THE IMPACT OF CREDIT INFORMATION SHARING ON THE LEVEL OF NON-PERFORMING LOANS OF COMMERCIAL BANKS IN KENYA.

BY

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UNITED STATES INTERNATIONAL UNIVERSITY
AFRICA

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A Research Project Report Submitted to the School of Business in Partial Fulfillment of the Requirement for the Degree of Masters in Business Administration (MBA)

UNITED STATES INTERNATIONAL UNIVERSITY - AFRICA

SUMMER, 2014
STUDENT’S DECLARATION

I, the undersigned, declare that this is my original work and has not been submitted to any other college, institution or university other than the United States International University in Nairobi for academic credit.

Signed: ______________________  Date: ______________________

Winfred Kalunde Kisengese (ID 636849)

This project has been presented for examination with my approval as the appointed supervisor.

Signed: ______________________  Date: ______________________

Francis Gatumo

Signed: ______________________  Date: ______________________

Dean, Chandaria School of Business
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WINFRED KALUNDE KISENGESE

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ABSTRACT
The purpose of this study was to assess the impact of the credit reference bureaus on non-performing loans of commercial banks in Kenya. The research objectively sought to find out the impact of introduction of Credit Reference Bureau (CRB) on non-performing loans in commercial banks. Specifically the study sought to answer the following questions; what is the extent of usage of Credit Information Sharing in Commercial Banks of Kenya? And how does sharing of customer credit information affect the non-performing loans in Commercial Banks of Kenya? This study may be useful to Commercial Banks in Kenya as it may help the banks in formulating effective policies related to full file credit access in Kenya, to the borrowers at it provides knowledge on the use of positive information shared by the commercial banks to engage the lender on the pricing as the credit score becomes a bargaining power. It may be useful for the government as it may aid in policymaking regarding access to credit and other regulatory requirements of the commercial banks as well as benefit researchers and academicians as it will be added to the existing body of knowledge on credit default risk management. The scope of this study focused on commercial banks with branches in Nairobi County.

The research design for this study was descriptive survey while the population of interest consisted of 43 financial institutions operating in Nairobi city of Kenya. Out of the 43 banking institutions only 30 were selected to form the sample through Cluster sampling. Primary data was collected by administering open and close-ended questionnaire to the respondents, which was administered through drop and pick method and was self-administered to reduce interviewer bias. The data collected was cleaned then coded and checked for any errors and omissions. Frequency tables and percentages were used to present the findings. Responses in the questionnaires were tabulated, coded and processed by use of a computer Statistical Package for Social Science (SPSS) version 17.0 programme to analyze the data.

The findings were that, all banks had challenges of non-performing loans. Sharing of customer credit information affected the Non-performing loans as it helped the banks to decline loaning chronic defaulters; Including all credit history from other credit suppliers (positive information) would increase credit approval by commercial banks, while low default rate would result from lending to borrowers based solely on all credit suppliers positive information which would increase credit approval by commercial Banks. Commercial Banks of Kenya were noted to have embraced the usage of CRB as indicated
by 70% of the banks that they received clients’ information from both Trans Union Africa and Metropol, 20% from Trans Union Africa, and 10% from Metropol.

The study concluded that Commercial Banks have embraced and utilised credit information sharing which has an impact in reducing non-performing loans and hence it is in line with the CBK for the launch of the concept of Credit Referencing.

The study recommended that commercial banks should fully adopt and practice the concept of credit information sharing at every stage of credit appraisal so as to enable them weed out potential loan defaulters. Suggested further research was in the; analysis of CRB activities on credit accessibility from the customers’ perspective; how the CRB has influenced the improvement of performing loans among the SACCOs; and Finding out the CRB effects on the performance of Deposit-Taking Microfinance (DTMs) in Kenya.
ACKNOWLEDGEMENT

I sincerely acknowledge my supervisor Francis Gatumo for the guidance and instructions during the development of the proposal and subsequently the research report. I also appreciate the guidance of Dr. George Kaol of United States International University for the support in understanding research methods. Finally I unreservedly appreciate the respondents for their time and contribution through the filling of the questionnaire.
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<th>Full Form</th>
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<tr>
<td>KBA</td>
<td>Kenya Bankers Association</td>
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<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
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<td>CRB</td>
<td>Credit Reference Bureau</td>
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<td>Central Bank of Kenya</td>
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<td>GDP</td>
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CHAPTER ONE

1.0 INTRODUCTION

1.1: Background of the Study
Credit referencing is the sharing of credit information among lenders. Credit reference bureaus are agencies that researches and collects individual credit information and sells it for a fee to creditors so that they can make a decision on granting loans. Typical clients include banks, mortgage lenders, credit card companies and other financing companies. Services of CRBs were first introduced in London and have now spread to other countries worldwide (Sacerdoti, 2005).

Globally, the biggest problem commercial banks are facing is the non-repayment of loans. Credit information sharing is one way to screen loan applicants in order to mitigate defaults on loan advances. It is a process where banks and other credit providers submit information about their borrowers to a credit reference bureau so that it can be shared with other credit providers. It enables the banks to know how borrowers repay their loans. Thus, the idea of establishing CRBs was conceived in order to enable banks in first sharing information on default among banks, secondly eliminating bad borrowers – those with the aim of borrowing from different financial institutions with the aim of defaulting, thirdly to provide commercial professional credit reference to prospective foreign investors and also to identify honest and credible borrowers based on known history and character (Pagano, 2000).

Credit reference bureaus enable information sharing about borrowers’ characteristics and their indebtedness. This improves the banks’ knowledge of applicants’ characteristics and permits a more accurate prediction of their repayment probabilities. They also operate as borrower discipline devices by eliminating borrowers’ incentive to become over-indebted by drawing credit simultaneously from many banks without any of them realizing. This in effect significantly reduces the probability of loan default (Pagano & Jappelli, 1993).

Kenyan banks have been accused of using negative reports as a threat to hold over those falling behind in their repayment schedules while declining loan applications from those listed, locking them out of credit access. Concerns have been growing over the accuracy, effectiveness and efficiency of the credit referencing system, an issue that is increasingly affecting the relationship between the banks and borrowers. As credit markets become
more competitive, it is essential for the monetary authorities to build a robust financial sector infrastructure to enable responsible lending and promote a more efficient and transparent marketplace. A key element of this infrastructure is a high quality credit information sharing system (IMF, 2009).

The Kenyan banking sector was in the 80’s and 90’s saddled with a momentous Non-Performing Loans (NPLs) portfolio. This invariably led to the collapse of some banks like Daima Bank. One of the catalysts in this scenario was serial defaulters who borrowed from various banks with no intention of repaying the loans. Undoubtedly these defaulters thrived in the information asymmetry environment that prevailed due to lack of credit information sharing mechanism (CBK, 2008).

Due to banking failures in Kenya and to find a way forward to prevent further failures, the Credit Information Sharing mechanism was launched following the legislation and gazette of the Credit Bureau Regulations in 2007. The Credit Bureau Regulations following the amendment to the Banking Act 2006 made it mandatory for the Deposit Protection Fund and institutions licensed under the Banking Act to share information on nonperforming loans through credit reference bureaus licensed by the Central Bank of Kenya. This was the result of negotiations and agreement between Kenya Bankers Association, Central Bank of Kenya, the Ministry of Finance and the office of the Attorney General to address the challenges facing the lending environment in Kenya banking sector. (Bank supervision annual report CBK, 2007).

Credit reference bureaus were introduced in Kenya in 2010. These agencies are licensed and supervised by the Central Bank of Kenya, (CBK) under The Banking (Credit Reference Bureau) Regulations 2008. As at 31st December 2013, there were two registered credit reference bureaus in the Kenya being CRB Africa and Metropol Bureau.

The introduction of credit reporting among banks in Kenya in August 2010 was a key development, but the initial focus centered on perfecting a system for mandatory reporting of non-performing loan data. This was perceived negatively by most bank customers as a “black list”, but was welcomed by the banks as it enabled them to avoid lending to customers with a previous history of delay in payment or outright default. The Kenya Bankers Association (KBA) encouraged positive data sharing by drafting a Code of Conduct for full-file sharing as a Closed User Group (CBK, 2012).
In addition, although some banks responded CRB initiative by showing their willingness to submit performing loan data in 2012, the sharing of data on performing loans was voluntary and required banks to obtain permission from their customers (CBK, 2012). This would take a long time to become fully institutionalized, and delay the realization of the full benefits of the mechanism. Long established banking practice, competition among banks for the best customers and bank secrecy laws account for the understandable reluctance of bank staff to divulge detailed information about their clients. Effective Credit Information Sharing can only be fully achieved by compulsory sharing within the confines of a legal framework that respects the confidentiality of the information shared among market participants and levels the playing field for different financial institutions (IMF, 2009).

In a number of countries, lenders (banks, finance companies, credit card companies, retailers, suppliers extending trade credit) routinely share information on the creditworthiness of their borrowers through credit bureaus. The bureaus collate information with data from sources like courts, public registers and tax authorities and compiles files on borrowers. Lenders then obtain a consolidated data about a credit applicant by requesting a credit report from the bureaus (Jappelli and Pagano, 1999).

CRBs thrive in a good legal environment where there is data protection law, a fair credit reporting law, a data retention law, consumer protection and admissibility of electronic evidence and certification of electronic signatures, without which credit reporting become a shenanigan (Sacerdoti, 2005).

CRBs were introduced to assess the credit worthiness of the loan applicants. They complement the central role played by banks and other financial institutions in extending financial services within an economy. They help lenders make faster and more accurate credit decisions. They collect, manage and disseminate customer information to lenders within a provided regulatory framework – in Kenya, the Banking (Credit Reference Bureau) Regulations, 2008 which was operationalized effective 2nd February 2009.

Credit histories not only provide necessary input for credit underwriting, but also allow borrowers to take their credit history from one financial institution to another, thereby making lending markets more competitive and, in the end, more affordable. Credit bureaus assist in making credit accessible to more people, and enabling lenders and businesses reduce risk and fraud. Sharing of information between financial institutions in
respect of customer credit behavior, therefore, has a positive economic impact. The development of a sustainable information sharing industry is therefore recognized as a key component of financial sector reforms in almost all developing and emerging economies (CBK, 2008).

A high proportion of the commercial banks’ credit risks results from credit default risk, which arises mainly due to the inability of the banks to carry out accurate credit assessment leading to high values of NPLs (CBK, 2008).

Given the importance of risk management in a bank's functioning, the efficiency of a bank's risk management is expected to significantly influence its financial performance (Harker and Satvros, 1998). It is due to this that assessing and managing credit risks has emerged as a very central activity (Focus Group, 2007).

It is in line with the CRBs effects on the Risk management, sharing of information, determination of future ability for customers to borrow as well as the legal provisions and gaps therein that led the researcher seek to determine the impact of credit information sharing on the level of non-performing loans of commercial banks in Kenya. The survey was conducted on the locally owned commercial banks within Nairobi in Kenya.

1.2: Statement of the Problem

Effective credit risk management which improves decision-making about risk of loans and advances is important to reduce weak appraisal mechanisms, incomplete security documentation, weak monitoring and control of adversely graded loans and ineffective remedial action (Rosenberg and Schuermann, 2006). A high proportion of the commercial banks’ credit risks may result from credit default risk hence the NPLs. Consequently lack of accurate information on the credit history and current financial ability of prospective borrowers may make it extremely difficult for lenders to assess their credit worthiness and likelihood to repay the loan (Jappelli and Pagano, 2006). According to Miller (2003) credit information sharing plays a key role in improving the efficiency of financial institutions by reducing loan defaults. Padilla and Pagano (1997) added that information sharing institutions, through their incentive effects on curtailing imprudent behavior of borrowers are also valuable in addressing moral hazard problems.

Munene (2012) studied the impact of credit reference bureaus have in accessing finance by SMEs in Kenya. The study found out that credit bureaus could alleviate a firm
financing constraints by providing information on individuals borrowing and bill paying habits. It enabled the lenders assess credit worthiness, the ability to pay back a loan, and this affects the interest rate and other terms of a loan. The study recommended further research to be undertaken to determine perceived impact of credit reference bureaus in accessing finance in Kenya. This, coupled with the highlights in the background of this study, lead the researcher to develop interest into the analysis and understanding of the performance of commercial banks since the introduction of credit referencing in Kenya and hence the need for this research study.

1.3: Objectives of the Study

1.3.1. General Objective
The general objective of the study is to investigate the impact of credit referencing information sharing on the level of non-performing loans of Commercial Banks in Kenya.

1.3.2: Specific Objectives
  i) To ascertain the usage of Credit Information Sharing by Commercial Banks in Kenya.
  ii) To determine the effects of the use of Credit Information Sharing on the level of non-performing loans in Commercial Banks of Kenya.

1.4: Significance of the Study

1.4.1 Commercial Banks
The study may be useful to Commercial Banks in Kenya as it may help the banks in formulating effective policies related to full file credit access in Kenya, the understanding of the concept of credit referencing, both negative and positive on credit default risk management. The findings of the study may be valuable to the banking industry stakeholders as it provides an insight to the commercial banks management into the best credit risk management practices that they can adopt in order to reduce the level of NPLs in the industry and also access to both types of information can give businesses a more complete picture of a customer’s financial commitments so they can make more informed decisions about extending credit.
1.4.2 Borrowers

The study may also be useful to the borrowers at it provides knowledge on the use of positive information shared by the commercial banks to engage the lender on the pricing as the credit score becomes a bargaining power.

1.4.3 Government

The study may be useful for the government as it may aid in policymaking regarding access to credit and other regulatory requirements of the commercial banks.

1.4.4 Researchers and Academicians

The study may consequently benefit researchers and academicians as it adds to the existing body of knowledge on credit default risk management and aid further research on credit risk management in the banking sector. This study well contributes to the literature by broadening the understanding of the concept of credit referencing on credit default risk management, it contributes to the general understanding of credit referencing on credit default risk management.

1.5: Scope of the Study

The study focused on locally owned commercial banks in Kenya capital city of Nairobi and those with branches in Nairobi county of Kenya. The representatives of these institutions from the credit departments were supplied with questionnaires with the aim of getting their views on the impact of credit information sharing on the general performance of the financial institutions in Kenya. Nairobi County was selected as the study site due to its proximity to the researcher, time available for the study and budgetary constraints.

1.6: Definition of Terms

1.6.1 Commercial Bank

Bank means a company which carries on, or proposes to carry on a combination of financial related activities such as accepting deposits, granting loans, foreign exchange dealings and other related financial intermediations.
1.6.2 Kenya Bankers Association (KBA)

Kenya Bankers Association is the umbrella body of the banking industry in Kenya whose membership is drawn from all commercial Banks in Kenya (IMF, 2009).

1.6.3 Credit Reference Bureau

A credit reference Bureau is a firm that gathers individual consumer credit information from various sources and provides the information to financial institutions for a variety of uses (Jappeli and Pagano, 1999).

1.6.4 Non-Performing Loans

A non-performing loan is any loan in which interest and principal payments are more than 90 days overdue, (IMF, 2009).

1.6.5 Credit Information Sharing

Credit information sharing is a mechanism that allows lenders to share information on their consumers through licensed credit reference bureaus in order to improve the way lending decisions are made (IMF, 2009).

1.6.6 Information Asymmetry

Information Asymmetry is the condition where some information is known to some but not to all parties involved (Stiglitz, 2004).

1.7: Chapter Summary

This chapter gives a general overview of the introduction of Credit Information Sharing and the response from commercial banks. The background of the study and the Research Objectives has been clearly stated. The Purpose was well defined and the Scope of the study which is limited to the locally owned commercial banks operating in Nairobi city. The significance of the study is justified and the study is useful to the banks, borrowers, government and the future researchers. This chapter is followed by chapter two; which depicts the literature review.
CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Introduction
This chapter summarizes the information from existing literature as well as from researchers who have carried out related studies in the same field. The specific areas covered here are Usage of Credit Information by commercial banks and the effect of Credit Information Sharing on Non-Performing Loans.

2.2 Usage of Credit Information by Commercial Banks
Credit information sharing is a process where banks and other financial institutions involved in lending submit credit information about their borrowers to a credit reference bureau so that it can be shared with other credit providers. It is one way to screen loan applicants in order to mitigate defaults on loan advances and it enables the banks to know how borrowers repay their loans. Thus, the idea of establishing CRBs was conceived in order to enable banks in first sharing information on default among banks, secondly eliminating chronic bad borrowers – those with the aim of borrowing from different financial institutions with the aim of defaulting, thirdly to provide commercial professional credit reference to prospective foreign investors and also to identify honest and credible borrowers based on known history and character (Pagano, 2000).

Recent theoretical research suggests a threefold effect of lenders’ exchanging information on the credit history of borrowers. Credit bureaus improve banks’ knowledge about applicants’ characteristics and permit more accurate prediction of repayment probability. This allows lenders to target and price their loans better, easing adverse selection problems. In this respect the benefit of establishing a credit bureau is greatest where each bank is confronted by a large number of customers on which it has no previous information, i.e., where borrowers are very mobile.

Credit bureaus reduce the informational rents that banks could otherwise extract from their customers. They tend to level the informational playing field within the credit market and force lenders to price loans more competitively. Lower interest rates increase borrowers’ net return and augment their incentive to perform. Credit bureaus work as a borrower discipline device: every borrower knows that if he defaults his reputation with all other potential lenders is ruined, cutting him off from credit or making it much more
expensive. This mechanism also heightens borrowers’ incentive to repay, reducing moral hazard (Jappelli and Pagano, 1999).

Lack of accurate information on the credit history and current financial ability of prospective borrowers may make it extremely difficult for lenders to assess their credit worthiness and likelihood to repay the loan (Jappelli and Pagano, 2006).

Coordination among lenders to share information about their clients’ past behavior alleviates asymmetric information problems. Pagano and Jappelli (1993) show that information sharing mechanisms reduce adverse selection by improving the pool of borrowers, the knowledge of applicants’ characteristics and therefore improve bank efficiency in the allocation of credit. Miller (2003) found out that credit information sharing plays a key role in improving the efficiency of financial institutions by reducing loan defaults. Padilla and Pagano (1997) also show that information sharing institutions, through their incentive effects on curtailing imprudent behavior of borrowers are also valuable in addressing moral hazard problems. Information sharing can also create incentives for borrowers to perform in line with bank’s interests. Klein (1982) shows that information sharing can motivate borrowers to repay loans, when the legal environment makes it difficult for banks to enforce credit contracts. In this model borrowers repay their loans because they know that defaulters will be blacklisted, reducing external finance in future. Credit information sharing also helps reduce the level of NPLs, improves availability and lower cost of credit to firms (Brown, Jappelli and Pagano 2009).

Information asymmetry happens where one party has more or better information than the other hence creating an imbalance of power in transactions and sometimes causing the transactions to go wrong. This can result to some kind of market failure in the worst case scenario (Yun, 2009).

Information asymmetry can constrain all types of external financing by either limiting availability or increasing costs. Consequently, information asymmetry affects the acquisition and use of bank lines since short-term bank credit is a primary external source of firm liquidity. One of the catalysts in loan defaults are serial defaulters who could borrow from various banks with no intention of repaying the loans. Undoubtedly these defaulters thrive on the information asymmetry environments that prevail due to lack of a credit information sharing mechanism (CBK, 2008).
Commercial banks, by screening and monitoring borrowers, can solve potential moral hazard and adverse selection problems caused by the imperfect information between borrowers and lenders. From the information obtained from checking account transactions and other sources, banks assess and manage risk, write contracts, monitor contractual performance, and, when required, resolve nonperformance problems. Banks’ ability to ameliorate informational asymmetries between borrowers and lenders and their ability to manage risks are the essence of bank production. These abilities are integral components of bank output and influence the managerial incentives to produce financial services prudently and efficiently (Bhattacharya and Thakor, 1993).

Use of short-term bank credit mitigates capital market frictions through increased monitoring and reduced information asymmetry (Faulkender and Petersen, 2006). Information asymmetry can have an important impact on bank lending and that limitations exist for certain firms in using bank lines as liquidity substitutes (Hardin and Hill, 2010). By and large, information asymmetry impacts a lender’s willingness to lend.

The business of lending involves the risk of default where part or whole of the loan granted is not repaid as per the terms of the loan. This risk is described as credit risk. According to the Basel Committee on Banking Supervision, 2006, credit risk is defined as an investor's risk of loss arising from a borrower who does not make payments as promised. The same committee defines credit risk as it relates to banks as the potential that a bank’s borrower or counterparty may fail to meet its obligations in accordance with agreed terms (Basel, 2006). Credit risk can also be defined as the possibility that the actual return on an investment or loan extended will deviate from that which was expected (Conford, 2000). Coyle (2000) defines credit risk as losses from the refusal or inability of credit customers to pay what is owed in full and on time thereby making the advanced credit to be described as non-performing.

A large body of literature shows that asymmetric information between borrowers and lenders can prevent the efficient allocation of credit. Lenders are often unable to observe the characteristics of borrowers, including the riskiness of their investment projects, and this induces adverse selection problems. Lenders may also be unable to control the actions that borrowers take after receiving a loan. A borrower may relax his effort to prevent default or hide the proceeds of his investment to keep from having to repay his debts. Even a solvent borrower may try to avoid repayment if the lender cannot observe
or sanction his actions. The consequence is that lenders may ration credit or charge high borrowing rates. It is often assumed that the only way lenders can overcome these informational problems is to produce information about their customers via screening and monitoring. For instance, they can interview applicants, visit their business before and after granting the loan, and gather information from public records. If lenders operate on a large scale, these data can be used for statistical risk management to grant and price loans on the basis of past performance.

Effective credit risk management improves decision-making by linking information about risk to pricing, monitoring and control of loans and advances. The main causes of credit risk involve weak appraisal mechanisms, incomplete security documentation, weak monitoring and control of adversely graded loans and ineffective remedial action (Rosenberg and Schuermann, 2006).

The collateral provided by a borrower provides a lender with the ‘security’ necessary to hedge against a borrower defaulting on a loan. More often than not, a security is valued either by lenders staff or by licensed valuers who prepare written reports outlining their ‘opinion’ of the properties. Default results in the value of the transferred assets being set-off against the transferor's obligations under the contract. Lenders also look at the macro and micro economic factors relevant to an industry type for them to judge the merit of the borrower’s application with the added strength (or lack of it) of sound future cash flows, industry growth, employment opportunities and/or demand for a security type. Macroeconomic factors and financial factors both have significant impact over the NPLs rate. Reported macroeconomic factors include the GDP growth, among financial factors; maturity, bank size, credit orientation, and credit terms (Rajan and Dhal, 2003).

According to the theory of Bank Risk Management was developed by Pyle of the University of California, credit and market risks management have an effect directly or indirectly on the banks’ survival as it influences the bank’s profitability (Pyle, 1997). The process of risk management comprises the fundamental steps of risk identification, risk analysis and assessment, risk audit monitoring, and risk treatment or control (Bikker and Metzmakers, 2005). Good risk management is not only a defensive mechanism, but also an offensive weapon for commercial banks and this is heavily dependent on the quality of leadership and governance. Jorion (2009) noted that a recognized risk is less risky than
the unidentified risk. While not avoidable, risk is manageable – as a matter of fact most banks live reasonably well by incurring risks, especially intelligent risks (Pyle, 1997).

The effective management of credit risk is a critical component of a comprehensive approach to risk management and essential to the long-term success of any banking organization (Basel, 2006).

Commercial banks are exposed to a variety of risks chief among them being credit risk (Cooperman, Gardener and Mills, 2000). In some instances, commercial banks and other financial institutions have approved credit decisions that are not vetted; there have been cases of loan defaults and nonperforming loans. Policies to minimize on the negative effects have focused on better banking practices but stringent lending, review of laws to be in line with the global standards, well capitalized banks which are expected to be profitable and credit information sharing (Uyemura and Van Deventer, 1992). To minimize risks, it is necessary for the financial system to adopt sharing of information about borrowers and reduction in non-performing loans (Sandstorm, 2009).

In the recent years, reducing the risk of loan default has received an increasing attention as a central activity of commercial banks. One of the approaches adopted by lenders in an attempt to reduce incidences of default is enhanced credit assessment process. Credit assessment process involves assessing the credit worthiness of the applicants. This process requires in depth analysis in order to weed out potential loan defaulters. Effective credit assessment therefore plays a very important role in the overall management of credit risk (Saunders & Wilson, 1999)

Credit assessment is necessary to review the borrower’s creditworthiness by the prospective lender prior to making a decision as to whether the loan application will be approved. The Basel Committee requires that the bank’s board of directors and senior management are responsible for ensuring that the banks have appropriate credit risk assessment processes and effective internal controls commensurate with the size, nature and complexity of the bank's lending operations to consistently determine provisions for loan losses in accordance with the bank's stated policies and procedures, the applicable accounting framework and supervisory guidance (Basel, 2006).

A bank’s credit risk assessment process for loans should provide the bank with the necessary tools, procedures and observable data to use for assessing credit risk,
accounting for impairment of loans and for determining regulatory capital requirements. In addition the Banking supervisors should also consider credit risk assessment and valuation policies and practices when assessing a bank's capital adequacy (Basel, 2006). The "Five (5) C's" of credit are the basic components of any credit analysis. The five C’s stand for capacity, credit, collateral, conditions and character of the borrower.

Character is the moral obligation that a borrower feels to repay the loan. The lender will investigate the borrower’s past payment experience, review a credit bureau report, and consider his educational background and experience in business. In addition character will be looked into as part of bank’s credit control policy (Pyle, 1997). Lenders start by evaluating the prospective borrower’s capacity to repay a loan. The lender merely has to confirm this information with the employer or through other documents such as Group Certificates, or computer generated pay slips that show the number of hours worked, year to date income earned and other information that the lender requires.

According to Saunders & Wilson (1999), banks need to gather adequate information about potential customers to be able to calibrate the credit risk exposure. The information gathered will guide the bank in assessing the probability of borrower default and price the loan accordingly. Much of this information is gathered during loan documentation.

2.3 Effect of Credit Information Sharing on Non-Performing Loans

According to the IMF (2009), a non-performing loan is any loan in which interest and principal payments are more than 90 days overdue, or more than 90 days' worth of
interest has been refinanced, capitalized, or delayed by agreement, or payments are less than 90 days overdue but are no longer anticipated. IMF also defines a non-performing loan as one in which the maturity date has passed but at least part of the loan is still outstanding. Ahmad and Ariff (2007) define NPLs as the percentage of loan values that are not serviced for three months and above.

Loans defaults reduce the profits of commercial banks through excessive provisioning and this has been a major problem that commercial banks face. Increase in NPLs rate is referred often as the failure of credit policy and this has led to the financial crisis that banking sector has been enduring. As a result, increases in NPLs’ rate are the main reason of reduction in earnings of banks (Irum, Rehana and Muhammad, 2012).

NPLs arise as a result of information asymmetry between borrowers and lenders and this can prevent the efficient allocation of credit. Lenders are often unable to observe the characteristics of borrowers, including the riskiness of their investment projects, and this induces adverse selection problems leading to high restrictions in the award of credit. Lenders may also be unable to control the actions that borrowers take after receiving a loan by relaxing their effort to prevent default or hide the proceeds of their investment to keep from having to repay their debts. This information gap on borrowers can be addressed through credit information sharing (Jappelli and Pagano, 1999).

Reducing the risk of loan default has received an increasing attention as a central activity of commercial banks. One of the approaches adopted by lenders in an attempt to reduce incidences of default is enhanced credit assessment process. Credit assessment process involves assessing the credit worthiness of the applicants. This process requires in depth analysis in order to reduce potential loan defaulters. Effective credit assessment therefore plays a very important role in the overall management of credit risk (Saunders & Wilson, 1999).

Turner and Varghese (2007) observed that credit bureaus help to solve a problem that is inherent in lending: imprecise knowledge of a borrower’s likelihood of repaying. The lender must instead infer the risk profile of the borrower. Incorrect assessments result in two symmetrical problems. Low-risk borrowers are mistaken as high-risk and high-risk borrowers are mistaken as low-risk. Consequently, low-risk borrowers face high interest rates that act as subsidies for high-risk borrowers. These rates price many low-risk borrowers out of the market. On the other hand, high-risk borrowers receive subsidies and
are hereby drawn into the market. Average prices go up to reflect the disproportionate presence of high-risk borrowers, and delinquency rates are higher. In response, lenders ration loans in a way that given two individuals with identical risk profiles and preferences, one will receive a loan and another will not. The study concluded that credit referencing drastically reduces the levels of default.

Credit Information sharing reduces information asymmetry and thus by reducing information asymmetry between lenders and borrowers, credit registries allow loans to be extended to safe borrowers who had previously been priced out of the market, resulting in higher aggregate lending (Pagano and Jappelli, 1993).

A research carried out by Brown and Zehnder (2006) showed that information sharing increases repayment rates, as borrowers anticipate that a good credit record improves their access to credit. This incentive effect of information sharing is substantial when repayment is not third-party enforceable and lending is dominated by one-shot transactions.

Historical information collected by a credit bureau has a powerful default predictive power and adds value by private information exchanges that share information on business payment performance. Exchange-generated information provides significant explanatory power in failure prediction models controlling for other credit information that is easily available to lenders. (Kallberg and Udell, 2003).

According to the CBK Banking supervision report contained in the Kenya Economic Survey 2011, during the year 2010, Kenya’s banking sector recorded significant growth in assets driven by growth in deposits, injection of capital and retention of profits. Performance over the last quarter of 2010 was largely supported by credit referencing and Agent banking among other initiatives pursued by the Central Bank (CBK, 2011).

2.4 Chapter Summary

This chapter summarizes information from the existing literature about Credit Information Sharing and non-performing loans. The chapter is followed by research methodology in chapter three.
CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1: Introduction

This chapter describes the methodology that was used to reach the objectives of the study. In this chapter, the research methodology is presented under the following sections; research design, population, data collection and data analysis.

3.2: Research Design

According to Mcmillan and Schumaker (2001) a research design is a plan for selecting subjects, research sites and data collection procedures to answer the research questions. It is the conceptual framework within which research is conducted and constitutes the blueprint for the collection of data and the analysis thereof of the collected data.

Primarily a descriptive study is concerned with determining the frequency with which something occurs or the relationship between variables. According to Cooper (2003), a descriptive study finds out, who, what, where, and how of a phenomenon which is the aim of this study. In addition a descriptive study is concerned with finding out the what, where and how of a phenomenon (Ngechu, 2004), thus, this approach was appropriate for this study, since the researcher intended to collect detailed information through descriptions and this was also useful for identifying variables and hypothetical constructs. Secondarily this study adopted a survey design which according to Churchill (1991) is appropriate where the study seeks to describe the characteristics of certain groups, estimate the proportion of people who have certain characteristics and make predictions. The research design was therefore descriptive survey.

The focus of the study was both quantitative and qualitative in order to gain a better understanding and more insightful interpretation of the results. The goal was to provide a clear understanding of Credit Information Sharing and its usage in financial institutions and therefore conclude on the impact it has on the performance of Commercial Banks in Kenya.
3.3: Population and Sampling Design

3.3.1 Population

Cooper and Emory (1995) define population as the total collection of elements about which the researcher wishes to make some inferences. An element is the subject on which the measurement is being taken and is the unit of the study.

Out of the 43 financial institutions, 30 banks are locally owned and 13 banks are foreign owned. The locally owned financial institutions comprise 3 banks with significant shareholding by the Government and State Corporations and 27 commercial banks.

The target population of this study was 30 out of the 43 financial institutions. The researcher selected the 30 locally owned banks to accommodate heterogeneity of the bank functions and the similarity of the credit policy since they are all governed locally by CBK.

3.3.2 Sampling Design

3.3.2.1 Sampling Frame

Denscombe (2007) defines a sampling frame as an objective list of the population from which the researcher can make a selection. The sample was collected from the five departments in credit since these are the people involved in the day to day lending business for the company and thus, are well conversant with the subject matter of the study.

The credit departments involved were Credit Administration Unit, Consumer Credit Unit, Corporate Banking, Business Banking and Personal Banking. In this case one employee per department was included in the sample, taking cognizant that homogeneity of the sample is high as the industry and the market for the banks is the same.

3.3.2.2 Sampling Technique

This study utilized cluster sampling technique. This is because there was evidence of "natural" but relatively homogeneous groupings in the statistical population under study and the population was easily divided into relevant and significant clusters based on the ownership of the financial institutions. Saunders, Lewis and Thornhill (2003) argue that
dividing the population into a series of relevant clusters means that the sample is more likely to be representative.

Moreover, cluster sampling technique chosen for this study will increase a sample’s statistical efficiency, provide adequate data for analyzing the various subpopulations or cluster and also enable different research methods and procedures to be used in different clusters (Coopers and Schindler, 2011).

### 3.3.3 Sample Size

Denscombe (1998) poised that, the sample must be carefully selected to be representative of the population and the researcher also needs to ensure that the subdivisions entailed in the analysis are accurately catered for.

The sample was selected from the five departments in credit since these are the people involved in the day to day lending business for the company and thus, are well conversant with the subject matter of the study.

The credit departments involved were Credit Administration Unit, Consumer Credit Unit, Corporate Banking, Business Banking and Personal Banking. In this case one employee per department was included in the sample, taking cognizant that homogeneity of the sample is high as the industry and the market for the banks is the same.

Hence the Sample Size will be 30*5=150

<table>
<thead>
<tr>
<th>Table 3.1: Sample Size</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Target Population Level</strong></td>
</tr>
<tr>
<td>Top level managers</td>
</tr>
<tr>
<td>Middle level managers</td>
</tr>
<tr>
<td>Low level managers</td>
</tr>
<tr>
<td><strong>Total</strong></td>
</tr>
</tbody>
</table>

Author (2014)

In Table 3.1 above, Top level managers selected were 20 out of the expected 30 (67%) because of convenience reasons since the researcher could not access all the top managers for the 30 banks, However 67% was considered reliable considering the heterogeneity of the bank functions and the varying bank to bank credit discretions.
Middle level managers were 60 and Low Level Managers were 70. This basically were representative employees from all the credit departments as stated above.

3.4: Data Collection Instrument and Method
Primary data was collected by administering open and close-ended questionnaire to the respondents. The questionnaire was delivered to the managers and employees in credit departments. This instrument allowed for cost and time savings for the respondents as well as the researcher. The questionnaire was administered through drop and picks method and was self-administered to reduce interviewer bias. Consequently the study used trained and qualified research assistants to assist with the questionnaire distribution. The researcher obtained a research permit from Chandaria School of Business to aid get authorization to collect data from the logistic firms.

3.5: Data Analysis and Presentation
According to Bryman and Bell (2003) data analysis refers to a technique used to make inferences from data collected by means of a systematic and objective identification of specific characteristics.

The quantitative data collected was analyzed by the use of descriptive statistics using Statistical Package for Social Sciences (SPSS) and presented through percentages, means, standard deviations and frequencies. This was be done by tallying, computing percentages as well as describing and interpreting the data in line with the study objectives and assumptions through use of SPSS. The information will be displayed by use of tables and graphs. Tables and other graphical presentations as appropriate will be used to present the data collected for ease of understanding and analysis.

3.6 Chapter Summary
This chapter has clearly described the methodology that was used to reach the objectives of the study. The research methodology was presented under the following sections; research design, population, sampling frame, sampling technique, Sample size, data collection and data analysis. The chapter is followed by Results and Findings in chapter four.
CHAPTER FOUR

4.0 RESULTS AND FINDINGS

4.1: Introduction

This chapter contains the analysis and presentation of the data according to research questionnaire. It constitutes both the quantitative and the qualitative data analysis.

4.2: Response Rate

According to Mugenda and Mugenda (1999), a response rate of 50% is adequate for analysis and reporting; a rate of 60% is good and a response rate of 70% and over is excellent. The response rate was 100% with 13% from top management, 40% from middle level managers and 47% from the low level of management. The study therefore attained an excellent response rate as presented in table 4.1 below.

Table 4.1: Response Rate

<table>
<thead>
<tr>
<th>Target Population Level</th>
<th>Sample</th>
<th>Response</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Top level managers</td>
<td>20</td>
<td>20</td>
<td>13</td>
</tr>
<tr>
<td>Middle level managers</td>
<td>60</td>
<td>60</td>
<td>40</td>
</tr>
<tr>
<td>Low level managers</td>
<td>70</td>
<td>70</td>
<td>47</td>
</tr>
<tr>
<td>Total</td>
<td>150</td>
<td>150</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Researcher, (2014)

4.3 General Information

4.3.1 Department of the Respondents

The study sought to establish the respondents’ departments of work. This was to ensure that the study reached respondents from all the credit departments. The respondents were from the credit administration unit with 56%, followed by personal banking with 18%, consumer credit unit with 13%, business banking with 9%, then corporate banking with 4%. As such, all departments can be said to be fairly presented hence diverse perspectives in responses as presented in figure 4.1 below
Figure 4.1: Department of the Respondents
Source: Researcher, (2014)

4.3.2 Duration the Bank has operated in Kenya

The study further sought to establish respondent banks’ length of operation in Kenya. This would indicate the length of experience different banks have had in the country. Table 4.2 below indicates that 83% of the respondents had their banks operate in Nairobi for more than 11 years while 13% had operated for between six and 10 years, and 3% for less than five years. Diverse experiences of operation in the country can thus be noted with over a half of the sample population being in operation for at least 6 years.

Table 4.2: Duration the Bank has operated in Kenya

<table>
<thead>
<tr>
<th>Period Worked</th>
<th>Response</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 1 year</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>1 to 5 years</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>6 to 10 years</td>
<td>4</td>
<td>13</td>
</tr>
<tr>
<td>11 years and above</td>
<td>25</td>
<td>83</td>
</tr>
<tr>
<td>Total</td>
<td>30</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Researcher, (2014)

4.3.3 Whether Non-Performing loans been a challenge to the bank

The study sought to establish whether Non-Performing loans been a challenge to the bank. The findings were that all the banks (100%) had challenges of non-performing loans. Table 4.3 below presents the results.
Table 4.3: Whether Non-Performing loans been a challenge to the bank

<table>
<thead>
<tr>
<th>Opinion</th>
<th>Response</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>150</td>
<td>100</td>
</tr>
<tr>
<td>No</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Not Sure</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>150</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Researcher, (2014)

4.3.4: Whether CRB is Accessible to you as a banker

The study sought to establish whether CRB is Accessible to you as a banker. Table 4.4 indicates that all the banks according to 100% of the respondents, had access to CRB

Table 4.4: Whether CRB is Accessible to you as a banker

<table>
<thead>
<tr>
<th>Opinion</th>
<th>Response</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>150</td>
<td>100</td>
</tr>
<tr>
<td>No</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>150</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Researcher, (2014)

4.3.5: CRB impact on the Non-Performing loans in your Bank

The study sought to establish the impact of CRB on the non-performing loans in the bank

Table 4.5, shows the extent of CRB Impact on Non-Performing loans, 56% by great extent, 23% by moderate extent, 23% by exceedingly great extent and 8% by just a little.

Table 4.5: Extent of CRB impact on the Non-Performing loans in your Bank

<table>
<thead>
<tr>
<th>Not at All</th>
<th>Little Extent</th>
<th>Moderate Extent</th>
<th>Great Extent</th>
<th>Very Great Extent</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
<td></td>
</tr>
<tr>
<td>0</td>
<td>12</td>
<td>35</td>
<td>84</td>
<td>19</td>
<td>150</td>
</tr>
<tr>
<td>0%</td>
<td>8%</td>
<td>23%</td>
<td>56%</td>
<td>13%</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: Researcher, (2014)

4.4: Usage of Credit Information Sharing among Commercial Banks in Kenya

This section sought to ascertain the Usage of Credit Information Sharing among Commercial Banks in Kenya.
4.4.1 CRB that Receives Customer’s Credit Information
The study further sought to establish which CRB their organizations forward its customer’s credit information. Table 4.6 shows that 70% of the banks responded that they received clients’ information from both Trans Union Africa and Metropol, 20% got only from Trans Union Africa, while 10% got only from Metropol.

**Table 4.6: CRB that Receives customer’s credit information**

<table>
<thead>
<tr>
<th>CRB</th>
<th>Response</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trans Union Africa</td>
<td>6</td>
<td>20</td>
</tr>
<tr>
<td>Metropol</td>
<td>3</td>
<td>10</td>
</tr>
<tr>
<td>Both</td>
<td>21</td>
<td>70</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>30</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

Source: Researcher, (2014)

4.4.2: Average Number of CRB inquiries you make per month
Respondents were further asked to indicate the number of CRB inquiries made per month. Table 4.7 indicates that 85% make more than 46 inquiries to CRB every month, while 15% make below 30 applications. With a majority of institutions making at least 46 inquiries per month, it can further be deduced that an adequate number of CRB applications are made every month hence a fair uptake and that respondents had adequate experience with issues pertaining to the research problem.

**Table 4.7: Average Number of CRB Inquiries you make per Month**

<table>
<thead>
<tr>
<th>Enquiries Per Month</th>
<th>Response</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 15 applications</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>16 to 30 applications</td>
<td>5</td>
<td>3</td>
</tr>
<tr>
<td>31 to 45 applications</td>
<td>17</td>
<td>11</td>
</tr>
<tr>
<td>46 applications and above</td>
<td>128</td>
<td>85</td>
</tr>
<tr>
<td>N/A</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>150</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

Source: Researcher, (2014)

4.4.3 Whether the Bank forward customers credit histories (Negative) to CRB
The study sought to establish whether banks forward negative credit histories to CRB. Table 4.8 indicates that 100% of the respondents said they forward all the negative history of the clients to CRB.
Table 4.8: Whether the Bank Forward Customers Credit Histories (Negative) to CRB

<table>
<thead>
<tr>
<th>Opinion</th>
<th>Response</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>150</td>
<td>100</td>
</tr>
<tr>
<td>No</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>150</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Researcher, (2014)

4.4.4: Percentage of approved loans based on the credit reference reports

The study sought to establish the percentage of approved loans based on the credit reference reports. Table 4.9 shows that 73% were for the opinion that only 20% of the loans were approved based on the CRB report, while 27% were for the opinion that only between 21% and 40% of the loans were approved based of CRB report. It can thus be deduced that only a small percentage of loan applications are approved based on the credit reference reports.

Table 4.9: Percentage of approved loans based on the credit reference reports

<table>
<thead>
<tr>
<th>Rate of Loans Approved</th>
<th>Response</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 20% applications</td>
<td>109</td>
<td>73</td>
</tr>
<tr>
<td>21 to 40% applications</td>
<td>41</td>
<td>27</td>
</tr>
<tr>
<td>41 to 60 applications</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>61 to 80% applications</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>80 to 100% applications</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>150</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Researcher, (2014)

4.4.5: Percentage of declined loans based on the credit reference reports

Respondents were also asked to indicate the percentage of loan applications declined based on the credit reference reports. Table 4.10 indicates that 92% of the respondents evidenced that only less than 20% of the loans applied were declined based on the CRB report, while 8% estimated the declined loans to be between 21% and 40%.
Table 4.10: Percentage of loans declined based on the credit reference reports

<table>
<thead>
<tr>
<th>Loans Declined</th>
<th>Response</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 20% applications</td>
<td>138</td>
<td>92</td>
</tr>
<tr>
<td>21 to 40% applications</td>
<td>12</td>
<td>8</td>
</tr>
<tr>
<td>41 to 60 applications</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>61 to 80% applications</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>80 to 100% applications</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>150</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Researcher, (2014)

4.4.6: Rating of Usage of Credit Information Sharing

The study further sought to find out respondents’ levels of agreement with statements pertinent to credit usage. This was on a 5-point likert scale, where: 5 = strongly agree; 4 Agree; 3 = Neutral; 2= Disagree and 1= strongly Disagree

According to the rating in table 4.11 below, 24% were for the opinion that including all credit history from other credit suppliers (positive information) would increase credit approval by commercial banks; 23% were for the opinion that Low default rate would result from lending to borrowers based solely on all credit suppliers (positive information) which would increase credit approval by commercial Banks.

In addition 18% felt that high default rate would result to lending to borrowers based solely on only the absence of default (negative) information from Credit Reference Bureau; 17% said that their banks forward list of credit defaults, overall loan exposure, guarantees and data from past credit history to Credit Reference Bureau; and 18% said that their banks forwarded only the list of credit defaulters (Negative Information) to credit reference bureau.
Table 4.1: Rating of Usage of Credit Information Sharing

<table>
<thead>
<tr>
<th>Rating (Extent of Agreement)</th>
<th>S</th>
<th>D</th>
<th>N</th>
<th>A</th>
<th>SA</th>
<th>xw</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Weights (w)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a) Your organization forwards list of credit defaulters (Negative Information) only to credit reference bureau</td>
<td>0</td>
<td>36</td>
<td>4</td>
<td>105</td>
<td>5</td>
<td>561</td>
<td>18</td>
</tr>
<tr>
<td>b) Your organization forwards list of credit defaults, overall loan exposure, guarantees and data from past credit history to Credit Reference Bureau</td>
<td>4</td>
<td>17</td>
<td>24</td>
<td>99</td>
<td>6</td>
<td>529</td>
<td>17</td>
</tr>
<tr>
<td>c) High default rate would result to lending to borrowers based solely on only the absence of default (negative) information from Credit Reference Bureau</td>
<td>1</td>
<td>35</td>
<td>16</td>
<td>75</td>
<td>23</td>
<td>553</td>
<td>18</td>
</tr>
<tr>
<td>d) Low default rate would result from lending to borrowers based solely on all credit suppliers (positive information) would increase credit approval by commercial Banks</td>
<td>0</td>
<td>7</td>
<td>0</td>
<td>4</td>
<td>139</td>
<td>732</td>
<td>23</td>
</tr>
<tr>
<td>e) Including all credit history from other credit suppliers (positive information) would increase credit approval by commercial banks</td>
<td>0</td>
<td>1</td>
<td>0</td>
<td>7</td>
<td>142</td>
<td>741</td>
<td>24</td>
</tr>
<tr>
<td>a) Total</td>
<td>5</td>
<td>44</td>
<td>96</td>
<td>290</td>
<td>315</td>
<td>3116</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Researcher, (2014)

4.5: Effect of Credit Information Sharing on Non-Performing Loans

This section sought to establish the effect of Credit Information Sharing on the Non-Performing Loans.

4.5.1: Extent of Credit Information Sharing Influencing Non-Performing Loans

Respondents were asked to indicate the extent to which the Credit Bureau information influences credit management which in turn impact on the level of non-performing loans.

This was on a 5-point likert scale, where: 5 = Very great extent; 4 Great extent; 3= Moderate extent; 2= little extent and 1= Not at all.

In table 4.12 below, non-performing loans were affected by Lowering bank’s risk level according to 24% of the respondents; choosing the right customer for lending through prudent lending according to 22%; reducing borrowing cost according to 15%; increasing
transparency among institutions according to 14%; and applicants over-indebtedness according to 6%. According to 19% credit-reporting bureaus changed the way of lending in their banks.

**Table 4.12: Extent of credit Bureau information influencing Non-Performing Loans**

<table>
<thead>
<tr>
<th>Rating</th>
<th>NA</th>
<th>LE</th>
<th>ME</th>
<th>GE</th>
<th>VGE</th>
<th>xw</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>b) Adverse selection (choosing the right customer for lending through prudent lending).</td>
<td>0</td>
<td>11</td>
<td>35</td>
<td>102</td>
<td></td>
<td>687</td>
<td>22</td>
</tr>
<tr>
<td>c) Increasing transparency among institutions.</td>
<td>2</td>
<td>46</td>
<td>56</td>
<td>41</td>
<td>7</td>
<td>449</td>
<td>14</td>
</tr>
<tr>
<td>d) Applicants over-indebtedness</td>
<td>124</td>
<td>26</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>176</td>
<td>6</td>
</tr>
<tr>
<td>e) Lowering bank’s risk level</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>7</td>
<td>142</td>
<td>741</td>
<td>24</td>
</tr>
<tr>
<td>f) Incentives to disciplined customers –Reducing borrowing cost</td>
<td>0</td>
<td>123</td>
<td>0</td>
<td>24</td>
<td>3</td>
<td>480</td>
<td>15</td>
</tr>
<tr>
<td>f) In your opinion, have credit-reporting bureaus changed the way lending in your organization?</td>
<td>2</td>
<td>37</td>
<td>1</td>
<td>83</td>
<td>27</td>
<td>582</td>
<td>19</td>
</tr>
<tr>
<td>Total</td>
<td>126</td>
<td>85</td>
<td>218</td>
<td>190</td>
<td>281</td>
<td>3115</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Researcher, (2014)

**4.5.2: Qualitative Data Analysis**

Credit Reference Bureau (CRB) has greatly improved the non-performing loans as defaulters have started paying and the general public is careful not to have their credit history get them to a situation where they would not get credit. Due to the requirement by government institutions that all employees must meet the criteria for integrity, many clients have paid their loans; a positive effect on the banking industry. This means that the effect of CRB has been positive to improve the overall performance and profitability of the banks.

**4.6: Chapter Summary**

This chapter gives both the quantitative and qualitative data analysis and presentation of the findings according to the research questionnaire. The chapter is followed by chapter five, which contains the Summary, Discussion, Conclusions and Recommendations.
CHAPTER FIVE

5.0 DISCUSSION, CONCLUSIONS AND RECOMMENDATIONS

5.1: Introduction
This chapter contains the summary, discussion, conclusions and recommendation according to the research questions.

5.2: Summary
The general objective of the study was to assess the impact of credit information sharing on the level of Non-performing loans, The study was guided by the following specific objectives: to ascertain the usage of credit information sharing among commercial banks and to establish the effect of Credit information sharing on Non-performing loans in Commercial Banks.

The population for the study included the 43 financial institutions out of which the 30 locally owned banks were chosen and one representative from the credit departments. The credit departments involved were Credit Administration Unit, Consumer Credit Unit, Corporate Banking, Business Banking and Personal Banking. In this case one employee per department was included in the sample, taking cognizant that homogeneity of the sample is high as the industry and the market for the banks is the same.

The study involved the use of cluster sampling technique since the financial institutions were clustered according to ownership i.e. locally owned and foreign owned. Descriptive analysis with the use of SPSS was used and the results were displayed by frequency tables and figures.

The study found out that commercial banks have fully embraced and started utilising the Credit Information Sharing as a tool to weed out chronic defaulters and also ensure they lend prudently. It was also established that commercial banks don’t forward positive information to CRB, which means that they have not embraced the full file credit sharing but instead most of them forward the negative information only.

The study revealed that credit information referencing has an effect on the level of NPLs as it reduces information asymmetry. Credit referencing by banks was observed to have a significant impact on the NPLs. This implies that if credit referencing is fully adopted
during the credit appraisal process then the NPLs will reduce and the same will benefit commercial banks a great deal.

5.3: Discussion
Discussion of the findings is presented below according to the research questions

5.3.1: Usage of credit information sharing by Commercial Banks in Kenya?
The study revealed that all the banks had access to CRB, which means CRB is applied to all local banks. It was also established that most of the commercial banks obtain credit information from both Trans Union Africa and Metropol which increases transparency and hence improves on the integrity of the data provided.
The number of CRB enquiries made per month was found to be very high with 85% making more than 46 inquiries to CRB every month hence its evident that CRB has been embraced and applied by local banks. All respondents said that they forward only the negative history of the clients to CRB hence the need to sensitise banks to forward full file information which includes also the positive information.

5.3.2: Effect of Credit Information sharing on the level of Non-Performing Loans in Commercial Banks of Kenya?
The study revealed that Credit Information sharing affects non-performing loans by Lowering bank’s risk level hence reducing the portfolio at risk and the provisioning for NPLS which in turn reduces the profitability of the bank, Choosing the right customer for lending through prudent lending which in turn reduces the level of NPL as the character of the borrower is checked through the credit information obtained and this ensures that banks only lend to customers whose credit history is favourable, Reducing borrowing cost since with a clean credit report, the borrower is able to bargain the interest rates to be charged on the loans, increasing transparency among institutions hence reducing information asymmetry which in turn eliminates the bad borrowers and applicant’s over-indebtedness where the information shared helps the banks to eliminate serial defaulters who borrow from one bank to the other with the intention of not paying. Generally credit-information sharing has changed the way of lending in the banks.

The study also revealed that Credit Reference Bureau (CRB) has greatly improved the non-performing loans as defaulters have started paying and the general public is careful not to have their credit history get them to a situation where they would not get credit.
Due to the requirement by government institutions that all employees must meet the criteria for integrity, many clients have paid their loans; a positive effect on the banking industry. This means that the effect of CRB has been positive to improve the overall performance and profitability of the banks.

The study further indicated that a small percentage of the loans applied were declined based on the CRB report meaning that chances of clients not accessing loans in future if they defaulted in any of the banks made many of them to pay, hence reducing the non-performing loans.

5.4 Conclusions
Conclusion of the research study is presented below according to the research questions;

5.4.1: Usage of credit information sharing in Commercial Banks in Kenya?
The study concludes that Credit Information sharing is applied and used by Commercial Banks of Kenya. Further, including all credit history from other credit suppliers (positive information) would increase credit approval by commercial banks.

5.4.2: Effects of Credit Information sharing on the level of Non-Performing Loans in Commercial Banks of Kenya?
The study concludes that Sharing of customer credit information positively affects the Non-performing loans as it helps the banks to decline loaning chronic defaulters. While low default rate would result from lending to borrowers based solely on all credit suppliers (positive information).

The study also concludes that all banks have suffered for non-performing loans as they all have had challenges of non-performing loans. All these banks have therefore embraced and utilised CRB to sort them out of the problem of non-performing loans.

5.5: Recommendations
Recommendations of the study are presented below according to the research questions;

5.5.1: To what extent has credit information sharing been applied or used in Commercial Banks in Kenya?
Commercial Banks in Kenya should make more use of the CRB reports so that they control their greatest problem of non-performing loans. The borrowers must ensure that their records are clean and therefore if they have clean history from the CRB, they could
bargain to get loans at low interest and better conditions. The recommendations based on the Major Findings are that all banks should embrace and use Credit Information sharing as a tool to reduce and control Non-performing loans resulting from chronic defaulters. The study also recommends Commercial Banks to embrace Positive Credit Information in order to increase the borrower’s bargaining power.

5.5.2: What have been the effects of Credit Information sharing on the level of Non-Performing Loans in Commercial Banks of Kenya?

The government should ensure mandatory compliance to settlement of debts as constitutionally required of the integrity section of the Kenyan law. This will make it easier for the current banks and prospective ones too. It’s an addition to the researchers and academicians as it add to the existing body of knowledge, hence good for empirical review of literature.

5.6: Suggestions for Further Research

During the literature review, data collection and analysis, the researcher felt that some of the issues required further research as the scope and limitations of this research could not permit their study. The suggested further research includes:

i) Analysis of CRB activities on credit accessibility from the customers’ perspective.

ii) How the CRB has influenced the improvement of performing loans among the SACCOs.

iii) Finding out the CRB effects on the performance of Deposit-Taking Microfinance (DTMs) in Kenya.
REFERENCES


Coyle, B. (2000). Framework for Credit Risk Management; Chartered Institute of Bankers, United Kingdom.


APPENDICES

APPENDIX 1: COVER LETTER

Winfred Kalunde Kisengese
United States International University,
P.O. Box 14634, 00800,
NAIROBI.
12/04/2014

RE: Request to fill in the Questionnaire

Dear Respondent,

I am a graduate student at United States International University, carrying out research on the impact of credit information sharing on the level of non-performing loans of commercial banks in Kenya. This is in partial fulfillment of the requirement of the Master of Business Administration (Finance) degree program at the United States International University (Africa).

You have been randomly selected among many to participate in this study. It is estimated that it will take less than twenty (20) minutes of your time to complete the questionnaire. Please respond as honestly and objectively as possible. Your participation is very essential for the accomplishment of this study and it will be highly appreciated. I guarantee that the information that you will provide will be treated with the utmost confidentiality and will be used only for academic purposes.

This is an academic research and confidentiality is strictly emphasized, your name will not appear anywhere in the report. Kindly spare some time to complete the questionnaire attached.

Thank you.

Yours faithfully,

Winfred K. Kisengese
APPENDIX 2: QUESTIONNAIRE

Section One: General Information

1) Name of the organization (Optional)............................................................................................................

2) In which of the following departments do you work?
   a) Credit Administration unit [  ]
   b) Consumer credit unit [  ]
   c) Corporate banking [  ]
   d) Business banking [  ]
   e) Personal banking [  ]
   f) Others (Please state)....................................................................................................................................

3) For how long has this bank been in operation in Kenya? (Tick as appropriate)
   a) Less than 1year [  ]
   b) 1 to 5 years [  ]
   c) 6 to 10 years [  ]
   d) 11years and above [  ]

4) Has Non-Performing loans been a challenge to the bank
   a) Yes [  ]
   b) No [  ]
   c) Not sure [  ]

5) Is CRB accessible to you as a banker?
   a) Yes [  ]
   b) No [  ]

6) To what extent has the introduction of CRB impacted on the Non-Performing loans in your organization
   
<table>
<thead>
<tr>
<th>Not at All</th>
<th>Little Extent</th>
<th>Moderate Extent</th>
<th>Great Extent</th>
<th>Very Great Extent</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
</tbody>
</table>

Section Two: Extent of Usage of Credit Information Sharing among Commercial Banks of Kenya

7) To which of the following CRB does your organization forward its customer’s credit information
   a) Trans Union Africa [  ]
   b) Metropol [  ]
   c) Both [  ]
8) How many CRB inquiries do you make per month?
   a) Less than 15 applications [   ]
   b) 16 to 30 applications [   ]
   c) 31 to 45 applications [   ]
   d) 46 applications and above [   ]
   f) N/A [   ]

9) Does your organization forward credit histories (Negative) of its customers to CRB?
   b) Yes [   ]
   b) No [   ]

10) Does your organization forward credit histories (Positive) of its customers to CRB?
    a) Yes [   ]
    b) No [   ]

11) What is the percentage of loan applications approved based on the credit reference reports?
    a) Less than 20% applications [   ]
    b) 21 to 40% applications [   ]
    c) 41 to 60 applications [   ]
    d) 61 to 80% applications [   ]
    e) 80 to 100% applications [   ]

12) What is the percentage of loan applications declined based on the credit reference reports?
    a) Less than 20% applications [   ]
    b) 21 to 40% applications [   ]
    c) 41 to 60 applications [   ]
    d) 61 to 80% applications [   ]
    e) 80 to 100% applications [   ]
13) To what extent do you agree with the following statements?

1=Strongly Disagree, 2=Disagree, 3=Neutral, 4=Agree and 5=Strongly Agree

<table>
<thead>
<tr>
<th>Statement</th>
<th>Strongly Disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly Agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>a) Your organization forwards list of credit defaulters (Negative Information) only to credit reference bureau.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>b) Your organization forwards list of credit defaults, overall loan exposure, guarantees and data from past credit history to Credit Reference Bureau.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>c) High default rate would result to lending to borrowers based solely on only the absence of default (negative) information from Credit Reference Bureau.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>d) Low default rate would result from lending to borrowers based solely on all credit suppliers (positive information) would increase credit approval by commercial Banks.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>e) Including all credit history from other credit suppliers (positive information) would increase credit approval by commercial banks.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a) Others(Specify)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Section Three: Effect of Credit Information sharing on the level of Non-Performing loans

14) With respect to your organization, please indicate to what extent the credit Bureau information influence the following aspects in credit management which in turn impact on the level of non-performing loans.

<table>
<thead>
<tr>
<th></th>
<th>Not at all (1)</th>
<th>Little extent (2)</th>
<th>Moderate extent (3)</th>
<th>Great extent (4)</th>
<th>Very great extent (5)</th>
</tr>
</thead>
<tbody>
<tr>
<td>b)</td>
<td>Adverse selection (choosing the right customer for lending through prudent lending).</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>c)</td>
<td>Increasing transparency among institutions.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>d)</td>
<td>Applicants over-indebtedness</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>e)</td>
<td>Lowering bank’s risk level</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>f)</td>
<td>Incentives to disciplined customers – Reducing borrowing cost</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>f)</td>
<td>In your opinion, have credit-reporting bureaus changed the way lending in your organization?</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

15) Any other comment roller

Thank you for your co-operation.
APPENDIX 3: LIST OF BANKS IN NAIROBI

1. ABC Bank (Kenya)
2. Bank of Africa
3. Bank of Baroda
4. Bank of India
5. Barclays Bank (Kenya)
6. CFCStanbic Holdings
7. Chase Bank (Kenya)
8. Citibank
9. Commercial Bank of Africa
10. Consolidated Bank of Kenya
11. Cooperative Bank of Kenya
12. Credit Bank
14. Diamond Trust Bank
15. Dubai Bank Kenya
16. Ecobank
17. Equatorial Commercial Bank
18. Equity Bank
19. Family Bank
20. Fidelity Commercial Bank Limited
21. First Community Bank
22. Giro Commercial Bank
23. Guaranty Trust Bank
24. Guardian Bank
25. Gulf African Bank
26. Habib Bank
27. Habib Bank AG Zurich
28. Housing Finance Company of Kenya
29. I&M Bank
30. Imperial Bank Kenya
31. Jamii Bora Bank
32. Kenya Commercial Bank
33. K-Rep Bank
34. Middle East Bank Kenya
35. National Bank of Kenya
36. NIC Bank
37. Oriental Commercial Bank
38. Paramount Universal Bank
39. Prime Bank (Kenya)
40. Standard Chartered Kenya
41. Trans National Bank Kenya
42. United Bank for Africa
43. Victoria Commercial Bank