INFLUENCE OF CREDIT RISK MANAGEMENT ON LOAN PERFORMANCE IN COMMERCIAL BANKS IN NAKURU TOWN, KENYA

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Abstract

Financial Institutions are in the business of mobilizing and lending financial resources to borrowers and allocation of savings to real investment. In the process of providing financial services, they assume various kinds of financial risks. This study, therefore, examined the effect of credit risk management practices on loan performance in commercial banks in Nakuru Town. The study specifically analyzed the effect of lending policy and credit standards on loan performance. A descriptive and correlation research design was adopted. The target population constituted 37 respondents drawn from the 37 commercial banks' branches in Nakuru town. A census design was employed. A structured questionnaire was used to collect data from the respondents. A pilot study was conducted prior to undertaking the main study with the aim of testing the instrument's reliability and validity. The collected data was analyzed both

descriptively and inferentially. The study established that there exists a moderately strong and positive relationship between lending policy and loan performance; and that the relationship between credit standards and loan performance was found to be positive, strong and statistically significant. It is recommended that every commercial bank should have an effective lending policy. Moreover, credit standards for commercial banks should be customized to the credit worthiness of prospective borrowers.

Keywords: Commercial banks, credit risk management, credit standards, lending policy, loan performance

INTRODUCTION

In recent years, a growing number of developing countries including Kenya have embarked on reforming and deregulating their financial systems, transforming their institutions into effective intermediaries and extending viable financial services on a sustainable basis to all segments of the population (Seibel, 2006). By gradually increasing the outreach of their financial institutions, some developing countries have substantially alleviated poverty by initiating a framework and infrastructure to encourage lending through public and private credit reference bureaus, institutional strategies to spur economic development such as the vision 2030 in Kenya and financial systems approaches which include alternatives to collaterals in order to access credit.

In the process, a new world of finance has emerged which is demand-led and savings driven and conforms to sound criteria of effective financial intermediation. According to Pronchnow (2001) credit allocation is the process of granting credit or loan to a borrower for a given economic undertaking. This is achieved after evaluation of the borrower's credit worthiness based on the bank's lending policy, credit standards, credit terms, the credit collection terms and credit reference reporting .The process of credit allocation is a two-step process. The first is to evaluate the credit allocation, which involves identifying the leading variables influencing credit allocation. The second is to devise methods to quantify the credit using mathematical models, in order to understand the profile of the instrument. Commercial banks while in the process of providing financial services, assume various kinds of financial risks. Hence, it is necessary that banks have in place a comprehensive management tool. At some institutions, a dual system is in place where both the borrower and the credit facility are rated. In the latter, attention centers on collateral and covenants, while in the former, the general credit worthiness of the borrower is measured. Some banks prefer such a dual system, while others argue that it obscures the issue of recovery to separate the facility from the borrower in such a manner.

According to Boland (2012) understanding of the business nuances of these countries and establishing credit risk management strategies in these markets to assure effective portfolio management. Failing to do so could result in control problems, credit losses and large exposures that eventually impair or doom overseas aspirations. The basics of sound credit decisions have not changed over the years.

According to Nyagah (2011) the different maturity levels of the various credit markets in Africa do not lend themselves to a one-size-fits-all risk management strategy. Some are relatively developed - as in South Africa. But most can be considered emerging markets. Each presents unique challenges, but there are common characteristics. For instance, a credit risk professional managing South African holdings will have access to more comprehensive historic default data than one overseeing investments in less-developed Sub-Saharan nations. The challenges in the former, is that, more developed market lie in recovery data (i.e. the losses and recoveries post-default) rather than in hard default data. Of course, there will be more available data than in the other African markets but there may still be insufficient data for risk managers of South African portfolios to develop statistical models. Yet risk managers of sub-Saharan African investment portfolios have more basic difficulties. These markets often lack historical data on default statistics as well as default recovery.

Risk management here would focus on risk advisory and development support, with a view to enhancing default data and building more robust probability of default measures. So lack of data is a problem common to both regions. However, the challenges posed by limited recovery data can be overcome in the use of sophisticated and tailored recovery modeling. To ensure best practice, fund managers must first conduct a full and frank assessment of the nature of their portfolio. Asset-class, size, diversity, exposure to emerging markets, future extension into data-poor environments - these are all aspects to consider. Next, define the methodology and data necessary to improve risk management capabilities. We recommend holistic frameworks that consider all asset classes in combination. This leads to an understanding of how asset classes interrelate, and how they can influence and be influenced by each other. Certainly, signals in the equity market can lead to significant arbitrage opportunities in the corporate bond market and vice versa. Indeed, the relationship between probability of default and market or liquidity risk, and the spread on corporate debt versus a company's share price can provide actionable insights for both investors and risk managers (Seibel, 2006).

According to Nzuve (2013), Credit risk management models include the systems, procedures and control which a company has in place to ensure the efficient collection of customer payments and the risk of non-payment. The high level of non-performing loans is a

challenge to many commercial banks in Kenya, which is evidence that commercial banks are faced by a big risk of their credit. Lending in commercial banks is the main source of profit making hence the need for efficient credit risk management practices within the industry. With the objective of determining the credit risk management in the Kenya Commercial banks the study will establish the best strategies to adopt and how they are applied in assessing and evaluating credit risk to minimize non- performing loans. Although the credit management is technical and consumes a lot of time the employees are trained regularly and manual used to create awareness. Different measures or models are employed in credit risk management like the quantitative method to check the client's ability to repay the loan as well as credit worthiness, terms of payment and interest to be charged, consequences in case of default, customer's character, deposit and collateral. The researchers recommends that credit risk management should be implemented in the Kenyan commercial banks as its useful in helping reduce the risk that is involved while lending to the customers. These policies associated with the credit risks have been very helpful in recovering what might not be recovered through the collateral securities or high rates hence minimizing the possibilities of a bank to fail.

Statement of the Problem

It is averred that all over the world, financial institutions face enormous credit risks (Krestlow, 2013). Financial institutions particularly banks are very important in not only banking the low income earners in the society but also advancing credit facilities to them (clients). However, just like other financial institutions, they experience many cases of default risks, moral hazard and adverse selection. CBK has set out a new directive on the treatment of credit risk management which thus has increased pressure on banks. The credit risk negates the profitability of financial institutions as they entirely depend on loan lending to increase its portfolios (Haneef et al., 2010). This is due to the fact that, when borrowers default in servicing their loans or in meeting their loan servicing obligations of the loans awarded to them, the lending institution will not get returns through interest charged on those loans. This is shown from the records of banks that borrowers do not effectively service their loans as and when it falls due in good time while others default completely.

Credit risks are not only argued to affect financial performance of loans but they also have far reaching implications. This is due to the fact that, other potential borrowers may fail to access credit facilities since part of the funds could have been extended as loans by commercial banks are still tied up due to default of clients from repaying. Ineffective credit risk management too affects the entire economy of a country which explains why the CBK sets guidelines to enable financial institutions to mitigate risk of default by having credit reference bureaus. The

purpose of credit risk management is to mitigate the risk of default which can result to reduction in lending institutions loan portfolio and its failure of granting loans to borrowers is an important activity in management of financial institutions (Motiet al., 2012). Despite many researches it is quite clear from the foregoing that very little research studies has been done on factors affecting credit risk as many of the researches concentrates largely on nonfinancial loans and credit allocation yet it is through improved credit risk management that banks loans portfolio will enlarge an banks would meet their ultimate goal of stimulating growth and performance in the economy. The importance of credit risk management to loan performance necessitates this study which aims to establish the effect of credit risk management on loan performance of commercial banks in Nakuru, Kenya.

Objectives of the Study

General Objective

To establish the influence of credit risk management on loan performance in commercial banks in Nakuru town, Kenya

Specific Objectives

i. To establish the effect of lending policy on loan performance of commercial banks in Nakuru town, Kenya

ii. To determine the effect of credit standards on loan performance of the banking institutions in Nakuru town, Kenya

Research Hypothesis

H_{01}: There is no significant effect of lending policy on loan performance of commercial banks in Nakuru town.

H_{02}: There exists no significant effect of credit standards on loan performance of the commercial banks in Nakuru town.

THEORETICAL REVIEW

Modern Portfolio Theory

Modern portfolio theory, theory that explains how risk-averse investors can construct portfolios to optimize or maximize expected return based on a given level of market risk, emphasizing that risk is an inherent part of higher reward. This theory was developed by Harry Markowitz stating that, it is possible to construct an efficient frontier of optimal portfolios offering the maximum possible expected return for any given level of risk. The theory also asserts that, the concept of

credit risk management is built on the principle of management of working capital. A sound policy on the management of working capital is essential in business and therefore the company must have adequate working capital at all times, funds tied up in working capital should be collected as quickly as possible so as to enhance the company's profitability (Nzuve, 2013). The theory was pioneered by Markowitz in his paper portfolio selection published in 1952 by the journal of Finance which explains the four basic steps involved in portfolio construction as; security valuation, asset allocation, portfolio optimization and performance management. The essence of coming up with the theory is to validate construction of an efficient portfolio that optimizes returns of a particular investment.

It suggests that it is not enough to look at expected risk and return of a particular stock, but by investing in more than one stock, an investor can reap the benefits of diversification, particularly a reduction in the riskiness of a portfolio. MPT quantifies the benefits of diversification also known as not putting all your eggs in one basket. It considers that, for most investors, the risk they take when they buy a stock is that the return will be lower than expected. In other words, it is the deviation from the average return. Each stock has its own standard deviation from mean which MPT calls it risk. Markowitz theory asserts that, the risk in a portfolio of diverse individual stock will be less than the risk inherent in holding any one of the individual stocks provided the risk of the various stocks are not directly related. He showed that investment is not just about picking stocks, but about choosing the right combination of stocks which to distribute ones' nest egg (Seibel, 2006).

An increasing body of analytical work has attempted to explain the functioning of credit markets using new theoretical developments. Challenging the model of competitive equilibrium, they have explored the implications of incomplete markets and imperfect information for the functioning of credit markets in developing countries. These provide a new theoretical foundation for policy intervention. . In this explanation, interest rates charged by a credit institution are seen as having a dual role of sorting potential borrowers and affecting the actions of borrowers. Interest rates thus affect the nature of the transaction and do not necessarily clear the market. Both effects are seen as a result of the imperfect information inherent in credit markets (Horne, 2006).

Adverse selection occurs because lenders would like to identify the borrowers most likely to repay their loans since the banks' expected returns depend on the probability of repayment. In an attempt to identify borrowers with high probability of repayment, banks are likely to use the interest rates that an individual is willing to pay as a screening device. Since the bank is not able to control all actions of borrowers due to imperfect and costly information, it will formulate the terms of the loan contract to induce borrowers to take actions in the interest of the

bank and to attract low risk borrowers. The result is an equilibrium rate of interests at which the demand for credit exceeds the supply. Other terms of the contract, like the amount of the loan and the amount of collateral, will also affect the behavior of borrowers and their distribution, as well as the return to banks (Moti et al., 2012).

Raising interest rates or collateral in the face of excess demand is not always profitable, and banks will deny loans to certain borrowers. Since credit markets are characterized by imperfect information, and high costs of contract enforcement, an efficiency measure as exists in a perfectly competitive market will not be an accurate measure against which to define market failure. These problems lead to credit rationing in credit markets, adverse selection and moral hazard. Adverse selection arises because in the absence of perfect information about the borrower, an increase in interest rates encourages borrowers with the most risky projects, and hence least likely to repay, to borrow, while those with the least risky projects cease to borrow (Ewert et al., 2000).

Interest rates will thus play the allocation role of equating demand and supply for loan funds, and will also affect the average quality of lenders' loan portfolios. Lenders will fix the interest rates at a lower level and ration access to credit. Imperfect information is therefore important in explaining the projects have identical mean returns but different degrees of risk, and lenders are unable to discern the borrowers' actions. An increase in interest rates negatively affects the borrowers by reducing their incentive to take actions conducive to loan repayment. This will lead to the possibility of credit rationing (Boland, 2012).

Asymmetry theory

In a debt market, information asymmetry arise when a borrower who takes a loan usually has better information about the potential risks and returns associated with investment projects for which the funds are earmarked. The lender on the other hand does not posses adequate information pertaining the borrower (Edward and Turnbull, 2004), for Perceived information asymmetry brings about two problems for financial institutions, moral hazard and adverse selection. MFIs finds it difficult to overcome these problems as it is not economical to devote resources to appraisal and monitoring where lending is for small amounts as in the case of MFIs loans. This is because data is needed to screen applicants and monitor borrowers are not freely available as and when it is required by banking institutions before giving out loans to its clients. Hence MFIs face a situation of information asymmetry while assessing lending applications (Binks & Ennew, 2004).

Derban, Binner and Mullineux (2005) recommended that borrowers should be screened especially by banking institutions in form of credit assessment. Collection of reliable information

from prospective borrowers becomes critical in accomplishing effective screening as indicated by asymmetric information theory. Qualitative and quantitative techniques can be used in assessing the borrowers although one major challenge of using qualitative models is their subjective nature. However according to Derban et al (2005), borrowers attributes are assessed through qualitative models can be assigned numbers with the sum of the values as compared to a threshold. This technique minimizes processing costs, reduces subjective judgments and possible biases. The rating systems will be important if it indicates changes in expected level of credit loan loss. Brown (2008) concluded that quantitative measures make it possible to numerically establish which factors are important in explaining default risk, evaluating the relative degree of importance of the factors, improving the pricing of default risk, screening out bad loan applicants and calculating any reserve needed to meet expected future loan losses.

EMPIRICAL REVIEW

Lending Policy

Bank Lending policy is a statement of its philosophy, standards, and guidelines that its employees must observe in granting or refusing a loan request. These policies determine which retail or corporate clients the commercial banks approved for loans and which will be avoided, and must be based on the bank lending laws and regulations. The banking industry plays a major role in economic growth and development through provision of credit to execute economic activities. However, the major concern of any lender while advancing credit is how they will get their money back. Credit risk emanates from the probability that borrowers will default on terms of debt, subsequently leading to high levels of non-performing loans. This concern has resulted into several attempts to manage the in Lending Policies in Commercial Banks.

The Companies Act, the Banking Act, the Central Bank of Kenya Act and the various prudential guidelines issued by the Central Bank of Kenya (CBK), governs the Banking industry in Kenya. The banking sector in Kenya was liberalized in 1995 and exchange controls lifted. The CBK, which falls under the Minister for Finance's docket, is responsible for formulating and implementing monetary policy and fostering the liquidity, solvency and proper functioning of the financial system. The Central Bank of Kenya (CBK) publishes information on Kenya's commercial banks and non-banking financial institutions, interest rates and other publications and guidelines. The Central Bank of Kenya acts as the main regulator of commercial banks in Kenya (CBK Annual Report, 2009). The CBK operates under a monetary policy programming framework that includes monetary aggregates (liquidity and credit) targets that are consistent with a given level of inflation and economic growth, KIPPRA (2006). For instance, the banks objective for the fiscal year 2005/2006 was to achieve inflation rate below 5% using quarterly

reserve targets. To this end, the CBK set a ceiling for reserve money and a floor for the net foreign assets.

This was the mainstay of monetary policy at least until the introduction of the Central Bank Rate (CBR). The use of monetary targeting as currently used by the CBK has also been criticized. Monetary aggregate targeting policy is more effective where there exists a stable demand for money relationship dependent on overall economic activity and price level, but this may not be the case in Kenya which has a financial sector which is at a period of growth, making demand for money unstable according to KIPPRA (2006). Commercial banks play an important role in the pass-through of monetary interest rates. Nevertheless, the efficiency of transmission of decisions of central banks is a complicated process and may depend on many factors, such as level of competition in financial industry, perception of credit risk, risk aversion, availability of close substitutes for loans, etc. Moreover, banks may influence the external finance premium not only via the interest rates but also modifying the available maturity of loans or changing collateral requirements.

Finally, as evidenced by broad literature on bank lending channel, credit rationing and uncertainty about creditworthiness of borrowers may markedly influence banks' risk taking thereby influencing their willingness to lend. The recent evidence suggest that this aspect of bank lending channel, namely risk taking channel, may play an important role in the monetary transmission (Altunbas et al., 2009) Credit risk is perhaps the oldest and most challenging risk for financial institutions, leading to innovations geared at addressing this problem (Broll et al., 2002). This risk emanates from the probability that borrowers will default on terms of debt, subsequently putting the capital of a bank in jeopardy. This concern has resulted into several attempts to manage the exposure of banks to credit risk, with the most outstanding one being the Basel-II accord – later revised to Basel-III. The Basel guidelines aim at entrenching strict culture of managing inherent credit risk by financial institutions globally increasing levels of NPLs.
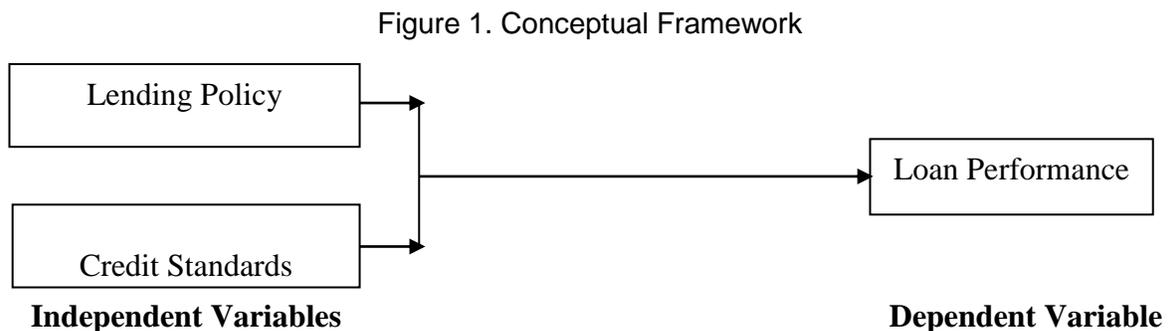
Credit Standards

These are the guidelines issued by the banking institutions that are used to determine if a potential borrower is credit worthy or not. Credit standards are often created after careful analysis of the past borrowers and market conditions and are designed to limit the risk of a borrower not making credit repayments or defaulting on loaned money. The term credit policy is used to include all the company's systems and include lending policy, credit standards, credit terms and collection policy. Normally a customer must meet certain minimum standards in terms of financial stability, before granting of credit. If the bank's credit standards are set too high then

sales and profit will be lost. Conversely, if they are set too low there is an increased risk of loss through bad debts as financially weak customers may be accepted. Credit standards also have a direct effect on the level of investment in debtors overall. Credit term is the period of credit allowed to a customer before payment becomes due which may be short term or long term, depending on the type of loans; secured, unsecured or mortgage.

Credit term may also include any discount terms which may be offered as an incentive for prompt payment to reduce the risk of non-payment or grace period before starting the repayment. Credit collection policies are the systems and procedures which a bank has in place to secure payment from its customers when payment becomes due. These systems are set out to follow up any late payment by employing procedures such as letter, telephone calls or personal visit. They will come into operation only when a customer's account becomes overdue.

Conceptual Framework

The relationship between the elements associated with the linkage between credit risk management practices and loan performance is outlined in Figure 1.

Figure 1. Conceptual Framework

Independent Variables   **Dependent Variable**

The conceptual framework indicates that lending policy and credit standards constitute the independent variables. On the other hand, loan performance is the dependent variable. The study was guided by the assumption that both lending policy and credit standards influence loan performance in commercial banks in Nakuru town, Kenya.

METHODOLOGY

Research Design

Research design is essentially the blue print of conducting the entire study (Ngechu, 2006). The study adopted both correlation design and descriptive survey design as it enables to respond to requisite questions which this study sought to address and will describe the relationship existing

between the variables while the correlation design was used to measure the strength of the relationship between independent and the dependent variable.

Target Population

The target population is the population to which the study findings are generalized Kothari (2008). The study was limited to credit managers of commercial banks in Nakuru town, Kenya. Hence the target population of this study comprised of 160 personnel drawn as respondents from the 37 commercial banks' branches credit department in Nakuru town.

Sampling Design

Nassiuma (2000) formula was adopted in calculating the sample size. This is outlined below. In addition, a stratified random sampling technique was employed to draw the sampled respondents from the target population.

$$n= \frac{N c^2}{C^{2+} (N-1)e^2}$$

Where   n= Sample size

        N= Population size

        C= Coefficient of variation (50%)

        e= Error margin

When these values are substituted in the equation, estimated sample size n was;

$$n = \frac{160 (0.5)^2}{0.5 + (160-1)0.5^2}$$

$$n= 63$$

The sample n=63 credit officers were drawn from the target population by use of stratified random sampling from the thirty commercial banks in Nakuru town. Each bank constituted a stratum. This reduced sampling bias since all commercial banks formed part of the study and credit officers from each bank had an equal chance of being selected to take part in the study.

Data Collection Instrument

A structured questionnaire was used to collect data from the sampled respondents. The questionnaire captured data relative to respondents' background and data with regard to both the independent and dependent variables. The questionnaire further captured data on a Likert for effective analysis.

Pilot Test

A pilot was carried out before the main study. The study involved about 10 per cent (16 of the respondents) of the target population. There were sixteen respondents who participated in the pilot test. These respondents were randomly selected and participants of the pilot study were excluded from the main study in order to avoid compromising the study findings of the main study. The rationale for pilot testing is to establish any potential weaknesses in the research instrument. This is to be achieved by determining both the reliability and validity of the research instrument.

Reliability of the Research Instrument

Reliability being the extent to which results are consistent over time and accurately representative of the total population, it is the consistency of research results if is repeated at different times the same results are obtained Kothari (2008). When reliability is upheld, then the research instrument should collect similar results when administered to different sampled populations exhibiting related characteristics. The study employed Cronbach's alpha to test reliability of the research instrument. The study variable values in the final instrument returned alpha values greater than $0.7 (\alpha > 0.7)$ and were as such deemed reliable.

Validity of the Research Instrument

This is the extent to which a concept, conclusions or measurement is well founded and clearly corresponds precisely to the real world that is the validity of a measurement tool. It is said to be the degree to which the tool measures what it claims to measure (Mugenda & Mugenda, 2009). The study sought to describe the content validity of the research instrument. Given that the content validity cannot statistically be determined, the researcher sought the expert opinion from the university supervisor.

Approach of Data Analysis

The collected data underwent cleaning to ensure only adequately and appropriately questionnaires are to be considered, this is done to get rid of non-responses and extreme outliers. The cleaned data was then coded and analyzed using both the descriptive and inferential statistics with the aid of statistical packages for social sciences (SPSS) version 21 program. Descriptive analysis involved frequencies and percentages for demographic data. As part of descriptive analysis, means and standard deviations were employed across all variables (independent and dependent). On the other hand, inferential analysis in the form of Pearson's

correlation was employed. The study findings were presented in form of tables that reflected both descriptive and inferential statistics.

EMPIRICAL FINDINGS

Descriptive Statistics

Lending Policies

In this section, the study outlined the respondents' views regarding lending policies in light of credit risk management. The pertinent findings are as shown in Table 1 and Table 2.

Table 1: Extent to which Effective Lending Policies are used in Credit Risk Management

	Frequency	Percent
very great extent	13	28.9
great extent	23	51.2
moderate extent	5	11.1
Low extent	3	6.6
Not at all	1	2.2
Total	**45**	**100.0**

Table 1 shows that according to a majority (51.2%) of respondents, effective lending policies are employed in credit risk management to a great extent whereas 2.2% opined that such policies were not at all used. The foregoing findings underscored the importance of commercial banks having effective lending policies as a way of mitigating credit risk management.

Table 2: Descriptive Statistics for Lending Policy

		n	Min	Max	Mean	Std. Dev
i.	Lending policy is a good strategy of credit management	45	4	5	4.90	.301
ii.	Failure to assess customers capacity to repay results in loan defaults	45	3	5	4.39	.715
iii.	There are competent personnel for carrying out lending policy	45	3	5	4.19	.601
iv.	Lending policy considers the proceed are and requirements of those seeking credit facilities	45	2	5	4.10	.944
v.	Aspects of collaterals are considered while coming up with effective lending policy	45	3.0	5.0	3.968	.7951

As outlined in Table 2, it was strongly agreed (mean = 4.90) that lending policy is a good strategy of credit management. respondents further admitted (mean ≈ 4.00) that failure to assess customers capacity to repay results in loan defaults; there are competent personnel for carrying out lending policy; lending policy considers the proceed and requirements of those seeking credit facilities; and that aspects of collaterals are considered while coming up with effective lending policy.

Credit Standards

In this section the study illustrates the findings in respect of credit standards as outlined by commercial banks. Table 3 shows the extent to which credit standards are employed in credit risk management by commercial banks in Nakuru town.

Table 3: Extent to which Credit Standards are used in Credit Risk Management

	Frequency	Percent
very great extent	12	26.7
great extent	23	51.1
moderate extent	7	15.6
Low extent	2	4.4
Not at all	1	2.2
Total	**45**	**100.0**

It is clear from the findings (Table 3) that slightly more than half (51.1%) of the credit managers were of the view that credit standards are used to a great extent in credit risk management by commercial banks. Only 2.2% of the respondents believed the credit standards are not at all used. The findings underlined the need of commercial banks to adopt effective credit standards.

Table 4: Descriptive Statistics for Credit Standards

		N	Min	Max	Mean	Std. Dev
i.	Imposing loan size limit is a good strategy in maintaining credit management	45	3	5	4.42	.720
ii.	Flexible credit standards improves loan repayment	45	2	5	4.32	.945
iii.	The use of credit worthiness is determining credit standards to be used improves monitoring and credit management as well	45	3	5	4.19	.703
iv.	The use of credit worthiness in determining credit standards to be used improves monitoring and credit management as well	45	3	5	4.19	.477

Table 4 indicates that respondents on average concurred (mean ≈ 4.00; std dev < 1.000) that imposing loan size limit is a good strategy in maintaining credit management; flexible credit standards improves loan repayment; the use of credit worthiness is determining credit standards to be used improves monitoring and credit management as well; and also that the use of credit worthiness in determining credit standards to be used improves monitoring and credit management as well.

Loan Performance

Moreover, the views of the credit managers on loan performance of their respective commercial banks were examined. The pertinent results are as shown in Table 5.

Table 5: Descriptive Statistics for Loan Performance

		n	Min	Max	Mean	Std. Dev
i.	It is efficient and productive for your customers to get loans in your banks	45	4	5	4.74	.445
ii.	In case of failure to repay the outstanding loan the bank takes measures to recover	45	3	5	4.42	.620
iii.	Loan products have increased the bank's profitability levels	45	3.0	5.0	4.35	.667
iv.	The degree of liquidity associated with financial loans management in repaying creditors in your bank is high	45	3	5	4.13	.718
v.	Your bank incurs a lot of costs in maintaining portfolio quality of loans given to customers	45	2	5	3.87	.806

The findings indicate that credit managers strongly agreed (mean = 4.74; std dev = 0.445) that it is efficient and productive for bank customers to get loans from commercial banks. It was further established that respondents held the view (mean ≈ 4.00; std dev < 1.000) that in case of failure to repay the outstanding loan the bank takes measures to recover the loan; the degree of liquidity associated with financial loans management in repaying creditors in banks is high; and that banks incur a lot of costs in maintaining portfolio quality of loans given to their customers.

Inferential Statistics

Effect of Lending Policy on Loan Performance

The study sought to examine how the lending policy adopted by various commercial banks in Nakuru town influences loan performance. Table 6 illustrates the pertinent correlation results.

Table 6: Correlation between Lending Policy and Loan Performance

		Loan Performance
Lending Policy	Pearson Correlation	.410[*]
	Sig. (2-tailed)	.022
	n	45

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

The findings indicate that there exists a moderately strong and positive relationship between lending policy and loan performance (r = 0.410; p < 0.05). It is also indicated that the relationship between the two variables is statistically significant at 0.05 significance level. Therefore, the first null hypothesis was rejected. The results imply that though to a moderate extent, the more effective the lending policy is, the better the loan performance and the reverse is true. Interpretatively, commercial banks need to ensure they have effective lending policies in order to improve the performance of the loans they advance to their customers.

Effect of Credit Standards on Loan Performance

In line with the second objective, the study analyzed the effect of credit standards adopted by commercial banks and loan performance. Table 7 illustrates the results of the correlation analysis.

Table 7: Correlation between Credit Standards and Loan Performance

		Loan Performance
Credit Standards	Pearson Correlation	.677[**]
	Sig. (2-tailed)	.000
	n	45

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

According to the findings the relationship between credit standards and loan performance is positive, strong and statistically significant at 0.05 level of significance (r = 0.677; p < 0.05). The second null hypothesis was as such rejected. This implies that alteration of credit standards had conspicuous implications on bank loan performance. Illustratively, enhancing credit standards betters the loan performance and vice versa.

Summary of findings

Effective lending policies were found to be employed in credit risk management to a great extent whereas. It was strongly agreed that lending policy is a good strategy of credit risk management. Respondents further admitted that failure to assess customers capacity to repay results in loan defaults; there are competent personnel for carrying out lending policy; lending policy considers the proceed and requirements of those seeking credit facilities; and that aspects of collaterals are considered while coming up with effective lending policy. It was also established that there exists a moderately strong and positive relationship between lending policy and loan performance (r = 0.410; p < 0.05).

It was established that that slightly more than 50% of the credit managers were of the view that credit standards are used to a great extent in credit risk management by commercial banks. It was further noted that imposing loan size limit is a good strategy in maintaining credit management; flexible credit standards improves loan repayment; the use of credit worthiness is determining credit standards to be used improves monitoring and credit risk management as well; and also that the use of credit worthiness in determining credit standards to be used improves monitoring and credit risk management as well. The relationship between credit standards and loan performance was fund to be positive, strong and statistically significant at 0.05 level of significance (r = 0.677; p < 0.05).

The findings indicated that credit managers strongly agreed that it is efficient and productive for bank customers to get loans from commercial banks. It was further established that respondents held the view that in case of failure to repay the outstanding loan the bank takes measures to recover the loan; the degree of liquidity associated with financial loans management in repaying creditors in banks is high; and that banks incur a lot of costs in maintaining portfolio quality of loans given to their customers.

CONCLUSIONS

It was concluded that effective lending polices played a significant role in credit risk management amongst commercial banks in Nakuru town. In line with the lending policies, it was inferred that indeed commercial banks did have competent personnel for appraising prospective borrowers and also that collateral was material in lending policies. Lastly, it was inferred that lending policies have significant influence on the performance of bank loans. The study concluded that credit standards were adopted by commercial banks in Nakuru town. In the same light, it was deduced that putting a ceiling on the loans advanced to bank customers could enhance credit risk management. The study further concluded that determination of borrowers'

credit worthiness is crucial in credit risk management. Lastly, credit standards were found to strongly affect loan performance of commercial banks.

RECOMMENDATIONS

It is recommended that every commercial bank should have an effective lending policy which should be enshrined in its credit risk management practices. Credit standards for commercial banks should be customized to the credit worthiness of prospective borrowers. It advisable for other financial institutions such as Saving and Credit Cooperatives (SACCOs), microfinance institutions (MFIs), and microfinance banks (MFBs) to have in place sound credit risk management practices. The foregoing is likely to enhance their financial performance by mitigating financial losses that would otherwise emanate from credit risks.

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