AN INVESTIGATION OF FACTORS AFFECTING LOAN SUPPLY BY COMMERCIAL BANKS IN KENYA

BY

CHARITY W. MURIUKI
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APRIL, 2012
DECLARATION

This research project is my own original work and has not been presented for award of a degree in any other university.

Signature.................................................. Date..............................
Charity W. Muriuki
D53/PT/CTY/13775/2009

Approved by supervisors

This is to certify that this research project has been submitted for review with our approval as University supervisors:

1. Signature.................................................. Date..............................
Mr. James Muturi
Lecturer; Department of Accounting and Finance

2. Signature.................................................. Date..............................
M/S Farida Abdul
Lecturer; Department of Accounting and Finance

Approval by Chairman of Department

This is to certify that this research project has been submitted for review with my approval as the Chairman of the department.

Signature.................................................. Date..............................
Mr. F. Ndede
Chairman; Department of Accounting and Finance
DEDICATION

This work is dedicated to my parents Mr. Titus Maingi and Mrs. Nancy Wanjiku for instilling value of education in my early life, my husband Francis Muriuki and to my daughters Nancy Wanjiku, Maureen Njeri, Grace Muthoni and Joan Wambui for their unending support and encouragement. May God bless them abundantly.
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<tr>
<td>CBK</td>
<td>Central Bank of Kenya</td>
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<tr>
<td>GDP</td>
<td>Gross domestic product</td>
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<tr>
<td>IMF</td>
<td>International monetary Fund</td>
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<td>KBA</td>
<td>Kenya Bankers Association</td>
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<td>KREP</td>
<td>Kenya Rural Enterprise Programme</td>
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<tr>
<td>NPAs</td>
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<td>ROK</td>
<td>Republic of Kenya</td>
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<td>Rotating savings and credit associations</td>
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DEFINITION OF TERMS

Credit Policy - Bank credit policy is a statement of its philosophy, standards, and guidelines that its employees must observe in granting or rejecting loan request.

Credit risk - Is the possibility of losing the outstanding loan partially or totally, due to credit events (default risk). Credit events usually include events such as bankruptcy, failure to pay and restructuring.

Raison d'être - Is a French word which means the claimed reason for the existence of something or someone; the sole or ultimate purpose of something or someone. It is simply justification for existence

Ex ante - Is a neo-Latin word meaning "before the event"

Ex post - Is a Latin word which means "after the fact". (Is the opposite of ex ante).

Exogenous - It means caused or produced by factors external to a model, organism, organization, or system.

Convexities - A volatility measure for bonds used in conjunction with modified duration in order to measure how the bond's price will change as interest rates change

Diversification - A portfolio strategy designed to reduce exposure to risk by combining a variety of investments, such as stocks, bonds, and real estate, which are unlikely to all move in the same direction.

Fiscal policies - Is the means by which a government adjusts its levels of spending in order to monitor and influence a nation's economy. These policies affect tax rates, interest rates and government spending, in an effort to control the economy.

Rapport - Relationship, especially one of mutual trust or emotional affinity
ABSTRACT

Banks mobilize, allocate, and invest much of society’s savings, so bank performance has substantive repercussions on capital allocation, firm growth, industrial expansion, and economic development. Thus, research on factors affecting loan supply in Commercial Banks and especially on the credit department has important policy implications. This study will investigate the factors affecting loan supply in Commercial Banks in Kenya. Specifically, the study will be determining whether credit policies, interest rates, credit information sharing and competition has any effect on loan supply in Commercial Banks in Kenya. Descriptive survey was used in this study. The population of study consisted of all the 43 commercial banks that were fully registered with Central Bank of Kenya by June 2011. The questionnaire will consist of both open ended and closed ended questions so as to capture the objectives of the study. Data was analyzed by descriptive analysis. Tables and charts were used to summarize responses for further analysis and facilitate comparison. The findings show that majority disagreed that the borrower complies regularly with agreed terms and conditions. Majority agreed that high default rate was witnessed when interest rate was high. The study concluded that credit policies administered by the banks in lending loans affected loan supply. For instance stringent credit policies such as credit worthiness, delays in loan processing, interest rates and security/collateral needed. It was evident that high default rate was witnessed when interest rate was high. The study further concluded that most of the respondents were neutral that business information sharing allows the bank to collaboratively manage credit risk. Thus the researcher recommended that Commercial banks and other formal institutions should provide credit policies that will cater for the credit needs of all consumers mainly their lending terms and conditions. Secondly commercial banks should exchange information about their customers, since it will help them improve their knowledge of applicants’ characteristics, past behavior and current debt exposure.
CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

There are many factors associated with financial institutions, which comprises of bank and micro finance institutions that offer loans (Chudasri, 2002). An analysis of the factors affecting loan supply in financial institutions requires a proper understanding. Among the challenges facing the loan supply in financial institutions include: credit risk, the risk that the loan will not be paid back on time or at all; interest rate risk, the risk that the interest rates priced on bank loans will be too low to earn the bank enough money; liquidity risk, the risk that too many deposits will be withdrawn too quickly, leaving the bank short on immediate cash and lastly inflation in the economy (Ding, 2011).

As is the case the world over, a central bank exists in a country to safeguard the value of its currency in terms of what it can purchase. When prices of goods and services in an economy keep on rising, the value of these goods and services that the currency can purchase diminishes. Monetary policy is the main tool used in the preservation of the value of the currency in an economy. It involves the control of liquidity circulating in an economy to levels consistent with growth and price objectives set by the Government. The volume of liquidity in circulation influences the levels of interest rates, and thus the relative value of the local currency against other currencies.

It is the responsibility of the Monetary Policy Committee to formulate the monetary policy of the Central Bank of Kenya. Maintaining price stability is crucial for a proper functioning of a market-based economy. It encourages long-term investments and stability in the economy (CBK, 1999). According to Bloem, (2002), low and stable inflation refers to a price level that does not adversely affect the decisions of consumers and producers. Price stability is a precondition for achieving a wider economic goal of sustainable growth and employment. High rates of inflation lead to inefficiency in a market economy and, in the medium to longer term, to a lower rate of
economic growth (Ding, 2011). Movements in the general price level are influenced by the amount of money in circulation, and productivity of the various economic sectors, the Central Bank of Kenya regulates the growth of the total money stock to a level that is consistent with a predetermined economic growth target as specified by the Government and outlined in its Monetary Policy Statement (CBK, 1999). In recent decades, a large number of countries have experienced financial distress of varying degrees of severity, and some have suffered repeated bouts of distress (Hardy, 1998).

In the 1980's and early 1990's, several countries in developed, developing and transition economies experienced several banking crises requiring a major overhaul of their banking systems (IMF, 1998). Several developed countries including the USA are experiencing a banking crisis. For example the Citibank group alone, has written off more than $39 billion in losses (Eliot, 2008). Despite the problems facing the global financial market, Canadian banks have remained relatively stable. Eliot (2008) attributes this to a combination of regulatory discipline and cultural mindset among Canadian banks.

According to Ndungu (2011), many financial institutions that collapsed in Kenya since 1986 failed due to non performing loans. Furthermore, Ndungu proceeds to state that Customer failure to disclose vital information during the loan application process has also contributed to a certain extent the collapse of most banks and financial institutions in Kenya. There is also lack of an aggressive debt collection policy which is perceived to be the main bank specific factor, contributing to the non performing debt problem in Kenya. This study closely examines the major factors facing loan supply with reference to Commercial Banks in Kenya.

1.1.1 Commercial Banks in Kenya
The Companies Act, the Banking Act, the Central Bank of Kenya Act and the various prudential guidelines issued by the Central Bank of Kenya (CBK), govern the Banking industry in Kenya. The banking sector was liberalised in 1995 and exchange controls lifted. The CBK, which falls under the Minister for Finance’s docket, is responsible for formulating and implementing monetary policy and fostering the liquidity, solvency and proper functioning of the financial
system. The CBK publishes information on Kenya’s commercial banks and non-banking financial institutions, interest rates and other publications and guidelines (finAccess, 2010).

Currently there are 43 licensed commercial banks and 1 mortgage finance company, fifteen micro finance institutions and forty-eight foreign exchange bureaus in Kenya. Thirty-five of the banks, most of which are small to medium sized, are locally owned (Central Bank of Kenya annual report 2007). The industry is dominated by a few large banks most of which are foreign-owned, though some are partially locally owned. Nine of the major banks are listed on the Nairobi Stock Exchange. The banks have come together under the Kenya Bankers Association (KBA), which serves as a lobby for the banks’ interests and addresses issues affecting member institutions. The commercial banks and non-banking financial institutions offer corporate and retail banking services but a small number, mainly comprising the larger banks, offer other services including investment banking, insurance services and custodial services among others (Dikken and Hoeksema, 2001).

Banks represent a significant and influential sector of business worldwide that plays a crucial role in the global economy. Commercial banks are financial intermediaries that serve as financial resource mobilization points in the global economy. They channel funds needed by business and household sectors from surplus spending to deficit spending units in the economy. A well developed efficient banking sector is an important prerequisite for saving and investment decisions needed for rapid economic growth. A well functioning banking sector provides a system by which a country’s most profitable and efficient projects are systematically and continuously funded. The role of banks in an economy is paramount because they execute monetary policy and provide means for facilitating payment for goods and services in the domestic and international trade (Shambe, 2003).

Commercial banks are custodians of depositor’s funds and operate by receiving cash deposits from the general public and loaning them out to the needy at statutorily allowed interest rates. Loans are based on the credit policy of the bank that is tightly coupled with the central bank interest rate policy. These in effect determine the level of financial risk in a particular bank.
1.2 Statement of the Problem

Commercial banks extend credit to different types of borrowers for many different purposes. For most customers, bank credit is the primary source of available debt financing. For banks, good loans are the most profitable assets. As with any investment, extending loans to businesses and individuals involves taking risk to earn high returns. The provision of credit has increasingly been regarded as an important tool for raising the incomes of populations, mainly by mobilizing resources to more productive uses. Improving the availability of credit facilities to this sector is one of the incentives that have been proposed for stimulating its growth and the realization of its potential contribution to the economy (ROK, 1994). Despite this emphasis, the effects of existing institutional problems, especially the lending terms and conditions on access to credit facilities, and the macro-economic factors have not been addressed; this further has an adverse effect on loan supply in commercial banks.

Studies on financial markets in Africa have shown that credit markets are segmented and unable to satisfy the existing demand for credit especially in rural areas. Whereas for informal markets it is the limited resources that bring the constraint, for the formal sector it is the difficulty in loan administration that is the problem. According to Aryeetey (1996b), credit markets in Africa have mainly been characterized by the inability to satisfy the existing demand for credit. However, whereas for the informal sector the main reason for non-performance of loans is the small size of the resources it controls, for the formal sector it is not an inadequate lending base that is the reason (Nissanke and Aryeetey, 1995). Furthermore, of late banks are known for hawking credit facilities from place to place looking for customers; this could mean that the facility is not fully utilized; but why and the demand for loans is high? This therefore creates a gap that needs to be filled by investigating the factors that affect loan supply in commercial banks despite their adequate lending base.

It is evident that there are a number of studies that have been conducted on the factors affecting the loan supply by financial institutions. Research done in this area close to this are Wanjiru (2000) who undertook a study to determine factors that influence productivity of credit officers in micro finance institutions, Rukwaro (2000) wrote on credit rationing by micro finance institutions and its influence on the operations of small and micro enterprises and indeed concluded that rationing impacts negatively on operations of micro and small enterprises, Kitaka Peter (2001) in his study determined the use of financial performance indicators by micro finance
institutions in Kenya and Mokogi (2003) established the economic implications of lending of micro finance institutions on MSEs.

From the researcher’s observation, little or no study has been conducted in the Kenyan context and thus a study in Kenya could reveal more insights. Therefore, this study will examine factors affecting the loan supply of financial institutions with reference to loan supply in Commercial Banks in Kenya.

1.3 Objective of the Study

1.3.1 General Objective
This Study intended to investigate the factors affecting loan supply in Commercial Banks in Kenya.

1.3.2 Specific Objectives of the Study
The study was guided by the following research objectives:

i. To determine the effect of credit policies on loan supply in Commercial Banks in Kenya.

ii. To determine the effect of interest rates on loan supply in Commercial Banks in Kenya.

iii. To determine the effect of credit information sharing on loan supply in Commercial Banks in Kenya.

iv. To determine the effect of competition on loan supply in Commercial Banks in Kenya.

1.4 Research Questions
The study was guided by the following research questions

i. What are the effects of credit policies on loan supply in Commercial Banks in Kenya?

ii. What are the effects of interest rates on loan supply in Commercial Banks in Kenya?

iii. What are the effects of credit information sharing on loan supply in Commercial Banks in Kenya?

iv. What are the effects of competition on loan supply in Commercial Banks in Kenya?
1.5 Significance of the Study

This study is hoped to be of significance to various stakeholders. These included:

The Bank Management

The findings of the study were expected to shed more light on how various factors that affect the loan supply and ultimately the operations of the entire bank. The findings are hoped to lay ground for designing and implementation of sound strategies to caution the effect of various factors that may affect the smooth running of the bank.

Government

Government plays a critical role in cautioning financial institutions against tough economic times. The findings of this study on how various factors affect the loan supply are hoped to bring about changes in financial policy formulation and implementation.

Scholars

The study findings were expected to arouse curiosity to researchers and scholars to investigate on other factors affecting the financial institutions in Kenya. Further, the study findings were expected to contribute to the global knowledge on the factors affecting the loan supply in Commercial Banks.

1.6 Limitation of the Study

As with any pursuit for information, the researcher expected there to be shortfalls and factors that may hinder access to information. One key limitation that was encountered in this study included, failure of some of the respondents to truly answer to the questions asked about the factors affecting loan supply in Commercial Banks. In some cases the management was not willing to give the expected information while the general staffs of the bank would be sanctioned against giving information to researchers.

Secondly, due to the nature of this research, the data did not reflect the proper representation of the population size, because the sample size was collected from the most convenient areas that have high potential of providing the required data. This study was restricted to head offices in Nairobi. This is to mean that collected data was not having equal representation of all banks around the country.
CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction
This chapter summarizes the information from other researchers who have carried out their research in the same field of study. The specific areas covered here are theoretical; which discusses the theories that support and are related to the study. The next area of discussion is the empirical review then followed by a conceptual framework drawn from the variables in the literature review.

2.2 Financial Intermediation Theory
In order to give firm ground to the study, we will review the doctrines of the theory of financial intermediation. These are specifications, relevant to the financial services industry, of the agency theory, and the theory of imperfect or asymmetric information. Basically, we may distinguish between three lines of reasoning that aim at explaining the raison d'être of financial intermediaries: information problems, transaction costs and regulatory factors.

2.2.1 Asymmetric information Approach
The concept of asymmetric information was first introduced by Akerlof 1970. In the paper, Akerlof develops asymmetric information with the example case of automobile market. His basic argument is that in many financial institutions a system where records are kept for a very short time and immediately erased upon late repayment would exert very little discipline on borrowers and correspondingly provide very little information on their track record to lenders. Akerlof argues that this information asymmetry gives firms which publish complete information on their activity to be better perceived by their creditors and, therefore, can obtain more favorable financial terms. These asymmetries can be of an ex ante nature, generating adverse selection, they can be interim, generating moral hazard, and they can be of an ex post nature, resulting in auditing or costly state verification and enforcement.

The theory of asymmetric information argues that it may be impossible to distinguish good borrowers from bad borrowers (Auronen, 2003), which may result in adverse selection and moral hazards problems. Adverse selection and moral hazards have led to substantial accumulation of non-performing accounts in cooperatives (Bester, 1994; Bofondi and Gobbi, 2003). The very
existence of cooperatives is often interpreted in terms of its superior ability to overcome three basic problems of information asymmetry, namely ex ante, interim and ex post (Uyemura and Deventer, 1993).

The "informational asymmetry" studies focus on the bank/borrower and the bank/lender relation in particular. In bank lending one can basically distinguish transactions-based lending (financial statement lending, asset based lending, credit scoring, etc.) and relationship lending. In the former class information that is relatively easily available at the time of loan origination is used. In the latter class, data gathered over the course of the relationship with the borrower is used (Lehman and Neuberger, 2001; Kroszner and Strahan, 2001; Berger and Udell, 2002). Central themes in the bank/borrower relation are the screening and monitoring function of banks (ex ante information asymmetries), the adverse selection problem (Akerlof, 1970), credit rationing (Stiglitz and Weiss, 1981), the moral hazard problem (Stiglitz and Weiss, 1983) and the ex post verification problem (Gale and Hellwig, 1985). Central themes in the bank/lender relation are bank runs, why they occur, how they can be prevented, and their economic consequences (Kindleberger, 1989; Bernanke, 1983; Diamond and Dybvig, 1983). Another avenue in the bank/lender relationship are models for competition between banks for deposits in relation to their lending policy and the probability that they fulfill their obligations (Boot, 2000; Diamond and Rajan, 2001).

2.2.2 Transaction Costs Approach

The second is the transaction costs approach as discussed by Benston and Smith, 1976; Campbell and Kracaw, 1980; Fama, 1980. In contrast to the first, this approach does not contradict the assumption of complete markets. It is based on non convexities in transaction technologies. Here, the financial intermediaries act as coalitions of individual lenders or borrowers who exploit economies of scale or scope in the transaction technology. The notion of transaction costs encompasses not only exchange or monetary transaction costs (Tobin, 1963; Towey, 1974; Fischer, 1983), but also search costs and monitoring and auditing costs (Benston and Smith, 1976). Here, the role of the financial intermediaries is to transform particular financial claims into other types of claims (so-called qualitative asset transformation). As such, they offer liquidity (Pyle, 1971) and diversification opportunities (Hellwig, 1991). The provision of liquidity is a key function for savers and investors and increasingly for corporate customers,
whereas the provision of diversification increasingly is being appreciated in personal and institutional financing. Holmström and Tirole (2001) suggest that this liquidity should play a key role in asset pricing theory. The result is that unique characteristics of bank loans emerge to enhance efficiency between borrower and lender. In loan contract design, it is the urge to be able to efficiently bargain in later (re)negotiations, rather than to fully assess current or expected default risk that structures the ultimate contract (Gorton and Kahn, 2000). With transaction costs, and in contrast to the information asymmetry approach, the reason for the existence of financial intermediaries, namely transaction costs, is exogenous. This is not fully the case in the third approach.

2.2.3. Regulation of Money Production
The third approach to explain the raison d'être of financial intermediaries is based on the regulation of money production and of saving in and financing of the economy (Guttentag and Lindsay, 1968; Fama, 1980; Mankiw, 1986; Merton, 1995b). Regulation affects solvency and liquidity with the financial institution. Diamond and Rajan (2000) show that bank capital affects bank safety, the bank’s ability to refinance, and the bank’s ability to extract repayment from borrowers or its willingness to liquidate them. The legal-based view especially, sees regulation as a crucial factor that shapes the financial economy (La Porta et al., 1998). Many view financial regulations as something that is completely exogenous to the financial industry. However, the activities of the intermediaries inherently “ask for regulation”. This is because they, the banks in particular, by the way and the art of their activities (i.e. qualitative asset transformation), are inherently insolvent and illiquid (for the example of deposit insurance, see Merton and Bodie, 1993). Furthermore, money and its value, the key raw material of the financial services industry, to a large extent is both defined and determined by the nation state, i.e. by regulating authorities par excellence. Safety and soundness of the financial system as a whole and the enactment of industrial, financial, and fiscal policies are regarded as the main reasons to regulate the financial industry (Kareken, 1986; Goodhart, 1987; Boot and Thakor, 1993). Also, the financial history shows a clear interplay between financial institutions and markets and the regulators, be it the present-day specialized financial supervisors or the old-fashioned sovereigns (Kindleberger, 1993).

Regulation of financial intermediaries, especially of banks, is costly. There are the direct costs of administration and of employing the supervisors, and there are the indirect costs of the
distortions generated by monetary and prudential supervision. Regulation however, may also generate rents for the regulated financial intermediaries, since it may hamper market entry as well as exit. So, there is a true dynamic relationship between regulation and financial production (Kane (1977) and Fohlin (2000).

2.3 Empirical Review

2.3.1 Credit Policies of Banks and Loan Supply

Bank credit policy is a statement of its philosophy, standards, and guidelines that its employees must observe in granting or rejecting loan request. These policies determine which sector of the industry or business will be approved for loans and which will not be approved and must be based on the country’s relevant laws and regulations. Commercial banks and other formal institutions fail to cater for the credit needs of all consumers mainly due to their lending terms and conditions. It is generally the rules and regulations of the formal financial institutions that have created the myth that the poor are not bankable, and since they can’t afford the required collateral, they are considered un-creditworthy (Adera, 1995). Hence despite efforts to overcome the widespread lack of financial services, and the expansion of credit facilities even in the rural areas, majority still have limited access to bank credit services to support their private initiatives; this on the other hand also affects loan supply among commercial banks (Braverman and Guasch, 1986).

The lending policies used by the main credit institutions in Kenya do not ensure efficient and profitable use of credit funds, and also result in a disparity between credit demand and supply (Atieno, 1994). This view is further supported by a 1995 survey by the Kenya Rural Enterprise Programme (KREP) showing that whereas credit is an important factor in enterprise expansion, it will most likely lead to enterprise contraction when not given in adequate amounts (Daniels et al., 1995). Hence, despite the existence of a sophisticated financial system, it has not guaranteed the access to credit.

The criterion of creditworthiness, delays in loan processing and disbursement, and the government approach to preferential interest rates, resulting in non price credit rationing, have limited the amount of credit available to smallholders and the efficiency with which the available
funds are used (Atieno, 1994). This can be seen as an indication of the general inadequacy of the formal credit institutions in meeting the existing credit demand in the country.

Existence of stringent credit policies by commercial banks have given rise to informal credit sources in Kenya which comprises of traders, relatives and friends, ROSCAs, welfare associations, and moneylenders. Ouma (1991) found that 72% of the sample surveyed saved with and borrowed from informal sources. Whereas in the formal credit market only a selected few qualify for the predetermined loan portfolios, in the informal market the diversified credit needs of borrowers are better satisfied. The problems of formal financial institutions, especially security, loan processing, inadequate loans given, unclear procedures in loan disbursement and high interest rates, all underscore the importance of informal credit and this has an effect on the loan supply of commercial banks.

2.3.2 Interest Rates

An interest rate is the cost of borrowing money. Among the many industries affected by fluctuations in interest rates, real estate and banking are perhaps the most directly impacted. When interest rates increase, borrowing becomes more expensive, dampening consumer demand for mortgages and other loan products and negatively affecting residential real estate prices. Rising interest rates can also lead to increased default rates, as holders of adjustable rate debt find themselves faced with higher payments. Vendors of mortgage backed securities, which consist of bundled mortgages, will see their ability to monetize the securities lessens as a result of the deterioration of the quality of the underlying asset.

Some studies have been carried out to examine the effects of interest rates in commercial banks. Wanjau and Ngetich conducted a study to establish the effects of interest rate spread on the level of Non Performing Assets in commercial banks in Kenya. They adopted a descriptive research design on a sample of all commercial banks in Kenya operating by 2008. The study used questionnaires to collect data from primary data sources and secondary data, collected from Bank Supervision Report, to augment the primary data findings. The study used both quantitative and qualitative techniques in data. The data were presented using graphs, table and pie-Charts. The study concludes that interest rate spread affect performing assets in banks as it increases the cost of loans charged on the borrowers, regulations on interest rates have far reaching effects on
assets nonperformance, for such regulations determine the interest rate spread in banks and also help mitigate moral hazards incidental to NPAs. Credit risk management technique remotely affects the value of a bank’s interest rates spread as interest rates are benchmarked against the associated nonperforming assets and non-performing assets is attributable to high cost of loans. The study recommends that commercial banks in Kenya should assess their clients and charge interest rates accordingly as ineffective interest rate policy can increase the level of interest rates and consequently NPAs. They apply stringent regulations on interest rates charged by banks so as to regulate their interest rate spread and enhance periodic/regular credit risk monitoring of their loan portfolios to reduce the level of NPAs.

2.3.3. Credit Information Sharing

In the past decade, we experienced a tremendous expansion of information sharing institutions (World Bank (2006). Information sharing is deemed to be crucial to improve credit market performance (Djankov et al. (2007) and Brown et. al. (2009)). While the impact of information sharing on reducing default rates is less debated (Jappelli and Pagano (2002), and Brown and Zehnder (2007), the impact of information sharing on credit availability and credit rationing is not clear. Brown et al. (2009) report firm-level evidence showing improved access to finance in countries with information sharing institutions. Others find that private credit bureaus, rather than public credit registries, are associated with lower perceived financing constraints and a higher share of bank financing (Love and Mylenko (2003), or that the lowering of reporting thresholds of a public credit registry results in lower lending to firms that had multiple lending relationships (Hertzberg et. al (2008).

By exchanging information about their customers, commercial banks can improve their knowledge of applicants’ characteristics, past behavior and current debt exposure. In principle, this reduction of informational asymmetries can reduce adverse selection problems in lending, as well as change borrowers’ incentives to repay, both directly and by changing the competitiveness of the credit market. It can also reduce each organization’s uncertainty about the total exposure of the borrower, in the context of multiple-bank lending.

A growing body of empirical evidence supports the hypothesis that information sharing enhances credit market performance. Analyses of credit bureau data confirm that credit reporting reduces
the selection costs of lenders by allowing them to more accurately predict individual loan defaults (Barron and Staten, 2003; Kallberg and Udell, 2003; Powell, Miller, Mylenko, and Majnoni 2004; Luoto, McIntosh, and Wydick, 2007). Experimental evidence by Brown and Zehnder (2007) shows that a public credit registry can motivate borrowers to repay loans, when they would otherwise default.

The impact of information sharing on aggregate credit market performance has been tested by two cross-country studies. Based on their own survey of credit reporting in 43 countries, Jappelli and Pagano (2002) show that bank lending to the private sector is larger and default rates are lower in countries where information sharing is more solidly established and extensive. These cross-sectional relations persist also controlling for other economic and institutional determinants of bank lending, such as country size, GDP, growth rate, and variables capturing respect for the law and protection of creditor rights. Djankov et al. (2007) confirm that private sector credit relative to GDP is positively correlated with information sharing in their recent study of credit market performance and institutional arrangements in 129 countries for the period 1978-2003.

2.3.4 Competition and loan supply of Banks

Research has shown that indicators of creditor and shareholder rights, banking and financial regulations, openness of trade and entry, and so forth have important effects on competition among banks and between banks and financial markets, with significant consequences for economic growth (La Porta, Lopez-de-Silanes, Shleifer, and Vishny 1997, 1998).

Some of the recent research on the effects of bank competition allows for the possibility that different sizes of banks may affect competitive conditions differently. Small banks are often considered to be "community banks" with different competitive advantages than large banks. Relative to large banks, small banks in developed nations tend to serve smaller, more local customers, and to provide more retail-oriented rather than wholesale-oriented financial services (DeYoung, Hunter, and Udell 2004). As well, banks of different sizes may deliver their services using different technologies. Large banks may have comparative advantages in lending technologies such as credit scoring that are based on "hard" quantitative data. Small banks, in contrast, may have comparative advantages in lending technologies such as relationship lending that are based on "soft" information that is difficult to quantify and transmit through the communication channels of large banking organizations (Stein 2002) and may create agency
problems that require a closely-held organizational structure (Berger and Udell 2002). Consistent with these arguments, large banks relative to small banks in the U.S. have been found to lend proportionately less of their assets to SMEs (Berger, Kashyap, and Scalise 1995), to lend to larger, older, more financially secure SMEs when they do so (e.g., Haynes, Ou, and Berney 1999), to charge lower rates, earn lower yields, and require collateral less often on their SME loans (Berger and Udell 1996, Carter, McNulty, and Verbrugge 2004), to have shorter and less exclusive relationships (Berger, Miller, Petersen, Rajan, and Stein 2002), to lend more often on an impersonal basis and at a longer distance (Berger, Miller, Petersen, Rajan, and Stein 2002), and to base their lending decisions more on financial ratios than on prior relationships (Cole, Goldberg, and White forthcoming). Thus, the literature is strongly consistent with the hypothesis that large banks tend to make hard-information-based transactions loans to larger, safer, more transparent borrowers, while small banks tend to make more soft-information-based relationship loans to smaller, riskier, more opaque borrowers.

Some research also suggests that foreign-owned banks may compete in different ways from domestically-owned institutions. Foreign-owned banks are also generally part of large banking organizations and so may have many of the same competitive advantages and disadvantages as large banks described above. In addition, foreign-owned banks may have other advantages over domestically-owned banks in serving multinational customers, access to capital, use of technology, and so forth. However, these institutions may also have disadvantages due to managing from a distance, dealing with different economic environments, processing “soft” information about local conditions, and so forth. The research evidence on efficiency and profitability often suggests that the advantages of foreign ownership outweigh the disadvantages on average in developed nations (e.g., DeYoung and Nolle 1996, Berger, DeYoung, Genay, and Udell 2000), and vice versa in developing nations (e.g., Claessens, Demirgüç-Kunt, and Huizinga 2001). Building on this work, one study found that it is regulatory restrictions on the entry of foreign banks, rather than the level of foreign-owned banks, that are robustly linked with bank interest margins (Levine 2003). This suggests that contestability of the market may be crucial for improving performance, rather than the national identity of bank owners.

Studies of the lending behavior of foreign-owned banks in developing nations is often consistent with competitive advantages for these banks in terms of credit availability (Dages, Goldberg, and
Kinney 2000, Clarke, Cull, and Martinez Peria 2002, Berger, Hasan, and Klapper 2004, Clarke, Cull, Martinez Peria, and Sanchez, forthcoming). However, some evidence suggests that foreign-owned banks may have problems supplying credit to informationally opaque institutions (Berger, Klapper, and Udell 2001).

Some of the recent research also takes into account the possibility that state-owned banks may compete in different ways from privately-owned institutions. State-owned institutions often hold substantial market shares in developing nations. State-owned banks generally have objectives other than profit or value maximization. Their stated goals often include developing specific industries, sectors, or regions, assistance to new entrepreneurs, expansion of exports, and so forth, which may result in more competition in these areas and less competition in other banking services hence affecting loan supply in some banks.

2.4 Conceptual Framework

The conceptual framework of the study is based on the relationship between loan supply of financial institution and the various factors affecting the department. These challenges include credit policies by banks, interest rates, credit information sharing and competition (See Figure 2.1).
Figure 2.1 Conceptual framework

Credit Policies of banks
- Guidelines observed in granting loan request,
- criterion of creditworthiness,
- Loan processing and disbursement procedures,
- security/Collateral

Interest Rate
- Risks
- Interest rate policy
- Inflation
- Taxes

Credit Information Sharing
- Shared information about customers
- Default customer rates

Competition
- Lending technologies
- Kind of customers the bank serve
- Nature of financial services

Loan Supply
- The amount of non-performing loans
- Loan disbursement and delinquency rate
- Quality of assets measured by Portfolio Risk

Independent Variables

Intervening variables

Dependent Variable

Source: (Author, 2011)
There are a number of factors affecting loan supply in financial institutions. These include credit policies by banks, interest rates, credit information sharing and competition. Review of literature shows that these factors do affect financial institutions in general. There is need to examine these factors with reference to Commercial Banks in Kenya. This could offer more tangible results which can be used to form a base for the way forward.
CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction
This chapter discusses the research methodology that was used in this study and provides a general framework for this research. The chapter presented details of the research design, target population, sample and sampling procedures, description of research instruments, data collection procedures and data analysis techniques.

3.2 Research Design
Research design is the plan and structure of investigation so conceived as to obtain answers to research questions. The plan is the overall scheme or program of the research (Robson, 2002). In this study, the research problem was best studied through the use of a descriptive survey. Descriptive research portrays an accurate profile of persons, events, or situations (Saunders, Lewis and Thornhill, 2003). Surveys allow the collection of large amount of data from a sizable population in a highly economical way. Therefore, the descriptive survey will be deemed the best strategy to fulfill the objectives of this study.

3.3 Target Population
A population is defined as the total collection of elements about which we wish to make some inferences (Cooper and Schindler, 2003). The population of study consisted of all the 43 commercial banks that were fully registered with Central Bank of Kenya by February 2012. The respondents were heads of credit department of the 43 commercial banks which all had their head office in Nairobi.

3.4 Sampling design and Procedures
“Sampling is the process of selecting a number of individuals for a study in such a way that the individual selected represents the large group from which they are selected.” (Mugenda & Mugenda, 2003: 260). According to Chandran (2003) a sample is a small proportion of an entire population; a selection from the population. According to Donald R. Cooper & Pamela S Schindler (2007) a census is feasible when the population is small and necessary when the
elements are quite different from each other. When the population is small and variable, any sample we draw may not be representative of the population from which it is drawn. No sampling will be carried out in this study since the population is small hence the population will be taken as whole. The population under study was therefore the staffs in the management level in all the 43 commercial banks that were dully registered with Central Bank of Kenya by February 2012.

3.5 Data Collection Instruments and Procedure

Data collection is gathering empirical evidence in order to gain new insights about a situation and answer questions that prompt undertaking of the research (Kothari, 2004). In this research, questionnaires were considered more appropriate. Questionnaires provided a high degree of data standardization and adoption of generalized information amongst any population. According to Davies (1997), they are useful in a descriptive study where there is need to quickly and easily get information from people in a non-threatening way. Secondly, it can cover a large number of people at a relatively affordable cost and it also limits interviewer bias (Mugenda & Mugenda, 2003). Questionnaires were randomly issued to only one credit department staff or manager of the commercial banks under study thus a total of 43 questionnaires was distributed.

3.5.1 Questionnaire

The questionnaires were selected because they were held to be straight forward and less time consuming for both the researcher and the participants (Owens, 2002). Use of questionnaire in this study made it possible to reach staff members of the credit department. The first part of the questionnaire sought the demographic information of the respondents while section two sought to answer the study objectives which guided the researcher in determining the factors affecting the loan supply in Commercial Banks in Kenya. The questionnaire consisted of both open ended and closed ended items that are meant to capture the responses of the respondents regarding the objectives of the study.

The questionnaire were administered by the researcher through direct interaction with the respondents to explain the motive of the study and for purposes of creating rapport that would facilitate the carrying out of interviews with these respondents. The first was designed in such a way that it clearly addressed the objectives of the study.
3.6 Data Analysis Procedure

The questionnaires containing data from the respondents were first edited then coded to facilitate statistical analysis. According to Mugenda (1999), data must be cleaned, coded and properly analyzed in order to obtain a meaningful report. Data collected will be analyzed by descriptive analysis. According to Myers, M. (1997), the descriptive statistical tool helps the researcher to describe the data and determine the extent to be used. These included frequency distribution tables and measures of central tendency (the mean), measures of variability (standard deviation) and measures of relative frequencies among others. The analysis was aided by the SPSS software, which was expected to produce various statistics, which then were applied to analyze the quantitative data in terms of percentages, frequency distribution, means and standard deviations. Tables and charts were used to summarize responses for further analysis and facilitate comparison.
4.1 Introduction
This chapter entails the findings of the study based on the data collected from the field. The study sought to investigate factors affecting loan supply by commercial banks in Kenya. A sample size of 27 banks was used and the information presented in form of pie charts, bar graphs and tables.

4.2 Demographic Information
In order to capture the general information of the respondents issues such as capacity, gender, department, period worked in the organization, highest qualification attained, existence of credit policy, effectiveness and challenges in implementing credit policies were captured in the first section of the questionnaire.

4.2.1 Job Category

According to the findings, 40% of the respondents were in the finance/accounts while 30% were credit managers. On the other hand 20% were risk managers while 10% were branch managers.
4.2.2 Education level

The findings show that 60% indicated that they had attained university education while 40% had college education.

4.2.3 Years of service/working period

The findings show that 60% indicated that they had attained university education while 40% had college education.

The findings show that 60% indicated that they had attained university education while 40% had college education.
The study shows that 50% of the respondents indicated that they had served in the bank for 15 years and above while 30% had served for a period of 10-15 years. Further 15% had worked for a period of 15% while 5% had served for only 0-5 years.

4.2.4 Credit Transactions in a Month

According to the findings, 55% of the respondents stated that they made 50-100 credit transactions within a month while 25% made 100-150 within a month. On the other hand 15% made over 150 credit transactions within a month while 5% made less than 50 credit transactions in a month.

4.2.5 Percentage of loan make up in the loan portfolio

<table>
<thead>
<tr>
<th>Loan type</th>
<th>Percentage composition in the loan portfolio</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Upto20%</td>
</tr>
<tr>
<td>Personal loans</td>
<td>-</td>
</tr>
<tr>
<td>Corporate loans</td>
<td>3</td>
</tr>
<tr>
<td>Business loans</td>
<td>-</td>
</tr>
<tr>
<td>Overdrafts</td>
<td>12</td>
</tr>
</tbody>
</table>
The study shows that most of the banks indicated offered personal loans at a percentage composition of 81% and above while corporate loans were offered at a 20-40%. The banks further indicated that business loans were offered at a percentage composition of 55.5%. Overdrafts were offered at a percentage composition of up to 20%.

4.3 Credit Policies and Loan Supply

This section of the study shows the credit policies and loan supply administered in the banks.

4.3.1 Loan advancement

Table 4.2 Loan advancement

<table>
<thead>
<tr>
<th></th>
<th>No extent</th>
<th>Little extent</th>
<th>Moderate extent</th>
<th>Great extent</th>
<th>Very great extent</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>F %</td>
<td>F %</td>
<td>F %</td>
<td>F %</td>
<td>F %</td>
</tr>
<tr>
<td>Criterion of creditworthiness</td>
<td>- - - -</td>
<td></td>
<td>2 7.4</td>
<td>16 59.3</td>
<td>9 33.3</td>
</tr>
<tr>
<td>Delays in loan processing</td>
<td>- - - -</td>
<td></td>
<td>5 18.5</td>
<td>12 44.4</td>
<td>10 37.0</td>
</tr>
<tr>
<td>Interest rates</td>
<td>- - 3</td>
<td>11.1</td>
<td>- -</td>
<td>11 40.7</td>
<td>13 48.1</td>
</tr>
<tr>
<td>Stringent credit policies</td>
<td>- - 1</td>
<td>3.7</td>
<td>2 7.4</td>
<td>14 51.9</td>
<td>10 37.0</td>
</tr>
<tr>
<td>Security/Collateral needed</td>
<td>- - - -</td>
<td></td>
<td>5 18.5</td>
<td>16 59.3</td>
<td>6 22.2</td>
</tr>
</tbody>
</table>

Majority of the respondents (59.3%) indicated that criterion of creditworthiness on loan advancement was to a great extent while 44.4% stated that delays in loan processing was to a great extent. On the other hand 48.1% said that interest rates was to a very great extent on loan advancement while 51.9% pointed out that stringent credit policies was to a great extent. Further 59.3% indicated that security/collateral needed was to a great extent on loan advancement.
4.3.2 Influence of Credit policies on loan supply

Figure 4.5 Influence of Credit policies on loan supply

According to the findings, 50% stated that credit policies influenced loan supply to a great extent while 30% stated that it was to a very great extent. On the other hand 20% said that credit policies influenced loan supply to a moderate extent.

4.4 Credit Information Sharing

This section outlines ways that the banks conduct information on credit sharing.
### 4.4.1 Credit information sharing

#### Table 4.3 Credit information sharing

<table>
<thead>
<tr>
<th></th>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>F</strong></td>
<td><strong>%</strong></td>
<td><strong>F</strong></td>
<td><strong>%</strong></td>
<td><strong>F</strong></td>
<td><strong>%</strong></td>
</tr>
<tr>
<td>We Share credit report with other banks regarding individual loans repayment history</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>5</td>
</tr>
<tr>
<td>We ensure granting and lending of loans conforms to the approved policy</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Business information sharing allows the bank to collaboratively manage credit risk</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>11</td>
</tr>
<tr>
<td>Business information sharing allows the banks to determine the credit worthiness of its clients</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>3</td>
</tr>
<tr>
<td>Business information sharing helps the bank in the development of a credit policy.</td>
<td>-</td>
<td>-</td>
<td>1</td>
<td>3.7</td>
<td>2</td>
</tr>
<tr>
<td>The borrower complies regularly with agreed terms and conditions</td>
<td>8</td>
<td>29.6</td>
<td>16</td>
<td>59.3</td>
<td>3</td>
</tr>
<tr>
<td>The financial condition of the borrower is regularly tracked understood and communicated effectively</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>2</td>
</tr>
<tr>
<td>The nature and condition of the portfolio is monitored for classification and correct provision in the books of accounts</td>
<td>10</td>
<td>37.0</td>
<td>13</td>
<td>48.1</td>
<td>4</td>
</tr>
</tbody>
</table>

The study shows that 55.6% agreed that banks shared credit report with other banks regarding individual loans repayment history while 66.7% agreed that they ensured granting and lending of loans conforms to the approved policy. Further 40.7% were neutral that business information sharing allows the bank to collaboratively manage credit risk while 63% agreed that business information sharing allows the banks to determine the credit worthiness of its clients. In addition 51.9% strongly agreed that business information sharing helps the bank in the development of a credit policy. However 59.3% disagreed that the borrower complies regularly with agreed terms and conditions. The respondents agreed that the financial condition of the borrower was regularly...
tracked understood and communicated effectively as shown by 66.7% while 48.1% disagreed that the nature and condition of the portfolio is monitored for classification and correct provision in the books of accounts.

4.4.2 Influence of Credit information sharing on loan supply

Forty five percent of the respondents indicated that credit information sharing affected loan supply to a great extent and this was concurred by 30% who stated that the influence was to a very great extent. Further 15% said that the influence was to a moderate extent while 6% and 4% stated that the effect was to a little extent and no extent respectively.

4.5 Effect of interest rate on Loan supply

This section of the study shows the effects that interest rate has on the loan supply.

4.5.1 Effects of Interest when High
Table 4.4 Effects of Interest when High

<table>
<thead>
<tr>
<th></th>
<th>Yes</th>
<th></th>
<th>No</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>F</td>
<td>%</td>
<td>F</td>
<td>%</td>
</tr>
<tr>
<td>High default rate</td>
<td>20</td>
<td>74.0</td>
<td>7</td>
<td>25.9</td>
</tr>
<tr>
<td>Non-performing assets</td>
<td>14</td>
<td>51.9</td>
<td>13</td>
<td>48.1</td>
</tr>
<tr>
<td>Reduction in value of collateral Securities</td>
<td>22</td>
<td>81.4</td>
<td>5</td>
<td>18.5</td>
</tr>
</tbody>
</table>

According to the findings, 74% agreed that high default rate is witnessed when interest rate was high. On the other hand 51.9% indicated that nonperforming assets was evident when the lending interest rate was high while 81.4% said that reduction in value of collateral securities occurred when the interest rate was high.

4.5.2 Effect of Interest rate on loan supply

The study shows that 56% stated that interest rate affected loan supply in banks to a great extent while 30% indicated that it was to a very great extent. Further 14% said that interest rate affected loan supply to a moderate extent.

4.6 Effect of Competition on Loan Supply

The study sought to find out whether competition affected loan supply in banks.
4.6.1 Performance of Loans

Table 4.5 Performance of Loans

<table>
<thead>
<tr>
<th></th>
<th>Very good</th>
<th>Good</th>
<th>Average</th>
<th>Bad</th>
<th>Very bad</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>F %</td>
<td>F %</td>
<td>F %</td>
<td>F %</td>
<td>F %</td>
</tr>
<tr>
<td>Time taken in processing loans</td>
<td>7 25.9</td>
<td>8 29.6</td>
<td>12 44.4</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Timeliness in serving customers</td>
<td>- -</td>
<td>- -</td>
<td>18 66.7</td>
<td>10 37.0</td>
<td>1 3.7</td>
</tr>
<tr>
<td>Management of external debts (if any)</td>
<td>- -</td>
<td>17 63</td>
<td>9 33.3</td>
<td>1</td>
<td>3.7</td>
</tr>
<tr>
<td>Speed of introducing new products (Loans) and services</td>
<td>15</td>
<td>55.6</td>
<td>10 37.0</td>
<td>2 7.4</td>
<td>- -</td>
</tr>
</tbody>
</table>

The respondents indicated that time taken in processing loans was average as shown by 44.4% while 66.7% stated that that there was timeliness in serving customers was average. On the other hand 63% pointed out that management of external debts was good while 55.6% indicated that the speed of introducing new products (loans) and services was very good.
4.6.2 Factors that affect the loan supply in banks

Table 4.6 Factors that affect the loan supply in banks

<table>
<thead>
<tr>
<th></th>
<th>Very great extent</th>
<th>Great extent</th>
<th>Moderate extent</th>
<th>Low extent</th>
<th>No extent</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>F</td>
<td>%</td>
<td>F</td>
<td>%</td>
<td>F</td>
</tr>
<tr>
<td>Buying-off of members loans by other commercial banks</td>
<td>8</td>
<td>29.6</td>
<td>11</td>
<td>40.7</td>
<td>5</td>
</tr>
<tr>
<td>procedures/requirements involved in application of loan</td>
<td>10</td>
<td>37.0</td>
<td>15</td>
<td>55.6</td>
<td>2</td>
</tr>
<tr>
<td>Sales and Marketing campaigns</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>14</td>
</tr>
<tr>
<td>Basing of Loans on performance the clients account</td>
<td>9</td>
<td>33.3</td>
<td>13</td>
<td>48.1</td>
<td>5</td>
</tr>
<tr>
<td>Lack of variety/new loan products</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>3</td>
</tr>
<tr>
<td>Repayment period of Loans</td>
<td>19</td>
<td>70.4</td>
<td>6</td>
<td>22.2</td>
<td>2</td>
</tr>
</tbody>
</table>

The study shows that most of the respondents (40.7%) indicated that buying-off of members loans by other commercial banks affected loan supply in banks to a great extent. Further 55.6% stated that procedures/requirements involved in application of loan affected supply of loans to a great extent. On the other hand 51.9% were moderate that sales and marketing campaigns affected loan supply while 48.1% stated that basing of loans on performance of the clients account affected loan supply in banks to a great extent. In addition 59.3% indicated that lack of variety/new loan products affected loan supply in banks to a low extent while 70.4% stated that repayment period of loans affected loan supply in banks to a very great extent.
4.6.3 Influences of Competition on loan supply in banks

According to the findings, 55% indicated that competition influenced loan supply in banks to a great extent while 30% said that competition influenced loan supply to a very great extent. Further 13% stated that the influence was to a moderate extent while 2% said that the competition influence loan supply to a little extent.
CHAPTER FIVE
SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction
This chapter provides a summary of the findings; the conclusion and the recommendations of the study which sought to investigate the factors affecting loan supply in Commercial Banks in Kenya.

5.2 Summary of Findings
The following were the summary of the research findings upon which the conclusion and recommendations of the study were made. The objective of the study was to investigate the factors affecting loan supply in Commercial Banks in Kenya. Thus the summary of the research questions and findings was done.

5.2.1 Credit Policies and Loan Supply
On credit policies, criterion of creditworthiness on loan advancement was to a great extent, delays in loan processing were to a great extent. On the other hand interest rates was to a great extent on loan advancement while majority pointed out that stringent credit policies was to a great extent. Further a good number indicated that security/collateral needed was to a great extent on loan advancement.

5.2.2 Credit Information Sharing
It was evident that the respondents agreed that banks shared credit report with other banks regarding individual loans repayment history while majority agreed that they ensured granting and lending of loans conforms to the approved policy. Further most of the respondents were neutral that business information sharing allows the bank to collaboratively manage credit risk while majority agreed that business information sharing allows the banks to determine the credit worthiness of its clients. In addition a good number strongly agreed that business information sharing helps the bank in the development of a credit policy. However majority disagreed that the borrower complies regularly with agreed terms and conditions. The respondents agreed that the financial condition of the borrower was regularly tracked understood and communicated
effectively, while most disagreed that the nature and condition of the portfolio is monitored for classification and correct provision in the books of accounts.

5.2.3 Effect of interest rate on Loan supply
According to the findings, majority agreed that high default rate was witnessed when interest rate was high. On the other hand a good number indicated that nonperforming assets was evident when the lending interest rate was high while majority said that reduction in value of collateral securities occurred when the interest rate was high.

5.2.4 Effect of Competition on Loan supply
Time taken in processing loans was average while majority stated that that there was timeliness in serving customers was average. On the other hand a good number pointed out that management of external debts was good while majority of the respondents indicated that the speed of introducing new products (loans) and services was good. The study showed that most of the respondents indicated that buying –off of members loans by other commercial banks affected loan supply in banks to a great extent. Further majority stated that procedures/requirements involved in application of loan affected supply of loans to a great extent. On the other hand the respondents were moderate that sales and marketing campaigns affected loan supply while most stated that basing of loans on performance of the clients account affected loan supply in banks to a great extent. In addition majority indicated that lack of variety/new loan products affected loan supply in banks to a low extent while a good number stated that repayment period of loans affected loan supply in banks to a great extent.

5.3 Conclusions
5.3.1 Credit Policies and Loan Supply
The study concluded that credit policies administered by the banks in lending loans affected loan supply. For instance stringent credit policies such as credit worthiness, delays in loan processing, interest rates and security/collateral needed. This concurs with the findings by (Adera, 1995) that Commercial banks and other formal institutions fail to cater for the credit needs of all consumers mainly due to their lending terms and conditions. It is generally the rules and regulations of the formal financial institutions that have created the myth that the poor are not bankable, and since they can’t afford the required collateral, they are considered un-creditworthy.
5.3.2 Credit Information Sharing

Most of the respondents were neutral that business information sharing allows the bank to collaboratively manage credit risk. However majority disagreed that the borrower complies regularly with agreed terms and conditions. This differs with findings in the literature review that by exchanging information about their customers, commercial banks can improve their knowledge of applicants’ characteristics, past behavior and current debt exposure. In principle, this reduction of informational asymmetries can reduce adverse selection problems in lending, as well as change borrowers’ incentives to repay, both directly and by changing the competitiveness of the credit market. It can also reduce each organization’s uncertainty about the total exposure of the borrower, in the context of multiple-bank lending.

5.3.3 Effect of interest rate on Loan supply

It was evident that high default rate was witnessed when interest rate was high. Lending interest rate was high and the reduction in value of collateral securities occurred when interest rate was high. This concurred findings in the literature review that stated that when interest rates increase, borrowing becomes more expensive, dampening consumer demand for mortgages and other loan products and negatively affecting residential real estate prices. Rising interest rates can also lead to increased default rates, as holders of adjustable rate debt find themselves faced with higher payments. Vendors of mortgage backed securities, which consist of bundled mortgages, will see their ability to monetize the securities lessens as a result of the deterioration of the quality of the underlying asset.

5.3.4 Effect of Competition on Loan supply

It was concluded that competition affected loan supply. Buying -off of member’s loans by other commercial banks affected loan supply in banks. Procedures/requirements involved in application of loan affected supply of loans and basing of loans on performance of the clients account. Repayment of loans by the clients affected loan supply in the banks. This is in agreement with findings of (Stein 2002) that, banks of different sizes may deliver their services using different technologies. Large banks may have comparative advantages in lending technologies such as credit scoring that are based on “hard” quantitative data. Small banks, in contrast, may have comparative advantages in lending technologies such as relationship lending.
that are based on “soft” information that is difficult to quantify and transmit through the communication channels of large banking organizations.

5.4 Recommendations

5.4.1 Credit Policies and Loan Supply
Commercial banks and other formal institutions should provide credit policies that will cater for the credit needs of all consumers mainly their lending terms and conditions. The rules and regulations to obtain financial services should favorable to enable expansion of credit facilities even in the rural areas. The lending policies used by the main credit institutions in Kenya should ensure efficient and profitable use of credit funds, and thus reduce disparity between credit demand and supply.

5.4.2 Credit Information Sharing
Information sharing is deemed to be crucial to improve credit market performance. Thus when commercial banks exchange information about their customers, they can improve their knowledge of applicants’ characteristics, past behavior and current debt exposure. This reduction of informational asymmetries can reduce adverse selection problems in lending, as well as change borrowers’ incentives to repay, both directly and by changing the competitiveness of the credit market. It can also reduce each organization’s uncertainty about the total exposure of the borrower, in the context of multiple-bank lending. Information sharing will enhance credit market performance in commercial banks by reducing the selection costs of lenders by allowing them to more accurately predict individual loan defaults.

5.4.3 Effect of interest rate on Loan supply
The study recommends that commercial banks in Kenya should assess their clients and charge interest rates accordingly as ineffective interest rate policy can increase the level of interest rates and consequently NPAs. They should further apply stringent regulations on interest rates charged by banks so as to regulate their interest rate spread and enhance periodic/regular credit risk monitoring of their loan portfolios to reduce the level of NPAs.
5.4.4 Effect of Competition on Loan supply

Commercial banks should have objectives that are aligned to benefits of profit or value maximization. Their stated goals should include developing specific industries, sectors, or regions, assistance to new entrepreneurs, expansion of exports, and so forth. The commercial banks should ensure comparative advantages in lending technologies such as credit scoring that are based on “hard” quantitative data so as to remain competitive and offer loans at a favorable rate that are enticing to their clients.

5.5 Suggestions for Further Studies

The research recommends the following areas for studies. The data collection was based on questionnaires. Further research can be carried by involving the respondents on discussions so as to generate workable solutions so as to find out the factors affecting loan supply by commercial banks in Kenya. Additional research should be carried out on government initiatives to control lending rate among the commercial banks. Moreover more research could be carried out on factors that affect the performance of commercial banks; and the adoption of new products in commercial banks.
REFERENCES


Djankov, S., C. McLiesh and A. Shleifer (2007): “Private Credit in 129 Countries”,


http://www.mku.ac.ke/journals
APPENDICES

Appendix I: Introduction Letter

Kenyatta University
Faculty of Accounting and Finance
School of Business Department
P.O. Box 80344
Nairobi

Dear Respondents,

I am a Masters of Business Administration student at Kenyatta University. I am conducting a Research Study to examine the factors affecting loan supply in financial institutions, specifically at Kenya Commercial Bank. You have been selected to take part in this study. I would be grateful if you would assist me by responding to all items in the attached interview guide.

Your name does not need to appear anywhere in this guide. The information will be kept confidential and will be used for academic research purpose only. Your cooperation will be greatly appreciated.

Thanks in advance.

Yours Sincerely,

Charity Muriuki.
Appendix II: Questionnaire

Please fill in all parts as sincerely as possible by putting a tick on one of the options given, where applicable. For those that require your opinion, please use the space provided.

SECTION A: Demographic Questions

1. Name of your organization .................................................................

2. Please indicate your job category
   - Finance / Accounts [ ] Credit managers [ ]
   - Risk manager [ ] Branch Managers [ ]

3. What is your education level? (Tick as applicable)
   - College [ ] University [ ]
   - Others-specify ..............................................................................

4. Years of service/working period (Tick as applicable)
   - 0-5 yrs [ ]
   - 5-10 yrs [ ]
   - 10-15 yrs [ ]
   - 15 yrs and above [ ]

5. How many credit transactions are done in your Branch within a month?
   - Less than 50 [ ]
   - 50 – 100 [ ]
   - 100 – 150 [ ]
   - Above 150 [ ]
6. Indicate the approximate percentage the following type of loan make up in the loan portfolio held in the bank.

<table>
<thead>
<tr>
<th>Loan type</th>
<th>Percentage composition in the loan portfolio</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Upto 20%</td>
</tr>
<tr>
<td>Personal loans</td>
<td></td>
</tr>
<tr>
<td>Corporate loans</td>
<td></td>
</tr>
<tr>
<td>Business loans</td>
<td></td>
</tr>
<tr>
<td>Overdrafts</td>
<td></td>
</tr>
<tr>
<td>Others (specify)</td>
<td></td>
</tr>
</tbody>
</table>

**Section B: Credit Policies and Loan Supply**

7. To what extent has a client declined loan advancement due to the following reasons. Use a scale of 1-5 where; 1 is No extent, To a little extent, To a moderate extent, To a great extent, To a very great extent

<table>
<thead>
<tr>
<th>Reason</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>criterion of creditworthiness</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Delays in loan processing</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest rates</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>stringnet credit policies</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Security/Collateral needed</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

8. In general, to what extent do credit policies influence loan supply in your bank?

- To a great extent ( )
- To a very great extent ( )
- To a moderate ( )
- To a little extent ( )
- No extent ( )
Credit Information Sharing

9. To what extent do you agree with the following statements on Credit information sharing. Use 1- Strongly disagree, 2- Disagree, 3- Neutral, 4- Agree, 5- Strongly agree.

<table>
<thead>
<tr>
<th>Statement</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>We Share credit report with other banks regarding individual loans repayment history</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>We ensure granting and lending of loans conforms to the approved policy</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Business information sharing allows the bank to collaboratively manage credit risk</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Business information sharing allows the banks to determine the credit worthiness of its clients</td>
<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Business information sharing helps the bank in the development of a credit policy</td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>The borrower complies regularly with agreed terms and conditions</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The financial condition of the borrower is regularly tracked understood and communicated effectively</td>
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<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The nature and condition of the portfolio is monitored for classification and correct provision in the books of accounts</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

10. In general, to what extent do credit information sharing affect loan supply in your bank?

   To a great extent ( )   To a very great extent ( )   To a moderate ( )
   To a little extent ( ) No extent ( )
11. Effect of interest rate on Loan supply

When interest rate is high does it have effect on lending please tick all that applies.

<table>
<thead>
<tr>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>High default rate</td>
<td>()</td>
</tr>
<tr>
<td>Non-performing assets</td>
<td>()</td>
</tr>
<tr>
<td>Reduction in value of collateral Securities</td>
<td>()</td>
</tr>
</tbody>
</table>

12. In general, to what extent do interest rate affect loan supply in your bank?

To a great extent ( )  To a very great extent ( ) To a moderate ( )
To a little extent ( )  No extent ( )

Effect of Competition on Loan supply

13. How would you rate the performance of loans in the following areas during the last one year? Please tick the appropriate rating for each dimension.

<table>
<thead>
<tr>
<th></th>
<th>Very good</th>
<th>Good</th>
<th>Average</th>
<th>Bad</th>
<th>Very bad</th>
</tr>
</thead>
<tbody>
<tr>
<td>Time taken in processing loans</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Timeliness in serving customers</td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Management of external debts (if any)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Speed of introducing new products (Loans) and services</td>
<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
</tbody>
</table>
14. To what Extent does the following affect the loan supply among bank? Use a scale of 1-5 where 1 is To a very great extent, 2 is To a great extent, 3 is To a moderate extent, 4 is To a Low extent, 5 is to no extent

<table>
<thead>
<tr>
<th></th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buying-off of members loans by other commercial banks</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>procedures/ requirements involved in application of loan</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sales and Marketing campaigns</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Basing of Loans on performance the clients account</td>
<td></td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Lack of variety/new loan products</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Repayment period of Loans</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

15. On overall, to what extent does competition from other financial institutions affect loan supply in your bank?

To a very great extent ( )  To a great extent ( )  To a moderate extent ( )
To a Low extent ( )  To a very low extent ( )
Appendix III: List of Commercial Banks

1. African Banking Corporation
2. Bank of Africa
3. Bank of Baroda
4. Bank of India
5. Barclays Bank of Kenya
6. CFC Bank
7. Chase bank
8. Citibank
9. City Finance bank
10. Commercial Bank of Africa
11. Consolidated bank
12. Co-operative bank of Kenya
13. Daima bank (Statutory)
14. Development bank of Kenya
15. Diamond Trust bank
16. Dubai bank
17. Eco bank
18. Equatorial Commercial bank
19. Equity bank
20. Euro Bank
21. Family bank
22. Fidelity Commercial
23. Fina bank
24. Giro commercial bank
25. Guardian bank
26. Habib A.G.Zurich
27. Habib bank
28. Imperial Bank
29. Investment and Mortgages bank
30. Kenya Commercial bank
31. Kenya Post Office Savings Bank
32. K-Rep bank
33. Middle East bank
34. National bank of Kenya
35. National Industrial Credit bank
36. Oriental Commercial bank
37. Paramount Universal bank
38. Prime Bank
39. Southern Credit bank
40. Stanbic bank
41. Standard Chartered bank
42. Trans-National bank
43. Victoria Commercial bank

Source: (CBK, 2012)