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CREDIT EVALUATION PRACTICES AND PROFITABILITY OF COOPERATIVE BANK, KENYA

George Abuta Abuga[1], Mr. Gerald Atheru[2]

[1,2]Department of Business Administration, School of Business, Kenyatta University, Kenya

Abstract: **The study aimed at assessing the effects of credit evaluation practices and profitability of Co-operative Bank in Kenya. The study population comprised of 94 staff from various management levels in the Bank. The study employed descriptive research design and employed a stratified proportionate sampling. Data was collected using questionnaires. The results of statistical analysis showed that credit evaluation practices positively affect profitability of Cooperative Bank, Kenya. The study recommends that creditors and lenders should use various tools in finance in order to evaluate credit the potential borrower credit worthiness. The bank should provide the lender information about various risk factors related to the loan applicant before providing the loan.**

Keywords: **Credit Evaluation Practices, Profitability.**

1. INTRODUCTION

The concept of fundamental information referencing is good in predicting the behaviour in the past (Powell, Majnoni, Miller & Mylenko, 2004). Credit referencing in a manner in which lenders provide information regarding their customers to a unified pool which can be accessed by all other lenders. According to Kenya Credit Referencing Initiative of 2011 the importance of credit referencing is that it enhances the system of credits efficiently and minimizes costs thus making banks to evaluate credit track of an individual customer in which they are able to lend.

Brown, Jappelli and Pagano (2016) indicate that credit sharing among lenders is based on the increase and manageable cost in transition countries in Eastern Europe. Endurance of a commercial banks in credit market relies on their capability in information collection and processing through professional screening and monitoring performance of those who are applying. Failure to obtain information which is accurate based on the history of credit and present prospect borrower's ability in finance becomes hard to evaluate the credit worthy of lenders and the ability in repaying the loan acquired.

According to Khan and Ahmed (2011) risk management factors by some banks contribute to loan defaulters which included assessment of credit risk management lax procedures, ignoring the process involved in monitoring those who are defaulting loans, loans acquired within, unskilled staff and failure to exercise proper aggressive methods in the collection of credits. Ng'etich (2011) argued that when loans are not performing the quality of assets declines and can affect the asset base of a bank and affects the bank's ability to lend further. These loan default scenarios would reduce the banks interest income.

Tetteh (2012) indicates that proper provision of credits is crucial methods which enhance commercial banks in their financial position. Credit has important role towards the country's growth and development. According to Nwankwo (2012) credit evaluation is a loan function that is basic to minimizing loan loss. Credit evaluation enables the bank to analyse and know the capability of the borrower in repaying the loan applied for.

2. STATEMENT OF THE PROBLEM

According to the statistics of June 2016 provided by the Central Bank of Kenya shows that there was a 36.04% increase in non-performing loans in commercial banks in Kenya compared to the results released in 2015. This led to freezing liquidity among lenders so as to minimize further losses and enable the banks to recover existing loans. This call for a need to give out a credit facility of higher quality to make credit referencing efficient and avoid information asymmetry. According to Stiglitz and Weiss (2015) note that credit risk management enables banks to survive and credit referencing assists in addressing challenges faced in loan defaults.

3. LITERATURE REVIEW

Chepkoech (2014) carried out a study on credit assessment process effects on repayment of bank loans in commercial banks in Kenya. Data collection was by means of a self-completion questionnaire and the annual reports from the publications by the Central Bank of Kenya were used to collect secondary data. The study revealed there were weaknesses in credit appraisal policies (82%), which allowed rogue bank staff to award loans to non-qualifying applicants. The study also revealed that the banks yet to fully integrate computerized credit appraisal techniques to include lie detectors to weed out borrowers who supply false information knowingly.

Kurawa and Garba (2014) study evaluated effect of credit risk management (CRM) effects on the profitability of Nigerian banks. The study recommends that banks' management should be more scientific (application of risk evaluation techniques) in their credit risk assessment and management of loan portfolios in order to minimize the high incidence of non-performing loans and their negative effect on profitability. Tetteh (2012) study focused on credit risk management practices evaluation in Commercial Banks in Ghana. The case study approach was employed where face-to face interview was conducted to collate the views of a senior credit officer at the Ghana Commercial bank Ltd on credit risk management strategies.

4. RESEARCH METHODOLOGY

This research utilized a descriptive design. The target population comprised of 94 respondents. A sample size of 38 respondents was obtained using stratified proportionate random sampling technique. Data was collected using questionnaires to gather information from management staff. Descriptive statistical analysis method was used to analyse the data.

5. FINDINGS

The study sought to find out the influence of credit evaluation practices on profitability of Co-operative Bank in Kenya. The study findings were as presented in the Table 1.

Table 1: Credit Evaluation Practices and Profitability

Statement	1	2	3	4	5	∑fi	∑fiwi	∑fiwi/∑fi
Challenges in selecting the most suitable customer to give loans using judicious loaning	10	8	4	2	1	25	80	3.2
Expanding straightforwardness among establishments.	1	1	2	6	15	25	78	3.12
Candidates over-Indebtedness	9	6	5	4	1	25	54	2.16
Minimization of risk level in banks	7	7	5	4	2	25	76	3.04
Motivating customers to diminish acquisition of cost	5	7	6	4	3	25	55	2.2

From the findings in Table 1, credit evaluation practices have a great impact on challenges in selecting the most suitable customer to give loans using judicious loaning, Expanding straightforwardness among establishments, Expanding straightforwardness among establishments, Candidates over-Indebtedness, minimization of risk level in banks and Motivating customers to diminish acquisition of cost. This indicates that CRBs alternate the lending process within the organization where incentives are offered to promising customers thus minimizing the cost in borrowing and applicants' over-indebtedness. This is consistent with Chepkoech (2014) who carried out a study on the effect of credit assessment process on repayment of bank loans in commercial banks in Kenya and revealed that the banks yet to fully integrate computerized credit appraisal techniques to include lie detectors to weed out borrowers who supply false information knowingly.

6. CONCLUSIONS AND RECOMMENDATIONS

The study aimed to determine the effect of credit evaluation practice on profitability. The results of statistical analysis demonstrated that credit evaluation practice has an effect on profitability. The researcher thus concludes that credit evaluation practice positively affects profitability of Cooperative Bank, Kenya. The study recommends that it is necessary for management of Cooperative Bank to focus on enhancing practices such the borrower's ability, willingness to pay and the chances of loan default. The study also recommends that creditors and lenders should utilize a number of financial tools to evaluate the credit worthiness of a potential borrower. The bank should provide the lender information about various risk factors related to the loan applicant before providing the loan.

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