Kabarak Journal of Research & Innovation Volume 5 Number 1 (2017)
ISSN 2305-784X (print) ISSN 2410-8383 (online) http://eserver.kabarak.ac.ke/ojs/

# Effectiveness of Credit Reference Bureau on Enhancing Financial Performance: A Survey of Financial Institutions in Nakuru County, Kenya

Ruthwinnie Munene* and Monicah Wanjiru
School of Business & Economics, Kabarak University, Kenya

*Submitted: 5th November 2015; Accepted: 29th October 2016; Published online: 21st July 2017*

**Abstract**
The study examined the effectiveness of credit reference bureau on the financial Performance in financial institutions in Nakuru County. The Study used a survey study research design. The population of the study involved 210 employees of financial institutions in Nakuru County. The study obtained primary data by the use of self-administered Questionnaires while review of related literature was used to collect secondary Data. The Primary data was analyzed using descriptive statistics. The researcher used the statistical Package for Social Sciences (SPSS) version 17 in analysis for the Study. The findings of the study were expected to provide a source of information for banking professionals to understand, control and to reduce the impact of increasing non-performing loans from the economy due to credit risk. CRB has played a significant role in as far as risk identification and monitoring is concerned. Moreover, CRB has significantly helped reduce the rate of loan default in the economy as well as increasing credit access. Lastly, it has led to a reduction in the level of moral hazard in financial institutions in Nakuru county.It has been deduced that clients are not getting appropriately rewarded for having a good credit repayment history. Measures need to be put in place to ensure that clients get an advantage for promptly repaying their loans in terms of the interest rate they pay. It is hoped that this will help cushion those with a good credit rating from CRB hence increasing efficiency in the banking sector.

Key words: Credit reference bureau, Financial Performance: Financial Institution

## ACRONYMS & ABBREVIATIONS

CBK -Central Bank of Kenya
CIS- Credit Information Sharing
CRB- Credit Reference Bureau
FI- Financial Institutions
HELB- Higher Education Loans Board
NPA- Non-Performing Assets
NPLs -Non- Performing Loans
PAR- Portfolio at Risk
PCR -Public Credit Registries

## INTRODUCTION

All over the world, financial institutions face enormous risks of non-performing loans (NPLs). To overcome this challenge, an institution is required to monitor the behavior of borrowers. Thus, the idea of establishing Credit Reference Bureau (CRB) was conceived in order to enable financial institutions to determine credit worthiness of their borrowers and to reduce the loan default risk (Epure and Lafuente, 2012). In this respect, CRB assists in sharing information on default among banks and eliminating those borrowers who may have the aim of borrowing from different financial institutions with the aim of defaulting. CRB allows for credit information sharing among financial institutions. Thus Credit Reference Reports help banks stem out malpractices in the banking sector since customers whose credit reports indicate as having been

* *Corresponding Author Email: ruthwinniem@gmail.com;*

involved in malpractices are subjected to stringent terms and conditions. This is also expected to help banks suppress the levels of NPLs while increasing their loan books. To bank customers, credit information sharing is expected to minimize the problem of information asymmetry in the financial sector (Epure and Lafuente, 2012). Information asymmetry between banks and borrowers is one of the main contributors to high cost of credit. To this end, banks tend to load a risk premium to borrowers because of lack of customer information. This in turn, increases cost of borrowing, meaning repayment of loans go up which translates to a high level of default. The Credit Information Sharing (CIS) mechanism is therefore expected to facilitate the development of information capital to increase information symmetry and allow cost of credit to decline substantially.

**Role of Credit Reference Bureau, CRB**

CRB is a company that collects information from various sources and provides consumer credit information on individual consumers for a variety of uses. It provides detailed information on a person's credit history, including information on their identity, credit accounts and loans, bankruptcies and late payments and recent inquiries. Other information shared include: proven frauds and forgeries; cheque kiting; false declarations and statements; receiverships, bankruptcies and liquidations; credit default and late payments; use of false securities; and misapplication of borrowed funds. Prospective lenders access the information only when they have permissible reason as defined in law, to determine the borrower's creditworthiness (Sullivan and Sheffrin, 2003). The individual information collected by CRBs is made available on request to customers of the credit bureau for the purposes of credit risk assessment, credit scoring or for other purposes such as employment consideration or leasing an apartment. Generally, CRB enables financial institutions to lend to more and better risky clients and to determine better the bad loans that they need to cover expected losses of credit to good payers. Second, credit bureaus reduce the borrowing cost by forcing creditors to be more competitive for good borrowers. Those lower costs for good credit risks motivate those borrowers to be more careful with repayment. Third, credit bureaus reduce moral hazard by developing a credit culture where they operate as borrowers become aware that credit market becomes aware of their credit history and rewards or punishes them accordingly (Sullivan and Sheffrin, 2003). According to Sinare (2008) CBRs are information brokers, providing creditors with reliable, relevant and comprehensive data on the repayment habits and current debt of their credit applicants. Under reciprocity agreements, credit bureaus obtain data from creditors and other 3 sources, consolidate and package information into individual reports, and distribute it to creditors for a fee. Lewis (2004) indicates that most financial institutions and most creditors prefer hard collateral-based credit but would extend cash flow-based credits if they can use a reliable and inexpensive system to exchange information on the character and ability to pay of borrowers. The need for establishment of CRB services in any financial system arises because of information asymmetry between lenders and borrowers (Psillaki, Tsolas, and Margaritis, 2010). When financial institutions compete with each other for customers, multiple borrowing and over-indebtedness increases loan default unless the financial institutions have access to databases that capture relevant aspects of clients' borrowing behavior. The CRB contributes significantly to reduction in the costs of screening loan applications by enabling the lender to sort out prospective borrowers who have defaulted with other lenders.

Research by Armstrong (2009) based on information from several countries across the globe shows that the existence of credit registries is associated with increased lending volume, growth of consumer lending, improved access to financing and a more stable banking sector. Further, Hansen et al, (2004) have highlighted that many borrowers make a lot of effort to repay their loans, but do not get rewarded for it because their good repayment history is not available to the bank that they approach for new loans. Whenever borrowers fail to repay their loans, banks are forced to pass on the cost of defaults to other customers through increased interest rates and other fees. Credit reporting allows banks to better distinguish between good and bad borrowers. Angulin and Scapens (2009) indicated that it is difficult to have accurate information on the financial ability of prospective borrowers and even more difficult to have accurate information on their credit history. This makes it extremely difficult for the lenders to assess the credit worthiness of potential borrowers and their ability to pay the loans. For many years, financial institutions in Kenya have had to contend with having incomplete information about borrowers that in turn translate to higher risk premiums on interest rates. Perennial defaulters had been the cause of high lending rates (Rukwaro, 2001). Currently, credit information sharing is a mechanism introduced by Central Bank requiring all banks to share data on the credit history of their customers. This information is shared by banks through credit reference bureaus when they want to establish the credit worthiness of a customer seeking a loan. Banks and other credit providers use credit reports obtained from credit bureaus as part of the lending decision process. Walsh (2003) warns that having only one half of the picture (negative information) runs the risk of it becoming the only deciding factor. Credit bureaus enable lenders to lend to more and better risk clients and to determine better the bad loan spread that they need to cover expected losses of credit to good payers. Those lower costs for good credit risks motivate those borrowers to be more careful with repayment (Djankov, McLiesh & Shleifer, 2005). Fulton (2004) indicated that originally, the credit approval decision was made using a purely judgmental approach by merely inspecting the application form details of the applicant and commonly focused on the values of the 5 Cs of a customer. These 5Cs are Character which measures the borrower's character and integrity including virtues like reputation and honesty; Capacity which measures the borrower's ability to pay for example job status, source of income and finally Conditions where the members' borrowing circumstances are evaluated for example market conditions, competitive pressure, and seasonal character (Bessis, 2003). Risk identification is vital for effective risk management. With the presence of a CRB, there is strong motivation for clients to repay their loans. In the case of this may lead to improved financial performance.

**CRB and Financial Performance**

Financial performance is defined as subjective measure of how well a firm can use assets from its primary mode of business to generate revenues (Waweru & Kalani, 2009). This term is also used as a general measure of a firm's overall financial health over a given period of time, and can be used to compare similar firms across the same industry or to compare industries or sectors in aggregation. There are many different ways of measuring financial performance, but all measures are taken in aggregation. Line items such as revenue from operations, operating income or cash flow from operations, as well as total unit sales can be used in measuring the financial performance. The emergence of Credit Reference bureaus has significantly revolutionized lending and contributed to the improved financial performance of many financial institutions in Kenya. Before the introduction of CRB, many borrowers used to borrow from one institution to the other without being identified. This led into many financial institutions experiencing immense losses as a result of NPLs. Through the use of CRB, the banks are in a position to obtain detailed information on a person's credit history, including information on their identity, credit accounts and loans, bankruptcies and late payments and recent inquiries. Other information shared include: proven frauds and forgeries; cheque kiting; false declarations and statements; receiverships, bankruptcies and liquidations; credit default and late payments; use of false securities; and misapplication of borrowed funds (CBK, 2009). Schreiner (2010) indicates that financial institutions are facing an enormous risk of NPLs noting that larger loans have greater risk exposure, so the variable costs per-dollar is higher. If lenders don't take extra care, there could be more loan defaults. CRB enables banks to determine credit worthiness of their borrowers and therefore reducing the loan default risk. In this respect CRB assists in first, sharing information on default among banks; secondly, eliminating corrupt borrowers, and thirdly, to provide commercial professional credit reference to prospective foreign investors; and also to identify credible borrowers based on known history and character.

**Statement of the Problem**

The high financial cost of borrowing generally reduces the borrowers' repayment capacity thus resulted in credit risk. An increase in credit risk is a critical source of economic distortion and stagnation which must not only be monitored but also controlled. In response, credit reference bureau has been used to manage credit risk in the financial sector. However studies have not been done to find out its effectiveness on addressing credit access and financial performance in financial institutions. This research sought to investigate this problem in Equity bank Nakuru.

**Purpose of the Study**

The purpose of the study was to assess the effectiveness of credit reference bureau and its impact on financial performance of Equity Bank Nakuru.

**Objectives of the Study**

The specific objectives of the study were; to find out whether CRB enhances risk identification in financial performance in Equity Bank. To establish whether CRB influences the rate of credit repayment enhancing financial performance in Equity Bank. Identify the influence of CRB on credit access in enhancing financial performance at Equity Bank and to identify the rate of reduction on moral hazard in enhancing financial performance in Equity Bank.

**Significance of the Study**

The findings of this study may help financial institutions in formulating effective policies related to credit access in FI institutions in Nakuru Town. The findings of the study may also be used by policy makers, researchers and microcredit professionals to understand and control the impact of increasing non-performing loans from the economy due to credit risk. Finally, the findings of the study may provide rich data for further research by university students specializing in finance and the general public interested in understanding the dynamics in the financial sector.

**Scope of the Study**

The extent of this study was restricted to analyzing the effectiveness of credit reference bureau on credit control and credit access in FI in Nakuru Town. The study focused on the influence of CRB on credit access, credit risk identification and loan repayment and moral hazard at Equity

Bank Nakuru . Equity Bank was chosen for this study due to its unique credit policy which relies mainly on borrowers CRB reports.

**Limitation of the Study**

Some respondents were not able to give relevant information because information on finance may be regarded as sensitive and confidential. Also the distribution and collection of the questionnaires was be time consuming and costly because the researcher collected them at the convenience of the respondents who work on a busy schedule. In addition the nature of data obtained from the study was influenced by the quality of the questionnaires.

**Study Assumptions**

The study assumed the following information that the information provided by the CRB was accurate concerning the credit risk of the prospective borrower. The financial institutions had full knowledge about the operations of the CRB and the customers were aware of the existence of the CRB.

## THEORETICAL FRAMEWORK

### Moral Hazard Theory

Moral hazard refers to the risk in which a party to a transaction provides misleading information about its assets, liabilities or credit capacity, or has an incentive to take unusual risks in a desperate attempt to earn a profit before the contract settles (Myerson, 2011). Usually a party to a transaction may not enter into the contract in good faith, thus providing misleading information about its assets, liabilities or credit capacity. Problems of moral hazard in financial institutions are evident at many stages of the recent financial crises (Myerson, 2011). This theory is considered relevant in this study since borrowers and lenders tend to conceal crucial information pertaining to the lending and borrowing agreement.)

### Adverse Selection Theory

Stiglitz and Weiss (1981) originated the concept of adverse selection. The theory rests on two main assumptions: that lenders cannot distinguish between borrowers of different degrees of risk, and that loan contacts are limited. This analysis is restricted to involuntary default, i.e., it assumes that borrowers repay loans when they have the means to do so. In a world with simple debt contacts between risk-neutral borrowers and lenders, the presence of limited liability of borrowers imparts a preference for risk among borrowers, and a corresponding aversion to risk among lenders. This is because limited liability of borrowers implies that lenders bear all the downside risk. On the other hand, all returns above the loan repayment obligation accrue to borrowers. Raising interest rates would affect the profitability of low risk borrowers disproportionately, causing them to drop out of the application pool. However, excess demand in the credit market may persist even in the face of competition and flexible interest rates. In the adverse selection theory, the interest rate may not raise enough to guarantee that all loan applicants secure credit, in times when loanable funds are limited. In general, borrowers who have greater wealth to put as collateral obtain cheaper credit and have incentives to work harder, and earn more income as a result. Reduction of informational asymmetries can reduce adverse selection problems in the lending, as well as change borrowers' incentives to repay (Pagano and Jappelli, 1993).

**Credit Rationing Theory**

According to Stiglitz and Weiss (1981), asymmetric information leads to credit rationing, as lenders cannot distinguish between high quality and low quality borrowers. However, De Meza and Webb (1987) showed that asymmetric information in credit markets can lead to the inverse result, which is an excess of credit or over lending. For banks to exist they have to screen and monitor borrowers more efficiently than other investors (Allen and Santomero, 1998). They are specialized in gathering private information about potential loan applicants (Freixas and Rochet, 1999). Nevertheless banks may suffer from informational asymmetries (Freixas and Rochet, 1999) such that evolution of prices cannot clear the credit market. Stiglitz and Weiss (1981) proved that credit rationing occurs if banks charge the same interest rate to all borrowers, because they cannot distinguish between borrowers and screening borrowers perfectly is too expensive. Banks are usually able to distinguish their borrowers up to a certain degree.

According to World Bank Survey (2009) about 60 countries have Public Credit Registries (PCRs). PCRs contain information on the performance of borrowers in financial systems and are administered and maintained by the central bank. The region with the highest coverage of public credit registries is Latin America, where 17 countries have established PCRs, including all the largest economies (Argentina, Brazil, Chile, Colombia, and Mexico). The first countries to establish public credit registries were in Western Europe – Germany in 1934 followed by France in 1946. By the mid-1960s, three other European countries – Italy, Spain and Belgium – had also established PCRs. Early adopters included the former French colonies in Western Africa which formed the West African Monetary Union in 1962 and immediately established public credit reporting following the French example. Also several Middle Eastern and North African nations adopted PCRs in the 1950s and 1960s (Egypt, 1957; Tunisia, 1958; Morocco, 1966; Jordan, 1966; and Turkey, 1951). The PCRs in Argentina and Brazil were established in the 1990s in response to financial crises also with the primary goal of supporting banking supervision. Over time, though, these registries were transformed to also enhance the information in private financial institutions.

**Credit Reference Bureaus in Kenya**

The operations, establishment, governance and management of CRBs is provided through the banking (Credit Reference Bureau) regulations of 2008. Establishment and licensing of credit reference bureaus in Kenya, is through an entity incorporated as a limited company under the companies Act and application for a license is made through the Central Bank of Kenya. A licensed bureau may engage in activities such as storing and updating the customer information, maintaining database and generating reports and assessing the creditworthiness of a customer.

**CRB as a Credit Risk Management**

One of the factors that banks consider when deciding on a loan application is the estimated chances of recovery (CBK, 2010). To arrive at this, information is needed on how well the applicant has paid past loans. This information is vital because there is usually a definite relationship between past and future performance in loan repayment. According to Chen and Pan (2012), CRB can be used to control losses from the refusal or inability of customers to pay what is owed in full and on time. In this way CRB maximizes bank's risk adjusted rate of return by maintaining credit risk exposure within acceptable limit in order to provide framework for understanding the impact of credit risk management on banks' profitability (Kargi, 2011).

Demirguc-Kunt and Huzinga (1999) have noted that the use of CRB as a credit risk management is in two-fold which includes, the realization that after losses have occurred, the losses becomes unbearable and the developments in the field of financing commercial, securitization, and other non-bank competition which pushed banks to find viable loan borrowers. According to Kithinji (2010) CBR may insure financial institutions against limited institutional capacity, inappropriate credit policies, volatile interest rates, poor management, inappropriate laws, low capital and liquidity levels, direct lending, massive licensing of banks, poor loan underwriting, laxity in credit assessment, poor lending practices, government interference and inadequate supervision by the central bank. However, managing financial resources by way of lending and borrowing is a key operational function of any financial system (Mohamud, 2009). Paroush (1999) argues that commercial banks plays an important and effective role in attracting investors with surplus wealth and divert these resources towards those having scarcity of financial resources. Consequently compensation is expected by resource owners for deferred spending of their savings. This is the cost ultimately born by the borrowers willing to repay additional sums on the borrowed money (Wong, 2002).

**Effects of CRB on Loan Repayment**

Managing financial resources by way of lending and borrowing is a key operational function of any financial system (Mohamud, 2009). Therefore loan repayment is very important. According to Hou (2007) a loan is considered as performing if the principal and interest is being paid in accordance with the agreed contractual terms of repayment. Failure to pay loans promptly may limit credit access. According to Hou (2007) inadequate access to credit limits people from a fair share of resources in society, depriving them of basic needs and opportunities in life. Universally, financial institutions are facing problems of non-repayment of loans. This problem can be overcome through monitoring the behavior of borrowers. Thus, the idea of establishing CRB is appropriate in managing potential loan default. Studies show that CRBs allows for credit information sharing among the financial institutions (Epure and Lafuente, 2012).With CRB a report is generated containing detailed information on a person's credit history, including information on their identity, credit accounts and loans, bankruptcies and late payments, and recent enquiries. Hull (2008) acknowledges that CRB endures that only those with repayment capacity get access to loans. Keys (2008) points out that financial institutions that have embraced CRB are can lend at a reasonable interest rate because there are fewer provisions of bad debts.

The high financial cost of borrowing generally reduces the borrowers' repayment capacity which results in credit risk. If the credit risk can be controlled it can lead to increased access to credit. This implies that credit risk is a critical source of economic distortion and stagnation which must not only be monitored but also controlled. Other researchers have recently reviewed the influence of CRB on credit access. For instance Sigei (2010) investigated the effectiveness of credit reference bureau in Kenya. His study revealed that CRBs play an important role in preventing serial loan defaulters from accessing credits from other financial institutions thus cushioning financial institutions against unforeseen credit risks. Similar sentiments are also shared by others researchers (Mumi, 2010; Gaitho, 2010; Nganga, 2011).

**Credit Risk Management and Financial Performance of Financial Institutions**

Credit risk is a serious threat to the performance of banks; therefore various researchers have examined the impact of credit risk management on banks in varying dimensions. Kargi (2011) evaluated the impact of credit risk on the profitability of banks. Financial ratios as measures of bank performance and credit risk were collected from the annual reports and accounts of sampled banks from 2004-2008 analyzed using descriptive, correlation and regression techniques. The findings revealed that the use of CRB and other credit risk management has a significant impact on the profitability of banks. Kargi (2011) concluded that banks' profitability is inversely influenced by the levels of loans and advances, non-performing loans and deposits thereby exposing them to great risk of illiquidity and distress. Epure and Lafuente (2012) examined bank performance in the presence of risk for Costa-Rican banking industry during 1998-2007. The results showed that performance improvements follow regulatory changes and that risk explains differences in banks and non-performing loans negatively affect efficiency and return on assets while the capital adequacy ratio has a positive impact on the net interest margin. Kithinji (2010) assessed the effect of credit risk management on the profitability of commercial banks in Kenya. Data on the amount of credit, level of non-performing loans and profits were collected for the period 2004 to 2008. The findings revealed that the bulk of the profits of commercial banks are not influenced by the amount of credit and non-performing loans, therefore suggesting that other variables other than credit and non-performing loans impact on profits. Felix and Claudine (2008) investigated the relationship between CRB and bank performance. It could be inferred from their findings that return on equity (ROE) and return on assets (ROA) both measuring profitability were inversely related to the ratio of non-performing loan to total loan of financial institutions thereby leading to a decline in profitability. Ahmad and Ariff (2007) examined the key determinants of credit risk of commercial banks on emerging economy banking systems compared with the developed economies. The study found that regulation is important for banking systems that offer multi-products and services; management quality is critical in the cases of loan-dominant banks in emerging economies. An increase in loan loss provision is also considered to be a significant determinant of potential credit risk. The study further highlighted that credit risk in emerging economy banks is higher than that in developed economies. Al-Khouri (2011) assessed the impact of bank's specific risk characteristics, and the overall banking environment on the performance of 43 commercial banks operating in 6 of the Gulf Cooperation 19 Council (GCC) countries over the period 1998-2008. Using fixed effect regression analysis, results showed that in circumstances that credit risks, management were evident, bank performance generally high. Ben-Naceur and Omran (2008) in attempt to examine the influence of bank regulations, concentration, financial and institutional development on commercial banks' margin and profitability in Middle East and North Africa (MENA) countries from 1989-2005 found that bank capitalization and credit risk management have positive and significant impact on banks' net interest margin, cost efficiency and profitability. Ahmed, Takeda and Shawn (1998) in their study found that loan loss provision has a significant positive influence on non-performing loans. Therefore, an increase in loan loss provision indicates an increase in credit risk and deterioration in the quality of loans consequently affecting bank performance adversely.

## Research Methodology

The study used a case study research design. The case study design was used because it gives a description behind the results by capturing whatever happens and gives opportunity to highlight and bring attention to particular challenges (Neale et al, 2006). The population of the study involved the staff of Equity bank Nakuru because they have adequate knowledge on CRB as a credit risk management strategy. Equity Bank has several employees ranging from administrators, credit officers, banking officers and information technology officers but the target population would be the credit officers of whom were involved in the study. The study obtained primary data by the use of self-administered questionnaires. To collect primary data, questionnaire was used because they were valuable methods of collecting a wide range of information from a large number of respondents and they are usually straightforward to analyze. The permit for the study was obtained from the branches managers of Equity bank. The instrument was piloted using 6 finance officers as respondents drawn from Rafiki bank in Nakuru Town. The said respondents had similar characteristics as the population of the actual study.

## DATA PRESENTATION AND ANALYSIS

### Response Rate

The researcher found out that 90% of the respondents accepted to fill and return the questionnaires while 10% of the respondents never responded.

### Gender analysis

The analysis of the gender, determined the level of gender sensitivity of the results showing that, 25
of the 32 respondents from the organization selected, 62 % were male and 38% were female. These results show that the research study carried out at Equity Bank was gender sensitive.

### Age Analysis

The research showed that 72% of the respondents belonged to the 20-45 year bracket which 28% belonged to the above 45 age bracket. The researcher deducts that most of the organizational policy makers at Equity Bank belong to the 20-45 age brackets.

### Working experience

The working experience distribution shows that 60% of the respondents had 1-10 years' work experience. 22% of the respondents had more than 10 years' work experience whereas 18% of the respondents had less than one year experience. The results of the findings imply that most of policy makers in the selected organization had about 1-10 years of work experience.

**Table 1: Frequency of failure to meet terms of contract**

| | | |
|---|---|---|
| Always | 5 | 17% |
| Sometimes | 16 | 56% |
| Rarely | 7 | 24 |
| Never | 1 | 3% |

Data in Table 1 show that, out of the 32 respondents 29 responded of customers having failed to meet the terms of the contract which constitute 91% while only 3 responded of customers never failing to honor the contract which is only 9%.

**Table 2:Techniques of managing risk**

| Technique | Distribution | Percentage | |
|---|---|---|---|
| Collateral | 28 | 88% | |
| Guarantees | 3 | 9% | |
| Netting off loan | 1 | 3% | |

Majority of the commercial banks 88% use collateral to manage risk with only 9 % using guarantees and 3% using Netting off loan (Table 2).

**Table 3: Financial Risk Encountered**

| Risk | Distribution | Percentage |
|---|---|---|
| Legal | 13 | 41% |
| Operational | 9 | 28% |
| Liquidity | 1 | 3% |
| Market risk | 9 | 28% |

The results in table 3 shows that the major risk facing commercial banks is the legal risk with 41% followed by operational and market risk with 28% respectively with only 3% being liquidity risk.

**Table 4: Consideration of Past and Future Payment before awarding loans**

| **Consideration** | **Frequency** | **Percentage** |
|---|---|---|
| **Past** | **28** | **94** |
| **Future** | **2** | **6** |

The results in table 4 shows that 94% of commercial banks consider past payments performances before awarding loans with only a minority of 2% considering future payment before awarding loans.

**Table 5: ROLES OF CRB on financial performance.**

| Role | Frequency | percentage |
|---|---|---|
| Control losses from customers failure to repay loan | 16 | 50% |
| Maintain credit risk exposure within acceptable limit | 16 | 50% |

The results in table 5 show that CRB equal roles in controlling losses from customers failure to repay loan and maintaining credit risk exposure with acceptable limit with equal response of 50% respectively.

**Table 6: Bank experiences non-performing loans**

| Response | Frequency | Percentage |
|---|---|---|
| Yes | 30 | 94% |
| No | 2 | 6% |

The results in table 6 shows that majority of the banks experience non-performing loans with 94% response rate with only 6% not experiencing non-performing loans.

## INDICATORS OF LOAN REPAYMENT

From the response received 72% of the respondents state that despite the importance of a good repayment history, it does not come with rewards during the loan process.94% of the respondents concur that credit reporting allows banks to distinguish between good and bad borrowers.84% of the respondents state that CRB is the best way to determine credit worthiness of a prospective borrower.69% of the respondents concur that CRB enables customers repay their loans promptly probably due to fear of listing. The second response on loan repayment was whether the bank relies on credit reports to establish on customers repayment behavior. Of the 32 respondents who responded 25 responded of the bank having to rely on credit reports which constitute 78% while 7 responded of the bank not relying on credit reports which is 28%.

**Table 7: Reliance of CRB credit report to issue loans**

| Response | Frequency | Percentage |
|---|---|---|
| Yes | 25 | 78% |
| No | 7 | 22% |

The results in table 7 shows that majority of commercial banks rely on CRB credit report to issue loans with 78% response rate with minority not relying on credit report to issue loans with 22% response rate.

**Table 8: Indicators of negative credit scores**

| **credit score** | **Frequency** | **Percentage** |
|---|---|---|
| Late payment | 15 | 46% |
| Bankruptcy | 5 | 16% |
| Fraud charges | 4 | 13% |
| Foreclosures | 1 | 3% |
| Loss of employment | 7 | 7 |

The results in table 8 shows that the major indicator of negative credit score is late payment with 46% response rate, followed by bankruptcy with 16%, Fraud charges 13%, loss of employment 7% and foreclose 3% respectively.

## CRB INFLUENCE ON CREDIT ACCESS

The results showed that 28 respondents agree that CRB does influence on credit access which constituted 88% of the respondents while only 4 gave no answers which translate to 12%.

## CRB AND MORAL HAZARD

### Influence of CRB on rate of moral hazard

67% (22 out of 32) of the respondents agreed that indeed it influenced the rate of moral hazard.

**Disclosure of all material information and CRB influence before disbursement**

Of the 32 respondents who responded the highest percentage of 63% agreed that all information is revealed and 48% also agreed that CRB influences bank decision before disbursement whereas 19% strongly agreed on the first parameter of revealing all information 31% strongly agreed on CRB influence before disbursement. 2 % did not have information whether the bank reveals information whereas1% also did not have information on whether the CRB influences the bank decision before disbursement 9% disagreed on first parameter whereas 9% disagreed on the CRB influence before loan disbursement. Of the total 9% strongly disagreed on revealing of information in the contract while 9 % also strongly disagreed on the CRB influence before disbursement of the loan.

## FINDINGS DISCUSSIONS, CONCLUSIONS AND RECOMMENDATIONS

From the findings it shows that CRB has had a significant impact on credit risk identification and monitoring at Equity bank it has also has had a positive influence on the rate of loan repayment in addition to ensuring that access to credit has improved this also result to high rate of moral hazard at Equity bank Nakuru. For the first objective, the researcher wanted to find out the influence of CRB on risk identification and monitoring at Equity Bank Nakuru. 94 % of the respondents stated that the bank considers the credit history of the prospective borrower with an aim of carrying out due diligence on the borrower. This is made possible by pulling the CRB report of any prospective borrower. As a result, 91% of the respondents stated that clients meet the terms of the contract. These high percentages are attributable to the presence of the CRB clearly demonstrating that CRB has had a positive impact on credit risk identification and monitoring at Equity Bank Nakuru. For the second objective, the researcher used a Likert scale to ascertain whether CRB has influenced the rate of credit repayment at Equity Bank Nakuru. 69% of the respondents felt that CRB has enabled clients promptly repay their loans while a further 84% argued that CRB is the best way to determine credit worthiness. Of importance to note is that 72% of the respondents felt that clients do not necessarily get rewarded because of their good repayment history. These responses can be interpreted to mean that whilst clients will be quick to repay their loans because of the fear of getting listed, a good 44 repayment history is no guarantee that the client will be rewarded in future. This is because there are other considerations to be made when determining whether or not to advance a facility. That said, CRB remains a potent avenue of determining credit worthiness. The third objective was interested in determining whether or not CRB has influence on the rate of credit access in Equity Bank Nakuru. 88% of the respondents felt that CRB has led to increased access to credit. This is because as the rate of non-performing loans reduces due to the significant impact that CRB has had, we are bound to witness a reduction in interest rates as the risk premium comes down resulting in increased capacity to lend by the bank notwithstanding the increased attractiveness of the loans in the market. The fourth objective focused on moral hazard. That is, has CRB influenced the rate of moral hazard in Equity Bank Nakuru? 88% of the respondents stated that they understood the concept of moral hazard and a further 67% of the respondents stated that indeed CRB has had positively influenced the rate of moral hazard in Equity Bank Nakuru. This phenomenon can be attributed to the fear of getting listed and the consequences thereof that is prevalent among clients.

### Conclusions

This research was conducted within the planned time frame and the findings showed that the answers to the research questions were met and therefore this research can be concluded that; CRB has played a significant role in as far as risk identification and monitoring is concerned. Moreover, CRB has significantly helped reduce the rate of loan default in the economy as well as increasing credit access.

Lastly, it has led to a reduction in the level of moral hazard in Equity Bank Nakuru.

**Recommendations**

From the study, it has been deduced that clients are not getting appropriately rewarded for having a good credit repayment history. Measures need to be put in place to ensure that clients get an advantage for promptly repaying their loans in terms of the interest rate they pay. This is what is envisioned in the recently introduced annual percentage rate (APR) method of pricing loans where one Kenya Bank's Reference Rate (KBRR) currently capped at 9.13% is applicable for all commercial banks. It is hoped that this will help cushion those with a good credit rating from CRB hence increasing efficiency in the banking sector. Moreover, more needs to be done in as far as updating client data by CRB. This stems from the current practice where some clients who have cleared their facilities find themselves listed because of failure by the CRB to update their records on time. A more efficient CRB is vital if the objectives of CRB are to be met and also for the financial health of the entire industry. Also, more needs to be done in terms of sensitization among the target population. This is because some clients have not yet gotten to the point of appreciating the process of getting listed and the consequences of getting listed. Quite a good number of clients get shocked when they find out they are listed showing they were not aware. Lastly, efforts need to be harnessed to ensure all financial institutions subscribe to CRB. This is a departure from the current practice where only the Banks and large micro finance organizations use CRB. As the number of Sacco's increase in the economy, these also need to be brought under the jurisdiction of CRB so as to increase efficiency in the Kenyan financial market.

## REFERENCES

Achou, T. K. (2008). Bank performance and credit risk management; Unpublished Masters Project, University of Skovde, Sweden.

Ahmad, N. H. and Ariff, M. (2007). Multi-Country Study of Bank Credit Risk Determinants, *International Journal of Banking and Finance*, 5(1), 135-152.

Ahmed, A. S., Takeda, C. and Shawn, T. (1998). Bank Loan Loss Provision: A Reexamination of Capital Management and Signaling Effects, Working Paper, Department of Accounting, Syracuse University, 1-37.

Al-Khouri, R. (2011). Assessing the Risk and Performance of the GCC Banking Sector, *International Journal of Finance and Economics*, ISSN 1450-2887, Issue65, 72-8.

Allen F, Santomero A., (1998). The theory of financial intermediation. *Journal of Banking and Finance*, 21, 1461-1485.

Andrew, P., Nataliya, M., Margaret, M. & Giovanni, M. (2006). Improving credit information, bank regulation and supervision: The role and design of public credit registries. *Journal of Corporate Finance*, 9, 25-30.

Anita, M. (2001). Credit Bureaus: A necessity for microfinance. *India Working paper no*. 2001-11-01.

Barron, J. M. & Staten, M. (2003). *The value of comprehensive credit reports*: Lessons from the U.S. Experience; Boston, MIT Press.

De Meza D. E., Webb, D. C. (1987). Too much investment: A problem of asymmetric information. *Quarterly Journal of Economics*, 102, 281-292.

Demirguc-Kunt, A. and Huzinga, H. (1999). Determinants of Commercial Bank Interest Margins and Profitability: Some International Evidence, *The World Bank Economic Review*, 13(2), 379-40.

Diamond, D., Rajan R., (2001). Liquidity risk, creation and financial fragility: A theory of banking. *Journal of Political Economy*, 2, 287-327.

Drehman, M., Sorensen, S. & Stringa, M. (2008). The Integrated Impact of Credit and Interest Rate Risk on Banks: An Economic Value and Capital Adequacy Perspective, *Bank of England Working Paper* No.339.

Epure, M. and Lafuente, I. (2012). Monitoring Bank Performance in the Presence of Risk, Barcelona GSE Working Paper Series No.61.

Felix, A.T and Claudine, T. N (2008). Bank Performance and Credit Risk Management, Unpublished Masters Dissertation in Finance, University of Skovde.

Freixas, X., Rochet J. (1999). Microeconomics *of banking*. MIT Press: Cambridge (Mass.)

FSD Kenya (2008). *Financial education in Kenya*, FSD Kenya.

Gieseche, K. (2004). Credit Risk Modelling and Valuation: An Introduction, Credit Risk: *Models and Management*, Vol.2, Cornell University, London.

Hardy, D. (1998). *Are banking crises predictable?* ; Finance & Development, IMF Quarterly Magazine.

Hoque, M, Z. (2009). Flawed working capital loan policy and loan default: Evidences from Bangladesh, *Journal of Accounting, Business and Management*, Vol.11, No. 2 .202- 13.

Jappelli, T, & Marco, P. (1993). Information sharing in credit markets, *Journal of Finance. 45 (2). 17-19.*

Jappelli, T. and Pagano, M. (2002): Information sharing, lending and defaults: Cross-country evidence, *Journal of Banking & Finance*, 5(3), 19-27.

Jevgenijs, S. F. H, and Mehnaz, S. (2006). *Unlocking dead capital: How reforming collateral laws improves access to finance*; A Paper presented at the Korean Finance Association Annual Meeting.

Jin, G. Z. (2005).Competition and disclosure incentives: An empirical study of HMOs, *Rand Journal of Economics.*

José, L. N. (2001). Credit information sharing mechanisms in Mexico: Evaluation, perspectives, and effects on firms' access to bank credit, *Working Paper No. 114.*

Kallberg, J. G., and Udell, G. F. (2003). The value of private sector credit information, *Journal of Banking and Finance.*

Kargi, H. S. (2011). Credit Risk and the Performance of Nigerian Banks, Ahmadu Bello University, Zaria.

Kenya Commercial Bank (1999). Chief executive reassures shareholders on bank's growth [online] available: http://www.kcb.co.ke/news/newsarticle.asp.

Kevin, G. & Tiffany, G. (2010). Forecasting non performing loans in Barbados: *Business, Finance & Economics in Emerging Economies* vol. 5.