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THE EFFECT OF NON-PERFORMING LOANS MANAGEMENT PRACTICES ON THE FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN KENYA

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Abstract: *Non-Performing loans are one of the major causes of the economic stagnation problems and failure of financial institutions. The eradication of non-performing loans is a necessary condition to improve the economic status and performance of financial institutions. This study therefore sought to investigate on the effects of non-performing loans management practices on the financial performance of commercial banks in Kenya. The study also sought to determine the effects of credit risk analysis, credit insurance and debt collection practices on the financial performance of commercial banks in Kenya. This study used descriptive research design. The target population for this study was 3 heads of departments from all the 43 commercial banks in Kenya. Stratified random sampling was used to select 50 per cent of the target population and hence the sample size will be 65 respondents. The study found that credit risk analysis has a positive effect on the financial performance of commercial banks in Kenya. The study further established that credit insurance has a positive effect on the financial performance of commercial banks in Kenya. Also, the study found that debt collection practices have a positive effect on the financial performance of commercial banks in Kenya. This study concludes that credit insurance influences the financial performance of commercial banks in Kenya most followed by debt collection practices and credit risk analysis had the least influence on the financial performance of commercial banks in Kenya. The study recommends that commercial banks should improve their credit risk monitoring practices like monitoring of clients' credit obligations, monitoring of clients monthly installments and enhance credit risk control. In addition, commercial banks should extend credit insurance to all types of loans so as to claim the debt from insurance companies upon clients default, insolvency and bankruptcy. This will go a long way in reducing non-performing loans. Also, commercial banks in Kenya should start offering training to their officers on debt collection. This may help in improving their skills on debt collection and hence reduce non-performing loans.*

Keywords: *credit risk, credit insurance, debt collection practices and financial performance*

Background of the Study

Commercial banks play an important role for economic development, and foster economic growth of any country through their intermediation role and financial services that they provide to community and nations (Ugirase, 2013). The credit facilities that they offer facilitate the exploration and expansion of productive investments avenues by individuals and institutional investors. However, there is a growing recognition that the quantity or percentage of NPLs is related to bank failures and the financial status of a country. Especially after the current global financial crisis, which started in US and spread to the whole world, especially Europe, the issue of NPLs has gained increasing attention because of the rapid increased default of sub-prime mortgage loans. Moreover, there are some evidences that financial and banking crises in East Asia and Sub Saharan African countries were preceded by increasing non-performing loans.

In a bank-centered financial system, non-performing loans can thwart economic recovery by shrinking operating margin and eroding the capital base of the banks to advance new loans. This is sometimes referred to as "credit crunch". In addition, non-performing loans, if created by the borrowers willingly and left unresolved, might act as a contagious financial malaise by driving good borrowers out of the financial market. Further, Tonui, Muturi and Nyangau (2013) argues that a bank with high level of NPLs is forced to incur carrying costs on non-income yielding assets that not only strike at profitability but also at the capital adequacy of a bank, and in consequence, the bank faces difficulties in augmenting capital resources. Karugu and Ntoiti (2012) also state that the probability of banking crises increases if financial risk is not eliminated quickly. Such crises not only lower living standards but can also eliminate many of the achievements of economic reform overnight.

Commercial Banks in Kenya: The Banking industry in Kenya is governed by the Companies Act, the Banking Act, the Central Bank of Kenya Act and the various prudential guidelines issued by the CBK. The CBK, which falls under the Minister for Finance docket, is responsible for formulating and implementing monetary policy and fostering the liquidity, solvency and proper functioning of the financial system. The banks have come together under the Kenya Bankers Association (KBA), which serves as a lobby for the banking sector's interests (Central Bank Annual Report, 2015).

During the period ended June 30, 2015, the Kenyan banking sector comprised 43 commercial banks, 1 mortgage finance company, 9 deposit taking microfinance institutions, 7 representative offices of foreign banks, 107 foreign exchange bureaus and 2 credit reference bureaus. The Sector recorded enhanced performance with the size of assets standing at Ksh 2.5 trillion, loans and advances amounting to Ksh 1.5 trillion, while the deposit base stood at Ksh 1.9 trillion and profit before tax of Ksh 61.5 billion as at June 30, 2015. During the same period, the number of bank customer deposit and loan accounts stood at 18.9 million and 3.8 million, respectively. The non-performing loans increased by from a gross figure of Ksh 57.5 billion in June 2014 to Ksh. 77.3 billion in June 2015 (Central Bank Annual Report, 2015).

Statement of the Problem

The fundamental role of banks in the maturity transformation of short-term deposits into long-term loans makes banks inherently vulnerable to liquidity risk, both of an institution-specific nature and that which affects markets as a whole (Sundararajan, 2007). Non-Performing loans are one of the major causes of the economic stagnation problems. The eradication of Non-Performing loans is a necessary condition to improve the economic status. If the Non-Performing loans are kept existing and continuously rolled over the resources are locked up in unprofitable sector; thus hindering the economic growth and impairing the economic efficiency. Therefore, commercial banks should be able to draw useful lessons from past experiences and develop strategies to deal with non-performing loans (Karugu & Ntoiti, 2012).

Most of banking crises emanate from consistent accumulation of non-performing loans. Loan provisions generally act as a cushion to customer's deposits and shareholders' funds in case of defaults. Under provisioning can lead to overstatement of profits while over provisioning can lead to understatement of the profits, which will affect other issues among them taxation, level of dividends (CBK, 2015). In an effort to address the issue of the increasing amount of non-performing loans, commercial banks in Kenya have adopted non-performing loans management practices such as debt collection practices, credit risk analysis and credit risk insurance. However, despite the adoption of these practices, non-performing loans in commercial banks in Kenya have been increasing.

Several studies have analyzed the influence of non-performing loans and financial performance of commercial banks. For instance, Asantey and Tengey (2012) conducted a study on the effect of bad loans on banks' lending potential and financial performance; Teshome (2010) conducted a study on non-performing loan and its management while Wanja (2013) conducted a study on the effects of credit policy on performance of commercial banks in Kenya, However, there are no empirical studies conducted on the influence of non-performing loans management practices on the financial performance of commercial banks. This study therefore seeks to investigate on the influence of non-performing loans management practices on the financial performance of commercial banks in Kenya.

Objectives of Study

i. To determine the effects of credit risk analysis on the financial performance of commercial banks in Kenya

ii. To establish the effects of credit insurance on the financial performance of commercial banks in Kenya

iii. To assess the effects of debt collection practices on the financial performance of commercial banks in Kenya

Literature Review

The study was guided by the following theories;

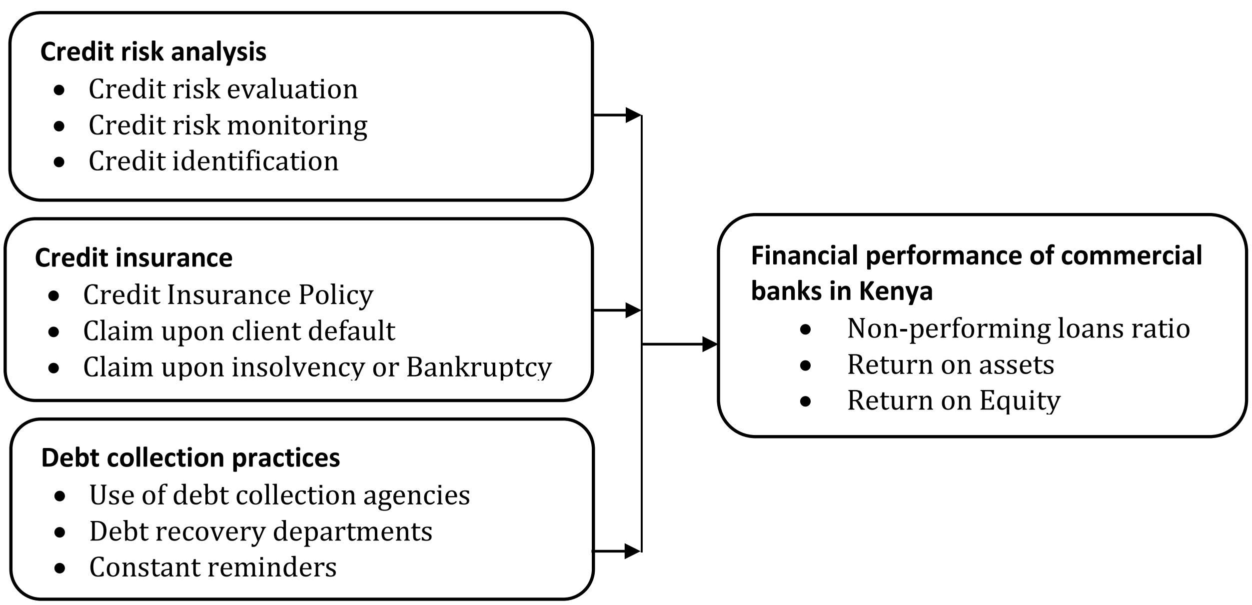
Theory of Asymmetric Information: The asymmetric information theory describes a condition in which all parties involved in an undertaking do not know relevant information (Xanthos, 2014). In a debt market, information asymmetry arises when a borrower who takes a loan usually has better information about the potential risks and returns associated with investment projects for which the funds are earmarked. The lender on the other hand does not have sufficient information concerning the borrower (Grossman, 2013).

This theory has various proponents. For instance, Gatuhu (2013) points out that perceived information asymmetry poses two problems for the banks, moral hazard (monitoring entrepreneurial behavior) and adverse selection (making errors in lending decisions). In addition, Kwambai and Wandera (2013) argues that the person that possesses more information on a particular item to be transacted (in this case the borrower) is in a position to negotiate optimal terms for the transaction than the other party (in this case, the lender). The party that knows less about the same specific item to be transacted is therefore in a position of making either right or wrong decision concerning the transaction. Adverse selection and moral hazards have led to significant accumulation of nonperforming loans in banks.

Expected Utility Theory: The expected utility theory was developed by John Von Neumann and Oskar Morgenstern in the year 1944. In this book, they moved on from Bernoulli's formulation of a utility function over wealth, and defined an expected utility function over lotteries, or gambles. Theirs is an axiomatic derivation, meaning, a set of assumptions over people's preferences is required before one can construct a utility function (Hartley & Farrell, 2012). The theory of the demand for insurance has been based on expected utility theory and an assumed preference for certain losses over uncertain ones of the same expected magnitude (Regan & Hur, 2007). The purpose of any insurance policy is to convert an uncertain, but potentially large, loss into a certain, small loss. Such a conversion benefits the consumer if greater losses cause progressively larger declines in utility (that is, if there is diminishing marginal utility of wealth) (Hartley & Farrell, 2012). At a more general level but still part of the demand-for-insurance-as-demand-for-certainty theory, other studies have postulated that the demand for insurance is by risk aversion consumers who use insurance to avoid, eliminate, hedge against, kill, manage, shed, protect against, or bear the risk of loss.

Debt collection theory: The debt collection theory was founded by Janis Pearl Sarra in the year 2003. Debt collection theory is a theoretical approach that has gained recognition all over the world, which suggests that bankruptcy normative policy objective is to collectivize the process by which a debtor's assets are made available to the claimants (Thomas *et al.*, 2016). The sole policy objective of bankruptcy law should be the enhancement of collection efforts of creditors, with a view of maximizing creditors' wealth. According to Redding *et al.*, (2015), this differs from pure market theory because it endorses state intervention to assist with collective action problems by creditors and cost-effective enforcement of claims. Debt collection regimes prevent a 'race to the finish' to realize on claims to the value of corporate assets. The law should be utilized to overcome the creditors' co-ordination problems regarding the common pool of assets. This can only be accomplished effectively if non-bankruptcy creditor priorities and entitlements are identified and translated without alteration into the bankruptcy forum. Thus, Thomas *et al.*, (2016) adds that a key feature of debt collection theory is that it advocates retaining non-bankruptcy law entitlements in bankruptcy as suggests that the law should not treat creditors of other stakeholders differently in or outside of bankruptcy. While the regime should help a corporation carry on business if it is worth more to creditors as a going concern than it would be wound up, rehabilitation should not be an independent policy objective because it does little to reconcile the diverse interests of creditors.

Conceptual Framework



Credit Risk Analysis: This is the process of determining the likelihood that a specified negative event will occur. Investors and business managers use risk assessments to determine things like whether to undertake a particular venture, what rate of return they require to make a particular investment and how to mitigate an activity's potential losses (Regan & Hur, 2007). A comprehensive risk analysis and mitigation methods for various risk arising from financing activities and from the nature of profit and loss sharing is the source of funds especially investment account holders are explained by Sundararajan (2007). He concludes that the application of modern approaches to risk analysis, particularly for credit and overall banking risks is important for Banks. Also, he suggests that the need to adopt new measures is particularly critical for Banks because of the role they play and the unique mix of risks in finance contracts.

Kimotho and Gekara (2016) conducted a study on the effects of credit appraisal analysis on financial performance of commercial banks in Kenya. The study adopted descriptive research design and the target population consisted of credit risk managers, credit analysts and debt recovery managers from any branch of all commercial banks in Nairobi as licensed by the Central Bank of Kenya. The study used a census method to select the sample size since the target population is manageable. The study revealed that a unit increase in credit appraisal analysis would lead to increase in financial performance of commercial banks in Kenya. This is an indication that there was positive association between credit appraisal and financial performance of commercial banks. Further, it established that client appraisal is a viable strategy for credit and aspects of collateral are considered while appraising clients. Client appraisal considers the character of the customers seeking credit facilities and that commercial banks have competent personnel for carrying out client appraisal.

Credit risk insurance: Credit risk insurance (CRI) is a tool to support lending and portfolio management. It is written by a deep and long-established market. CRI offers banks a means of increasing lending limits on key borrowers and, where approved, reducing risk-weighted assets (RWAs) where it qualifies as a guarantee under banking regulations to deliver credit risk mitigation (Sarra, 2004). In contrast to residual value insurance (RVI), CRI pays compensation in the event of a payment default by a borrower under a loan (Thomas et al., 2016). The eventual sale of the ship constitutes a recovery. Insurers are developing their appetite for shipping and offshore loans and will also cover ports, terminals and aviation assets.

Kimotho and Gekara (2016) conducted a study on the effects of Credit Risk Management Practices on Financial Performance of Commercial banks in Kenya. Specifically, the study examined the effects of credit risk insurance on financial Performance of commercial banks in Kenya. The study adopted descriptive research design. The study used a census method to select the sample size since the target population is manageable. Primary data from the respondents was collected using a semi structured questionnaire. Secondary sources of data gave insights into the concept prior to the study being conducted. The study revealed that a unit increase in credit risk assurance would lead to increase in financial performance of commercial banks in Kenya.

Debt collection practices: Debt Collection practices help a firm to take control of its accounts receivable and save time and potential legal hassle down the road (Anh, 2013). Having debt collection strategies in place helps in identifying the essential elements of effective debt collection and use them to evaluate the policies in place in an organization; ranking accounts to help prioritize and determine an effective and appropriate contact strategy; gathering all information necessary to start building positive relationships with debtors upon first contact; motivating even slow pays, large accounts, and big clients by using benefits rather than consequences; addressing debtors' responses and reasons for nonpayment with positive and productive conversation; remaining calm and cool when clients get hot, and finally negotiating verbal agreements with debtors that will keep repayment on track and on schedule (Adhikary, 2013).

Research Methodology:

This study used a descriptive research design. This design refers to a set of methods and procedures that describe variables. The target population for this study was the heads of credit, risk and finance departments from all the 43 commercial banks in Kenya. The study used proportionate stratification to ensure that the sample size of each stratum is proportionate to the population size of the stratum. This means that each stratum has the same sampling fraction. The sample size of this study was 65 respondents. This study made use of both primary and secondary data. The research instrument generated both quantitative and qualitative data. The data was then presented in tables and graphs. Further, a multiple regression analysis was used to establish the relationship between the dependent and the independent variables.

Research Findings and Discussion

Credit Risk Analysis

The credit, risk and finance managers were asked to indicate how effective credit risk analysis is in reducing non-performing loans in their banks. The results were as presented in Table 1

Table 1 Effectiveness of Credit Risk Analysis in Reducing Non-Performing Loans

	Frequency	Percent
Very effective	9	14.1
Effective	29	45.3
Moderately effective	14	21.9
Not effective at all	12	18.8
Total	64	100.0

From the findings, 45.3% of the credit, risk and finance managers indicated that credit risk analysis was effective in reducing non-performing loans in their banks, 21.9% indicated that it was moderately effective, 18.8% indicated that it was not effective at all and 14.1% indicated that it was very effective. This implies that credit risk analysis was effective in reducing non-performing loans in commercial banks in Kenya. These findings agree with Mimra and Wambach (2014) argument that monitoring of particular credit is done in order to ensure the persistent control on the capability of the client to meet credit obligations.

Credit Risk Analysis and Financial Performance of Commercial Banks: The respondents were requested to indicate whether credit risk monitoring in reducing non-performing loans influences the financial performance of commercial banks in Kenya. The results were as shown in Figure 1.

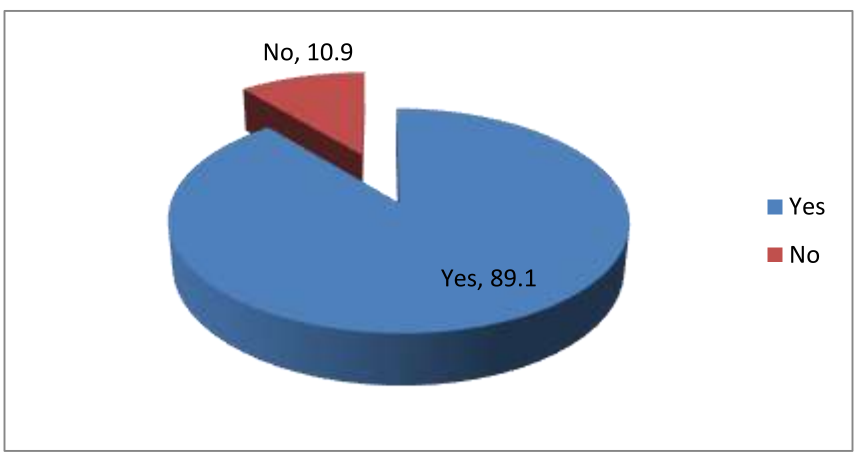


Figure 1 Credit Risk Analysis and Financial Performance of Commercial Banks

According to the findings, 89.1% of the credit, risk and finance managers indicated that credit risk analysis in reducing non-performing loans influences the financial performance of commercial banks in Kenya while 10.9% disagreed. This implies that credit risk analysis in reducing non-performing loans influences the financial performance of commercial banks in Kenya. These findings are in line with Hackmann *et al.*, (2015) findings that financial institutions are monitoring not only particular credit, but also the quality of the whole credit portfolio. The findings also agree with Biwott, Ombui and Kagiri (2014) findings that credit risk analysis improves loan performance in commercial banks in Kenya.

Aspects of Credit Risk Analysis: The respondents were asked to indicate the extent to which various aspects of credit risk analysis influence the financial performance of commercial banks in Kenya. Where 1 was no extent at all, 2 was low extent, 3 was moderate extent, 4 was great extent, 5 was very great extent. The results were as presented in Table 2

Table 2 Aspects of Credit Risk Analysis

	1	2	3	4	5	Mean	Std. Deviation
Credit risk identification	1.6	4.7	12.5	29.7	51.6	4.250	.959
Credit risk evaluation	1.6	1.6	12.5	29.7	54.7	4.343	.876
Credit risk monitoring	9.4	10.9	0.0	25.0	54.7	4.046	1.361
Credit appraisal	0.0	0.0	12.5	45.3	42.2	4.296	.682
Credit risk scoring	0.0	9.4	14.1	25.0	51.6	4.187	1.005
Credit approval process	6.3	10.9	3.1	31.3	48.4	4.069	1.239

According to the findings, as shown in Table 2, the credit, risk and finance managers indicated with a mean of 4.296 that credit appraisal influences the financial performance of commercial banks in Kenya to a great extent. These findings are in line with Kimotho and Gekara (2016) findings that client appraisal is a viable strategy for credit and aspects of collateral are considered while appraising clients. Client appraisal considers the character of the customers seeking credit facilities and that commercial banks have competent personnel for carrying out client appraisal.

In addition, the credit, risk and finance managers indicated with a mean of 4.343 that credit risk evaluation influences the financial performance of commercial banks in Kenya to a great extent. The credit, risk and finance managers also indicated that credit risk identification and credit risk scoring influence the financial performance of commercial banks in Kenya to a great extent, as shown by means of 4.250 and 4.187, respectively. These findings are in line with Ugirase (2013) findings that credit risk scoring and credit analysis and assessment were considered significant to explain the financial performance of commercial banks in Rwanda. Further, the credit, risk and finance managers indicated that credit approval process and credit risk monitoring influence the financial performance of commercial banks in Kenya to a great extent, as shown by means of 4.069 and 4.046, respectively.

Effect of Credit risk analysis on Financial Performance: The respondents were asked to indicate how credit risk analysis affects financial performance. They indicated that credit analysis is the method by which one calculates the creditworthiness of a business or organization. They also indicated that clear established process for approving new credits and extending the existing credits has been observed to be very important while managing credit risks in banks. Monitoring involves, among others, frequent contact with borrowers, creating an environment that the bank can be seen as a solver of problems and trusted adviser; develop the culture of being supportive to borrowers whenever they are recognized to be in difficulties and are striving to deal with the situation; monitoring the flow of borrower's business through the bank's account; regular review of the borrower's reports as well as an on-site visit; updating borrowers credit files and periodically reviewing the borrowers rating assigned at the time the credit was granted. These findings agree with Al-Tamimi and Al-Mazrooei (2007) findings that UAE commercial banks have an efficient risk monitoring and controlling system and it has positive influence on risk management practices.

Credit Insurance

The second objective of the study was to establish the effects of credit insurance on the financial performance of commercial banks in Kenya.

Credit Insurance Policy: The respondents were requested to indicate whether there was a credit insurance policy in their banks. The results were as shown in Figure 2

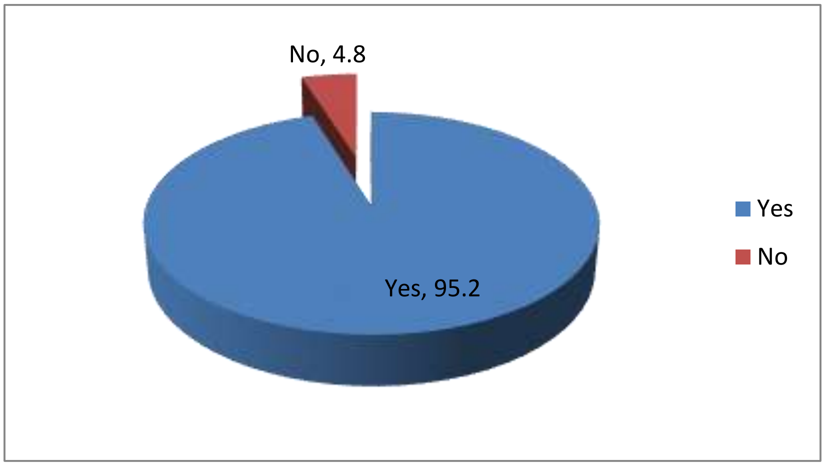


Figure 2 Credit Insurance Policy

According to the findings, 95.2% of the respondents indicated that there was a credit insurance policy in their banks while 4.8% disagreed. This implies that commercial banks in Kenya had a credit insurance policy. These findings agree with Sarra (2004) argument that commercial banks had begun adopting credit insurance policy.

Types of Credit Covered by Insurance Companies: The respondents were asked to indicate the types of credit covered by insurance companies. The respondents indicated that credit covered included asset financing, mortgages, education loans, farming credit, import credit and export credit.

Aspects of Credit Risk Insurance: The respondents were asked to indicate the extent to which various aspects of credit risk insurance as a way of reducing non-performing loans influence the financial performance of their banks. The results were as presented in Table 3.

Table 3 Aspects of Credit Risk Insurance

	1	2	3	4	5	Mean	Std. Deviation
Credit Insurance Policy	0.0	6.3	15.6	25.0	53.1	4.250	.942
Claim upon client default	3.1	4.7	4.7	26.6	60.9	4.380	0.867
Claim upon insolvency	0.0	9.4	7.8	34.4	48.4	4.218	.950
Claim upon Bankruptcy	1.6	3.1	9.4	32.8	53.1	4.328	.891

According to the findings, the credit, risk and finance managers indicated with a mean of 4.380 that claim upon client default as a way of reducing non-performing loans was influencing the financial performance of their banks to a great extent. In addition, the respondents indicated with a mean of 4.328 that claim upon bankruptcy as a way of reducing non-performing loans was influencing the financial performance of their banks to a great extent. Further, the respondents indicated with a mean of 4.250 that credit insurance policy as a way of reducing non-performing loans was influencing the financial performance of their banks to a great extent. These findings concur with Kimotho and Gekara (2016) findings that there was positive association between credit insurance policy and financial performance of commercial banks. Also, the credit, risk and finance managers indicated with a mean of 4.218 that claim upon insolvency as a way of reducing non-performing loans was influencing the financial performance of their banks to a great extent. These findings are in line with Sarra (2004) findings that credit risk insurance (CRI) is a tool to support lending and portfolio management while reducing non-performing loans in financial institutions.

Influence of Credit Insurance on Financial Performance: The respondents were asked to indicate how credit insurance influences the financial performance of their banks. The respondents indicated that credit insurance is a useful tool to insure against the risk of non-payment. They also indicated that credit insurance policy can help to maximize working capital availability and hence improve performance. These findings are in line with Kimotho and Gekara (2016) findings that there was positive association between credit insurance policy and financial performance of commercial banks. The respondents further indicated that credit insurance primarily protects a bank from the impact of bad debts or customer insolvency. If customers fail to pay, the insurance kicks in to ensure the business is not left with a cash flow problem.

Debt collection practices: The third objective of the study was to assess the effects of debt collection practices on the financial performance of commercial banks in Kenya

Offering Training to Staff on Debt Collection: The credit, risk and finance managers were requested to indicate whether their organizations were offering training to their staff on debt collection. The results were as shown in figure 3

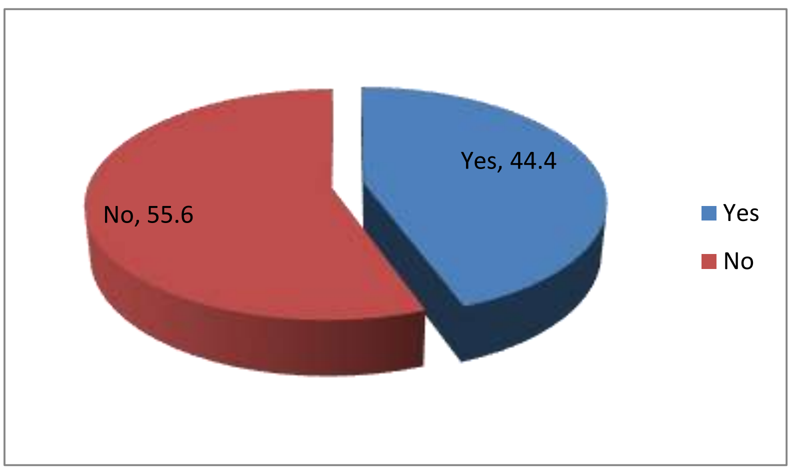


Figure 3 Offering Training to Staff on Debt Collection

From the findings, 55.6% of the credit, risk and finance managers indicated that their institutions were not offering training to their staff on debt collection while 44.4% indicated that they were offering training. This implies that most of the commercial banks in Kenya were not offering training to their staff on debt collection. These findings disagree with Karugu and Ntoiti (2013) findings that collection staffs were trained on relevant legal debt collection resolutions, and their roles and responsibilities in the collections process were well defined.

Debt Collection Practices and Financial Performance: The credit, risk and finance managers were also requested to indicate the extent to which debt collection practices influence the performance of commercial banks in Kenya. The results were as shown in Table 4

Table 4: Debt Collection Practices and Financial Performance

	Frequency	Percent
No extent at all	2	3.1
Low extent	1	1.6
Moderate extent	3	4.7
Great extent	23	35.9
Very great extent	35	54.7
Total	**64**	**100.0**

From the findings, 54.7% of the credit, risk and finance managers indicated that debt collection practices influence the performance of commercial banks in Kenya to a great extent, 35.9% indicated to a very great extent, 4.7% indicated to a moderate extent, 3.1 indicated to no extent at all and 3.1% indicated to a low extent. This findings show that debt collection practices influence the financial performance of commercial banks in Kenya to a great extent. These findings agree with Adhikary (2013) argument that debt collection practices help a firm get results and keep the firm legally compliant with government guidelines and hence influences financial performance.

Aspects of Debt Collection Practices: The credit, risk and finance managers were requested to indicate the extent to which various aspects of debt collection practices influence the financial performance of their commercial banks. The results were as presented in Table 5

Table 5: Aspects of Debt Collection Practices

	1	2	3	4	5	Mean	Std. Deviation
Use of debt collection agencies	1.6	12.5	9.4	15.6	60.9	4.218	.947
Debt recovery departments	4.7	1.6	9.4	35.9	48.4	4.248	.815
Building relationships with debtors	6.3	4.7	3.1	32.8	53.1	4.238	.833
Constant reminders	6.3	3.1	4.7	26.6	59.4	4.296	.922
Litigation	1.6	4.7	7.8	32.8	53.1	4.312	.923
Change of Payment Terms	1.6	0.0	14.1	26.6	57.8	4.390	.847

From the findings, the credit, risk and finance managers indicated with a mean of 4.390 that change of payment terms as a debt collection practice influences the financial performance of their commercial banks to a great extent. In addition, they indicated that litigation and constant reminders as debt collection practices influence the financial performance of their commercial banks to a great extent as shown by means of 4.312 and 4.296.

These findings agree with Mbatha (2013) findings that the main debt collection strategies at Standard Chartered Bank Kenya Limited included litigation, debt collection agencies, change of payment terms and constant reminders. The credit, risk and finance managers indicated that debt recovery departments and building relationships with debtors as debt collection practices had an influence on the financial performance of their commercial banks to a great extent as shown by means of 4.248 and 4.238, respectively. These findings are in line with Kariuki (2011) findings that firms should establish debt collection departments as a way of reducing non-performing loans. They further indicated with a mean of 4.218 that the use of debt collection agencies that as debt collection practices had an influence on the financial performance of their commercial banks to a great extent. These findings are contrary to Mbatha (2013) argument that the most effective debt collection strategies such as change of payment terms and constant reminders while litigation and debt collection agencies were ineffective and costly.

Effects of Debt Collection Strategies on Financial Performance: The respondents were asked to indicate the effects of debt collection strategies on the financial performance of their banks. The results indicated that the popular debt collection strategies that are employed by their banks are, subcontracting of debt collection to third party agents that work on commission and this is also supplemented by use of internal debt collection unit in the banks, adoption of both enforcement and proactive debt collection strategies. The respondents indicated that internal debt collection strategies are updated frequently to cope with the challenges that arise in the operating environment since the market will always develop mechanism to evade paying the rates and levies. These findings agree with Anh (2013) findings that the subcontracting of the debt collection to third parties and the enforcement strategies have a positive relationship with the level of debts while proactive debt collection strategies and the use of internal debt collection units have a positive effect on the level of debt collection in the banks.

The respondents further indicated that the banks have set aside enough resources to facilitate and mobilize the employees working in the debt collection departments to carry out their duties effectively and efficiently. The respondents also agreed that the banks provide vehicles for staff mobilization while carrying out their duties, the bank provides airtime for staff in debt collection department for follow up calls, the bank has enough number of staff in the debt collection department, the employees of the bank are well remunerated to avoid corruption issues and the bank has invested heavily in technological resources to ensure smooth work flow of employees.

Financial Performance of Commercial Banks

The respondents were asked to indicate whether non-performing loans in their banks have been increasing or decreasing for the last five years. The results were as shown in figure 4

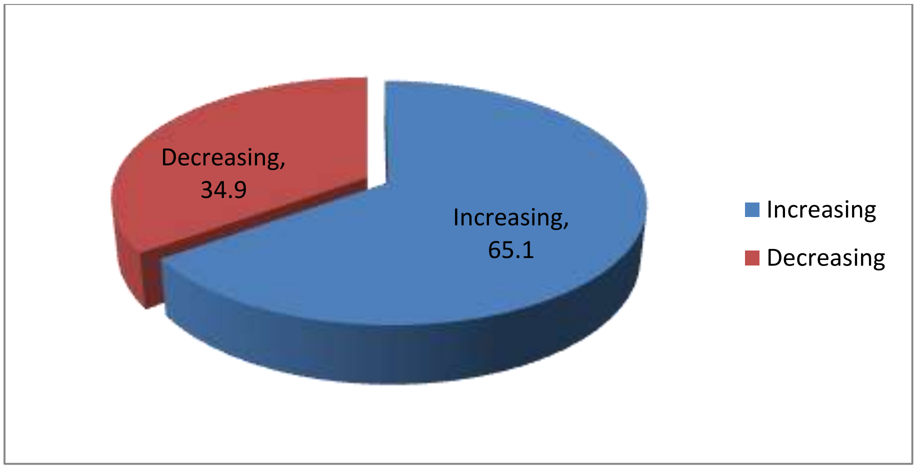


Figure 4: Non Preforming Loans

According to the findings, 65.1% of the respondents indicated that non-performing loans in their banks have been increasing for the last five years while 34.9% indicated that they have decreasing. This implies that non-performing loans in their banks have been increasing for the last five years.

Measures of Financial Performance for the last five years: The following were the measures of the financial performance in commercial banks in Kenya for the last five years. The results were as presented in Table 6.

Table 6: Measures of Financial Performance for the last five years

	2012	2013	2014	2015	2016
Non-performing loans ration	4.7	5.2	5.6	6.8	7.2
Liquidity ration	41.9	38.6	37.7	38.1	37.3
Capital adequacy ration	23	21	20	19	21
ROE	30	29.2	28.2	24.4	24.7
ROA	4.7	4.7	4.46	3.86	3.99

From the findings, non-performing loans ratio or commercial banks in Kenya has been increasing over the years. In the year 2012 it was 4.7%, increased to 5.2% in 2013, 5.6% in 2014, 6.8% in 2015 and 7.2% in 2016. These findings agree with Central Bank of Kenya (2015) report that non-performing loans in commercial banks in Kenya have been increasing over the years.

Liquidity ratio has also been fluctuating over the last five years. In the year 2012 it was 41.9%, decreased to 38.6% in 2013, decreased to 37.7% in 2014, increased to 38.1% in 2015 and decreased to 37.3% in 2016. Similarly, capital adequacy ratio has been fluctuating over the last five years in Kenya. In the year 2012, it was 23%, decreased to 21% in 2013, decreased again to 20% in 2014, decreased again to 19% in 2015 and increased to 21% in 2016.

In the year 2012 return on equity in commercial banks in Kenya was 30%, which decreased to 29.2% in 2013, decreased to 28.2% in 2014, decreased again to 24.4% in 2015 and increased to 24.7% in 2016. This shows that return on equity among commercial banks in Kenya has been fluctuating over the years. In the year 2012, return on assets among commercial banks in Kenya was 4.7%, which remained stagnant in 2013, before decreasing to 4.46% in 2014. This figure decreased to 3.86% in 2015, but increased to 3.99% in 2016. This implies that return on assets among commercial banks in Kenya has been fluctuating.

Inferential Statistics

The study used both correlation analysis and regression analysis to establish the influence of the independent variables (credit insurance, credit risk analysis and debt collection practices) on the dependent variable (financial performance of commercial banks in Kenya).

Correlation Analysis: This study made use of Pearson product-moment correlation analysis to determine whether there is a relationship between the independent variables and the dependent variable. A correlation is defined as a number between -1 and +1 that measures the degree of association between two variables. A positive value for the correlation implies a positive association. A negative value for the correlation implies a negative or inverse association. A coefficient of zero means there is no relationship between the two items and that a change in the independent item will have no effect in the dependent item.

Table 7: Correlation Coefficients

		Financial Performance	**Credit Risk analysis**	**Credit Insurance**	**Debt collection strategies**
Financial Performance	Pearson Correlation	1			
	Sig. (2-tailed)				
	N	64			
Credit Risk analysis	Pearson Correlation	.873**	1		
	Sig. (2-tailed)	.000			
	N	64	64		
Credit Insurance	Pearson Correlation	.894**	.961**	1	
	Sig. (2-tailed)	.000	.000		
	N	64	64	64	
Debt collection strategies	Pearson Correlation	.842**	.971**	.965**	1
	Sig. (2-tailed)	.000	.000	.000	
	N	64	64	64	64

**. Correlation is significant at the 0.01 level (2-tailed).

According to the findings, there is a positive and significant association between credit risk analysis and the financial performance of commercial banks in Kenya as shown by a correlation coefficient of 0.873 and a p-value of 0.000. These findings agree with Sundararajan (2007) findings that the application of modern approaches to risk analysis, particularly for credit and overall banking risks is important for banks.

Further, the findings show that there is a positive and significant association between credit insurance and the financial performance of commercial banks in Kenya. This is shown by a correlation coefficient of 0.894 and a p-value of 0.000. These findings are in line with Kimotho and Gekara (2016) findings that credit risk assurance has an effect on the financial performance of commercial banks in Kenya.

Lastly, the findings show that there is a positive association between debt collection practices and the financial performance of commercial banks in Kenya as shown by a correlation coefficient of 0.842 and a p-value of 0.000, where the p-value was less than 0.05 and hence the association was significant. These findings agree with Kariuki (2011) findings that there is a relationship between debt collection management and financial performance in terms of the profitability, liquidity, solvency, and market ratios.

Regression Analysis: A multivariate regression analysis was used to determine the relationship between the dependent and the independent variables. The multivariate regression model was:

The regression model was;

$$\mathbf{Y=\beta_0 + \beta_1X_1+ \beta_2X_2+ \beta_3X_3 + \pi}$$

Where Y is the dependent variable, financial performance of commercial banks in Kenya and X_1-X_3 were the independent variables; $\boldsymbol{\beta_0}$ is the regression intercept the value of Y when X values are zero and $\boldsymbol{\pi}$= Error term normally distributed about the mean of zero.

Table 8: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.906[a]	.821	.813	.30905

a. Predictors: (Constant), Debt collection strategies , Credit Insurance , Credit Risk analysis

The R-squared is the proportion of variance in the dependent variable which can be explained by the independent variables. From the findings, the R-squared in this study was 0.821, which shows that the three independent variables (credit insurance, credit risk analysis and debt collection practices) can explain 82.1% of the variation in the dependent variable, financial performance of commercial banks in Kenya. This clearly shows that other factors not considered in this study explain 17.9% of the variation in the dependent variable, financial performance of commercial banks in Kenya.

Table 9: Analysis of Variance

Model		Sum of Squares	Df	Mean Square	F	Sig.
	Regression	26.364	3	8.788	92.008	.000[b]
1	Residual	5.731	60	.096		
	Total	32.094	63			

a. Dependent Variable: Financial Performance

b. Predictors: (Constant), Debt collection strategies , Credit Insurance , Credit Risk analysis

From Table 9, the analysis of variance in this study was used to determine whether the model is a good fit for the data. The results indicate that the model was significant since the p-value (0.000) was less than 0.05 thus the model is statistically significance in establishing the influence of credit insurance, credit risk analysis and debt collection practices on the financial performance of commercial banks in Kenya. Further, the F-calculated (92.008) was found to be more than the F-critical (2.5252) which shows that the models was fit in establishing the influence of the four independent variables on the dependent variable.

Table 10: Regression Coefficients

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	.566	.222		2.550	.013
Credit Risk analysis	.416	.182	.562	2.287	.026
Credit Insurance	.887	.199	1.006	4.464	.000
Debt collection practices	.487	.189	.674	2.574	.013

a. Dependent Variable: Financial Performance

From the table above, credit risk analysis has a positive and significant effect on the financial performance of commercial banks in Kenya as indicated by a regression coefficient of 0.416. This shows that a unit improvement in credit risk analysis would lead to a 0.416 increase in the financial performance of commercial banks in Kenya. The relationship was significant as the p-value (0.026) was less than the significance level (0.05). The findings concur with Kimotho and Gekara (2016) argument that there is a positive association between credit appraisal and financial performance of commercial banks.

From the findings, the study found that credit insurance has a positive and significant effect on the financial performance of commercial banks in Kenya as shown by a regression coefficient of 0.887. This indicates that a unit improvement in credit insurance would lead to a 0.887 increase in the financial performance of commercial banks in Kenya. The relationship was found to be significant as the p-value (0.000) was less than the significance level (0.05). These findings concur with Thomas et al., (2016) argument that credit risk insurance influence the financial performance of commercial banks.

Lastly, the study results show that debt collection practices had a positive and significant effect on the financial performance of commercial banks in Kenya as shown by a regression coefficient of 0.487. This indicates that a unit improvement of debt collection practices would lead to a 0.903 increase in the financial performance of commercial banks in Kenya. This relationship was significant as the p-value (0.013) was less that of the significance level (0.05). These findings are in line with Wambugu (2012) debt collection practices had an influence on the financial performance of commercial banks.

This infers that credit insurance influences the financial performance of commercial banks in Kenya most followed by debt collection practices and credit risk analysis had the least influence on the financial performance of commercial banks in Kenya.

Conclusions

The study concludes that credit risk analysis has a positive effect on the financial performance of commercial banks in Kenya. The study found that credit risk identification, credit risk evaluation, credit risk monitoring, credit appraisal, credit risk scoring and credit approval process affect the financial performance of commercial banks in Kenya.

The study further concludes that credit insurance has a positive effect on the financial performance of commercial banks in Kenya. The study established that credit insurance policy, claim upon client default, claim upon insolvency and claim upon bankruptcy were effective in reducing non-performing loans and hence influenced the financial performance of commercial banks.

Lastly, the study concludes that debt collection practices have a positive effect on the financial performance of commercial banks in Kenya. The study found that use of debt collection agencies, debt recovery departments, building relationships with debtors, constant reminders, litigation and change of payment terms were effective in reducing non-performing loans and hence influenced the financial performance of commercial banks.

Recommendations

The study found that credit risk analysis was influencing reducing non-performing loans in commercial banks. Therefore, commercial banks should improve their credit risk monitoring practices like monitoring of clients' credit obligations, monitoring of clients monthly installments and enhance credit risk control.

The study found that credit insurance was playing a major role in reducing non-performing loans and hence influenced financial performance. Thus, commercial banks should extend credit insurance to all types of loans so as to claim the debt from insurance companies upon clients default, insolvency and bankruptcy. This will go a long way in reducing non-performing loans.

The study found that most of the commercial banks in Kenya were not offering training to their staff on debt collection. The study therefore recommends that commercial banks in Kenya should start offering training to their officers on debt collection. This will help in improving their skills on debt collection and hence reduce non-performing loans.

Suggestion for Further Studies

This study was limited to commercial banks in Kenya and hence its findings cannot be generalized to microfinance institutions and SACCOs. The study therefore suggests that similar studies to be conducted in microfinance institutions and SACCOs. The study found that non-performing loans in commercial banks have been increasing for the last five years. The study therefore suggests further studies to be conducted on the factors contributing to the increasing non-performing loans in commercial banks in Kenya.

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