pay their loans as they have to pay for those who default. Their study revealed that that interest rates charged by banks in unstable economic environments are rapidly outdone by inflation that makes it uphill for borrowers to repay their loans owing to income decreases, increase in insider loans, and over-concentration in certain portfolios resulting in credit risk.

According to Richard, Chijoriga, and Kaijage (2010), the credit risk management staff's quality in terms of experience and education is a critical success factor in credit management. This is because employees guarantee that the necessary depth of knowledge and judgment is always available. As a result, personal judgment and intuition play a significant part in credit risk management. Furthermore, Muhamad & Basah (2016) found that education background influenced credit risk management awareness, implying that knowledge of the staff is an important component of credit risk management. Furthermore, the quality of the loan authorization process is determined by the staff who handle the loan application and is a crucial determinant of the credit management system's effectiveness.

Theoretical framework

This study is underpinned on the dynamic theory of lending standards. From this theory, banks are required to undertake rigorous assessment and review of all loan applications and even detect the one that has been rejected by other financial institutions. Several activities and gathering of information, having models to estimate how the good credit probability of default, and expected loss from funded loan needs to be in place. Based on this theoretical framework, we come up with an analytical model as in (3.1) in which the lending performance of commercial banks is a function of credit risk control practices and control variables.

$$\left(\begin{array}{c} \text{Lending performance} \\ \text{of commercial} \\ \text{banks} \end{array} \right) = f \left(\begin{array}{c} \text{Credit Risk} \\ \text{Control Practices,} \\ \text{variables} \end{array} \right) \quad (3.1)$$

III. Methodology

Data sources and measurement of variables

Primary data was collected in 2019 from Kenya's 42 commercial banks, with a focus on Nairobi County branches. A structured questionnaire was distributed to the bank's staff, including the credit manager and credit officers, and 79 percent of them responded. This response rate was sufficient, and the respondents' category was significant because they play critical roles in the bank's lending. To measure the credit risk control practices, a five-point Likert scale questionnaire was used, coded as 1, Strong disagree, 2 Disagree, 3 Neutral, 4 Agree, and 5 Strong agree. Respondents were expected to indicate their responses in terms of agreement with the credit risk control practices statements provided.

The dependent variable, which was lending performance, was measured by establishing whether loan applications that are approved and funded have increased or not. This was coded as 1 if the loan applications approved and funded by the bank have increased, and 0, if the loan application approved and funded by the bank has not increased. On control variables, the level of education was coded as 1, secondary education, 2 diploma level, 3 bachelor's degrees, and 4, a master's degree and above. The years of experience in banking which is important in enhancing practical skills was coded as 1, below 5 years, 2, between 5 and 10 years, 3, between 11 and 15 years, 4, between 16-20 and 5, above 21 years of experience.

Empirical Equation

We estimate equation 3.2 using logistic regression. Positive values indicate that a bank’s lending performance is more likely to improve, while negative values indicate that a bank’s lending performance is less likely to improve.

$$Ln(\text{odds ratio of Lending performance}) = \beta_0 + \beta_i \text{Credit risk control practices} + \beta_j \text{Control variables} + \varepsilon \tag{3.2}$$

Where β_0 is the constant, β_i is the vector of variables on the credit risk control practices, and β_j is a vector of control variables, and μ is a stochastic error term measuring the effect of other variables that influence lending performance in the commercial bank. The specific variables comprising of the credit risk control practices include *loan is used as per loan agreement, assessment and review of loan applications, loans classifications, absorption of anticipated losses from loans, updates on change on borrower financial capability, and adherence to set credit guidelines*. The control variables include the *level of education of credit officers and years of experience of employees* that deal with lending.

IV. Results

Summary of descriptive statistics

We conducted summary descriptive statistics as shown in table 1. The statistics show that approving borrower's loans application and funding is very important as that is the only way to transfer financial resources to the sectors that need funds for development and investment. The summary statistics show that majority agreed at an average of 0.14 which signifies that loan applications approved and funded by commercial banks had not improved. Though it’s within the borrower's responsibility and willingness to ensure that the loan issued is used as per the loan agreement, summary statistics show that majority disagreed at an average of 2.37 that they follow the borrower to ensure that the loan approved and funded is used as per the loan agreement. Further, it is required that banks should conduct an assessment and review of all loan applications before approving and funding the loan. It was found from the majority at an average of 4.27 that banks conduct an assessment and review of all loan applications before the decision to approve and fund the application is considered. In addition, loans are supposed to be classified not only for categorization but also, it’s a requirement to classify them by the risk associated with each category of loans. It was found that the majority agreed at an average of 4.02 that banks categorize loans according to the risk associated with them. Further, on the absorption of anticipated losses from loans by commercial banks as required by IFRS 9, it was found that not all banks have implemented this provision at an average of 3.80. This requirement requires automation and modeling, and some commercial banks may require a consultant to guide the processes. Adherence to credit policies and other set credit guidelines is very important in controlling credit risks. In addition, the statistics show that the majority of banks do not get updates on the change in borrower financial capability at an average of 1.88. The summary statistics show that the majority of banks at an average of 4.33 adhere to the set credit guidelines when issuing loans. Further, the level of education was found at an average of 3.27 which connotes that the majority are bachelor’s degree holders while on work experience, the majority agreed at an average of 2.15 that they have experience of between 5-10 years.

Table 1: Summary descriptive Statistics

Variable	Mean	Std. Dev.	Min	Max
<i>Dependent Variable</i>				
Approved loan applications	.143	.351	0	1
<i>Credit risk control practices</i>				
Loan used as per loan agreement	2.368	1.068	1	5
Assessment and review of loan applications	4.268	.786	2	5
Loans classifications	4.018	.923	2	5
Absorption of Anticipated losses	3.798	.921	2	5
Change in borrower financial capability	1.868	.857	1	5
Adherence to set credit guidelines	4.331	.551	3	5
<i>Control Variables</i>				
Level of education	3.272	.576	2	4
Years of experience	2.151	.705	1	4

Source: Authors computation

Diagnostic tests

We tested for normality of continuous variables, multicollinearity, and heteroscedasticity tests as shown in table 2 and table 3 to ensure that the variables considered in the empirical estimations met the neoclassical regression requirements. Using a 5% level of significance, the Shapiro-Wilk normality test was employed to see if the continuous variables had a normal distribution. Continuous variables had a p-value ($p=0.00$) indicating that they were normally distributed. To evaluate if multicollinearity is a serious issue affecting the analysis, the Variance Inflation Factor (VIF) was used. The obtained mean VIF was 1.75 and it was concluded that multicollinearity is not a problem. When the variance of the error terms is not constant across observations, heteroscedasticity arises. Although the coefficients produced in the presence of heteroscedasticity are unbiased, hypothesis testing inference is inefficient. We tested whether the residuals from the logistic estimator were normally distributed at a 5% level of significance to control for heteroscedasticity. The χ^2 -value obtained was $p=0.00$, indicating that heteroscedasticity was not a significant issue in the analysis

Table2: Test of Multicollinearity

	VIF	1/VIF
Absorption of Anticipated losses	3.081	.325
Assessment and review of loan applications	2.618	.382
Adherence to set credit guidelines	1.669	.599
Change in borrower financial capability	1.549	.646
Loan used as per loan agreement	1.418	.705
Years of experience	1.284	.779
Loans classifications	1.228	.814
Level of education	1.117	.895
Mean VIF	1.745	.

Source: Authors computation

Table 3: Shapiro-Wilk W test for normal data

Variable	W	V	z	Prob>z
Approved loan applications	0.962	7.476	4.700	0.000
Loan used as per loan agreement	0.921	15.345	6.380	0.000
Assessment and review of loan applications	0.942	11.291	5.663	0.000
Loans classifications	0.975	4.911	3.718	0.000
Absorption of Anticipated losses	0.969	6.144	4.241	0.000
Change in borrower financial capability	0.925	14.583	6.261	0.000
Adherence to set credit guidelines	0.987	2.551	2.188	0.014
Level of education	0.992	1.493	0.937	0.174
Years of experience	0.991	1.794	1.365	0.086

Source: Authors computation

Breusch-Pagan / Cook-Weisberg test for heteroskedasticity

Ho: Constant variance chi2(1) = 94.80
 Variables: fitted values of approved loan applications Prob > chi2 = 0.00

Source: Authors computation

V. Discussions

The study utilized a logistic regression model to estimate the effect of credit risk control practices on the lending performance of banks in Kenya. The logistic model was a good fit as shown by the p-value ($p=.000$, $\chi^2=79.681$). The results in table 4 show that the use of loans as per loan agreement, assessment and review of loan applications, adherence to set credit guidelines, level of education, and years of experience were statistically significant. However, variables such as loans classifications, absorption of anticipated losses, update in the change in borrower financial capability, were not statistically significant.

The borrower's proper usage of the loan as per the loan agreement was shown to be statistically significant at a 1 percent level of significance. This is because the underlying purpose for borrowing, which was evaluated and made into a funded loan, was determined to be a worthwhile cause that will allow the borrower to use the loan while maintaining the ability to pay. We found that banks that encourage borrowers to use their

loans appropriately on the project they are funding are .21 times more likely to enhance their lending performance than banks that do not encourage borrowers to use their loans for the reasons they are borrowing. The findings support Maluni's (2009) conclusions that the purpose of the loan, which indicates how the funds will be utilized, is one of the factors examined in credit scoring before a loan is accepted and disbursed.

At a 5 percent level of significance, the assessment and review of loan applications were statistically significant. We found that banks that do adequate loan application assessment and review are .30 times more likely to enhance their lending performance than banks that do not conduct adequate loan application assessment and review. This study supports Kithinji's (2010) assertion that risk control in commercial banks is centered on credit officers assessing and reviewing all loan applications before lending is approved.

Banks' adherence to established credit guidelines while issuing loans was also found to be statistically significant at a 5 percent level of significance. We found that banks that adhere to set credit guidelines when granting loans are 3.10 times more likely to enhance their lending performance than banks that do not adhere to set credit guidelines. This is supported by the fact that there are credit-issuing policies and guidelines which must be followed at all times. This study concurs with Mumbi & Omwaga (2017), who found that credit policies had a significant impact on commercial bank financial performance and indicated that rigorous adherence to credit policies would save the commercial banks from non-performing loans and enhance lending performance. As such, strict adherence to adhere to all the lending requirements is key for commercial banks in mitigating credit risk and enhancing lending.

The level of education of credit officers was found to be statistically significant at a 1 percent level of significance. We found that banks that consider education level when employing credit officers are .31 times more likely to increase their lending performance than banks that do not consider education level when hiring credit officers. This study corresponds with Muhamad & Basah (2016), who found that education background influenced credit risk management awareness, demonstrating that education level affects credit risk management understanding. As a result, the personnel processing loan applications is a critical determinant of the credit management system's effectiveness, as personal judgment and intuition play a significant part in loan assessment and implementation of credit risk control procedures.

Years of lending experience among bank personnel were shown to be statistically significant at a 1 percent level of significance. We found that banks with experienced credit officers are .07 times more likely to enhance their lending performance than banks without experienced credit officers. This research supports the findings of Richard, Chijoriga, and Kaijage (2010), who found that staff quality, in terms of experience and education, is a critical success element in credit risk management.

Table 4: Logistic regression

Approved loan applications	Odds Ratio	St.Err.	t-value	p-value	[95% Conf. Interval]	Sig
Loan used as per loan agreement	.214	.1	-3.31	.001	.086	.533 ***
Assessment and review of loan applications	.302	.151	-2.40	.017	.114	.804 **
Loans classifications	.819	.203	-0.81	.419	.504	1.329
Absorption of Anticipated losses	2.218	1.083	1.63	.103	.852	5.776
Change in borrower financial capability	1.319	.363	1.01	.315	.769	2.261
Adherence to set credit guidelines	3.082	1.629	2.13	.033	1.093	8.684 **
Level of education	.314	.12	-3.04	.002	.148	.662 ***
Years of experience	.07	.041	-4.59	.000	.023	.219 ***
Constant	1457.828	5355.741	1.98	.047	1.088	1953592.8 **
Mean dependent var	0.143	SD dependent var				0.351
Pseudo r-squared	0.356	Number of obs				272
Chi-square	79.681	Prob > chi2				0.000
Akaike crit. (AIC)	161.934	Bayesian crit. (BIC)				194.386

*** $p < .01$, ** $p < .05$, * $p < .1$

Source: Authors computation

VI. Conclusions and recommendations

The objective of this study was to examine how credit risk control practices affect Kenyan commercial banks' lending performance. The study found that credit risk control practices had a statistically significant effect on lending performance. Other significant findings include how borrowers use the loan, and particularly in accordance with the loan purpose that was funded in the loan agreement, which has been found to statistically affect lending. We conclude that encouraging borrowers not to use the loan for other purposes is critical. When a bank loan is used for the same reason as stated in the loan agreement, the borrower's capacity to pay is less likely to be harmed than when the loan is diverted to other uses. It is evident that assessment and review of loan applications, as well as adherence to established credit guidelines when issuing loans, should not be compromised at any cost because they statistically affect lending performance. Finally, education and

work experience levels are important factors that have been statistically proven to influence lending performance. This is especially important for employees in the credit department because it reflects their ability to practically implement all credit risk control practices and, as a result, improve the bank's lending performance.

VII. Policy recommendations

Credit risk management in banks is an important activity, given that the SMEs and private sector continue to struggle to obtain credit, despite the fact that these sectors are critical in terms of job creation, poverty reduction, and GDP contribution. Businesses' access to financial resources has greatly helped in the reduction of the country's social and economic inequalities. As a result, banks' effective credit risk management would support economic growth and development. As a result, the following policy recommendations are made;

1. Commercial banks need to develop a policy that provides a framework that binds the borrowers from diverting funded loans to other uses and this should be communicated to the borrowers. Further, this should be institutionalized and anchored as a bank's culture to encourage borrowers to use their loans for the funded purpose only.
2. Commercial banks need to strengthen their assessment and review of loan applications through use of modern technology to ensure chances of errors in risk management and controls are minimized.
3. There is a need for continuous training and development of credit officers on credit guidelines and policies with an emphasis on adherence to credit guidelines.
4. Commercial banks should review their credit officer qualifications to ensure that risk management skills are prioritized. There is a need to provide targeted continuous professional training in credit risk management to develop the capacity of staff who deals with lending.
5. Credit officers' years of experience requirements, particularly in lending, should be assessed and enhanced by commercial banks to ensure that credit officers have adequate experience in lending.

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