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EFFECT OF CREDIT DOCUMENTATION ON LOAN PORTFOLIO PERFORMANCE IN COMMERCIAL BANKS IN MOMBASA COUNTY: A CASE OF KENYA COMMERCIAL BANK

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ABSTRACT

The main objective of the study was to investigate the effect of credit documentation on loan portfolio performance among Kenyan commercial banks. The study targeted 76 management staff of the Kenya Commercial Bank. The study adopted descriptive research design. Stratified sampling technique was used to select the sample size. The sample of 64 was calculated using the mathematical approach developed by Miller and Brewer. A structured questionnaire was used to collect data from the respondents. A pilot study was conducted prior to undertaking the main study with the aim of testing the instrument's reliability and validity. The collected data was analyzed both descriptively and inferentially. The study established that the bank usually finds out the customer's past transactions before authorizing any loan. The findings revealed that majority of the respondents agreed with the statement that past transactions determine the amount of loan issued and the bank usually research on the customers' commercial relationships with other entities before giving them loans. The study further established the bank always require the customer to provide credit reference report. The findings revealed that the bank always researches the customer's credit history before issuing loans and the bank always determine the customer's ability to pay before authorizing any loans. The study concluded that in order to minimize on non-performing loans, the bank usually searches for customer's past transactions before authorizing any loan to the customer. This is done by checking the historical data of the customer from credit bureau. It was concluded that the amount of loan given to the applicant is dependent on the individuals past transactions and the bank usually research on the customers' commercial relationships with other entities before giving them loans. The study recommended that banks should issue loans based on the amount to be repaid by the customer since it was established that repayment amount is an important determinant of our portfolio performance while loan repayment period is an important determinant of the bank's loan portfolio performance. The bank should come up with a mechanism to justify the source of loan repayment prior to any loan authorization.

Key Words: *Credit Appraisal, Credit Security, Credit Reference, Credit Contract, Loan Portfolio Performance*

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INTRODUCTION

Banks generally do not grant credit to every customer who requests it. They decide which customers are riskier than others and extend credit to those customers who are less risky. The bank identifies risky customers by analyzing the customer's credit report, which details other credit accounts the customer has and their payment history (Florin, 2014). Lending is the principal business activity for most commercial banks. The loan portfolio is typically the largest asset and the predominate source of revenue. As such, it is one of the greatest sources of risk to a bank's safety and soundness. Whether due to lax credit standards, poor portfolio risk management, or weakness in the economy, loan portfolio problems have historically been the major cause of bank losses and failures. Credit documentation includes the information and/or verifications used to analyze and support the loan decision and any subsequent loan servicing decision. Documentation needs will vary given the loan size, risk, and complexity (Waemustafa & Sukri, 2016).

Credit documentation must provide adequate support for the decision made. The bank officer's judgment is essential in determining the degree or extent of documentation necessary to support the loan decision (Waemustafa & Sukri, 2016). Therefore, the required documentation is differential and commensurate with the size, complexity, history, and credit quality of the applicant. The following list represents documentation guidelines for loan origination and servicing. Loan portfolio performance refers to the rate of profitability or rate or return of an investment in various loan products. Broadly, it looks at the number of clients applying for loans, how much they are borrowing, timely payment of instalments, security pledged against the borrowed funds, rate of arrears recovery and the number of loan products on the chain. The loan products may comprise of; salary loans, group guaranteed loans, individual loans and corporate loan, among others. Establishing sound, well-defined credit-granting criteria is essential to approving credit in a safe and sound manner. The criteria should set out who is eligible for credit and for how much, what types of credit are available, and under what terms and conditions the credit should be granted (Chen & Lin, 2016).

In Kenya, despite the good overall financial performance of banks in Kenya, banks continue to write off bad debts as losses (Oloo, 2015). It is averred that all over the world, financial institutions face enormous credit risks (Krestlow, 2014). Financial institutions particularly banks are very important in not only banking the low income earners in the society but also advancing credit facilities to them (clients). However, just like other financial institutions, they experience many cases of default risks, moral hazard and adverse selection. CBK has set out a new directive on the treatment of credit risk management which thus has increased pressure on banks. The credit risk negates the profitability of financial institutions as they entirely depend on loan lending to increase its portfolios (Haneef, 2014).

KCB Bank Kenya Limited is a wholly owned subsidiary of KCB Group (Kenya Commercial Bank Limited) which is a holding company. Other banks within the Group include subsidiaries in Uganda, Rwanda, Tanzania, Rwanda, Burundi and South Sudan. KCB Bank started in 1896 in Zanzibar as a branch of National Bank of India. The bank extended its headquarters to Nairobi which had become the headquarters of the expanding railway line to Uganda in 1904. Grindlays Bank merged with the National Bank of India to form the National and Grindlays Bank. In 1970, the Government of Kenya acquired majority shareholding and changed the name to Kenya Commercial Bank. The Government later sold 20% of its shares at NSE through an IPO that saw 120,000 new shareholders acquire the bank. In 1997, the bank resolved to spread its operations to various viable markets in the region starting with Tanzania and later Uganda, Rwanda, South Sudan and Burundi. In pursuit of its vision, the bank rebranded itself to KCB Bank Limited with

a broad reaching internal and external program. In 2011 and in its 115th year of operations, the bank posted a profit of KES 15.1 Billion to become the most profitable bank in Eastern Africa – a position which it has held to date. KCB Group Plc has grown to become the region's largest banking institution with an asset base of KES 595 Billion (USD 5.84 Billion) and a market capitalization of KES 105 Billion (USD 1.02B) and broad regional distribution in 7 countries with over 265 branches, 13,562 agents and 962 ATMs.

Various similar studies have been conducted in Kenya. Kisaka (2016) studied the effect of credit rating practices on loan book performance of commercial banks in Kenya. The study aimed to determine whether historical background of customers, capacity to pay loans, credit reference report for each customer, collateral for the loan and credit rationing influence the performance of the loan book in commercial banks of Kenya. The results indicated a positive relationship between credit rating practices and performance of the loan book in commercial banks of Kenya. The regression analysis revealed that all credit rating variables had a positive impacted on the performance of the loan book of commercial banks. The most influential variable was capacity to pay loan followed by credit reference report. Historical background, collateral for the loan and credit rationing were also considered important in credit risk assessment by the commercial banks.

George (2016) studied credit appraisal process and repayment of loan at GN Bank in Nigeria. The study found that the relationship between loan officers and customers had no effect on loan repayment and that number of customers who defaulted on loan repayment had no relationship with the attitude of loan officers. Lagat, Mugo and Otuya (2015) studied the effect of credit risk management practices on lending portfolio among savings and credit cooperatives in Kenya. The purpose of this study was to examine the effects of credit risk management practices on lending portfolio among Sacco's in Nakuru County, Kenya. Data on risk identification, risk analysis, risk monitoring, risk evaluation and risk mitigation obtained from 59 Sacco's sampled from among SACCOs in Nakuru County were analyzed using regression models to identify its effect on lending portfolio. Results indicated a significant effect of all the risk management practices on lending portfolio except risk evaluation which did not register a significant effect on the lending portfolio of the SACCOs. The findings further showed that majority of the SACCOs have largely adopted risk management practices as a means of managing their portfolio.

Statement of the Problem

In Kenya, financial institutions have constantly reported deteriorating asset quality due to non-performing and defaulting loans. Losses turn from outright default due to inability or unwillingness of customers or counterparties to meet commitment in most banking institutions. For instance, Daima Bank, as per Mullei (2015) was set under statutory administration for neglecting to meet the base center capitalization edge and in addition poor administration of credit portfolios. As indicated by the Central Bank of Kenya (2016), the proportion of gross NPLs to net loans expanded from 8.4% in June 2016 to 9.1% in September 2016. Kenya Commercial bank is no exception as it has faced hurdles in reducing the rate of non-performing loans.

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portfolio among savings and credit cooperatives in Kenya and results indicated a significant effect of all the risk management practices on lending portfolio except risk evaluation which did not register a significant effect on the lending portfolio of the SACCOs. However, based on the reviewed studies, there is very few literatures which have investigated the effect of credit documentation as a whole and none has attempted to link its effect on loan portfolio performance focusing on commercial banks in Mombasa. This study sought to bridge the knowledge gaps by investigating the effect of credit documentation on loan portfolio performance of commercial banks in Mombasa County focusing on Kenya Commercial Bank.

Research Objectives

The general objective of the study was to determine the effect of credit documentation on loan portfolio performance in commercial banks in Mombasa focusing on Kenya Commercial Bank. The specific objectives were;

- To determine the effects of credit appraisal documentation on the loan portfolio performance of Kenyan commercial banks.
- To establish the effects of credit security documentation on the loan portfolio performance of Kenyan commercial banks.
- To assess the effects of credit reference documentation on the loan portfolio performance of Kenyan commercial banks.
- To evaluate the effect of credit contract documentation on the loan portfolio performance of Kenyan commercial banks.

This study was guided by the following null hypothesis;

- **Ho_1:** Credit appraisal documentation has no statistically significant relationship on the loan portfolio performance of Kenyan commercial banks.
- **Ho_2:** Credit security documentation has no statistically significant relationship on the loan portfolio performance of Kenyan commercial banks.
- **Ho_3:** Credit reference documentation has no statistically significant relationship on the loan portfolio performance of Kenyan commercial banks.
- **Ho_4:** Credit contract documentation has no statistically significant relationship on the loan portfolio performance of Kenyan commercial banks.

LITERATURE REVIEW

The Theory of Planned Behavior

The theory of the planned behavior is the main theory used in the study. The theory is used to determine factors influencing effective loan repayment behaviour. According to the theory of planned behaviour, human action is guided by three factors. These include behavioral beliefs, normative beliefs and control beliefs which are considered as borrowers' behaviour (Ajzen, 2016). The study identified the relationship between the theory of planned behaviour on one hand and borrowers' behaviour on the other so as to show clearly the specific factors that influence the whole process of loan repayment by the loan borrowers to the financial institutions. Basically, the loan repayment process is the function of borrowers' behaviour, business characteristics, financial institutions' characteristics and policy and regulatory issues. The borrowers' behaviour, business characteristics, financial institutions' characteristics and policy and regulatory issues are believed to influence the whole loan repayment process (Ajzen, 2016).

Rough Set Theory

The rough set approach was proposed by Pawlak (1982, 1991) as a tool for dealing with imperfect knowledge, in particular with vague concepts Rough Set Theory is concerned with the classification and analysis of imprecise, uncertain or incomplete information and knowledge and is considered one of the first non-statistical approaches in data analysis (Zhang, Jia, Diao, Hai & Li, 2016). The fundamental concept behind Rough Set Theory is the approximation of lower and upper spaces of a set, the approximation of spaces being the formal

classification of knowledge regarding the interest domain. The subset generated by lower approximations is characterized by objects that will definitely form part of an interest subset, whereas the upper approximation is characterized by objects that will possibly form part of an interest subset. Every subset defined through upper and lower approximation is known as Rough Set. Over the years Rough Set Theory has become a valuable tool in the resolution of various problems, such as: representation of uncertain or imprecise knowledge; knowledge analysis; evaluation of quality and availability of information (Zhang *et al.*, 2016).

Modern Portfolio Theory

Modern portfolio theory (MPT) was pioneered by Markowitz (Grasse, Whaley & Ihrke, 2016) It is a theory on how risk-averse investors can construct portfolios to optimize or maximize expected return based on a given level of market risk, emphasizing that risk is an inherent part of higher reward. According to the theory, it is possible to construct an efficient frontier of optimal portfolios offering the maximum possible expected return for a given level of risk. One of the major concepts that most investors should be aware of is the relationship between the risk and the return of a financial asset. There is a positive relationship between the risk and the expected return of a financial asset. This means that when the risk of an asset increases, so does its expected return. Therefore, if an investor is taking on more risk, they are expected to be compensated for doing so with a higher return. Similarly, if the investor wants to boost the expected return of the investment, they need to be prepared to take on more risk. Banking is a highly regulated industry with many regulatory prescriptions which govern their day-to-day functioning (Pfaff, 2016).

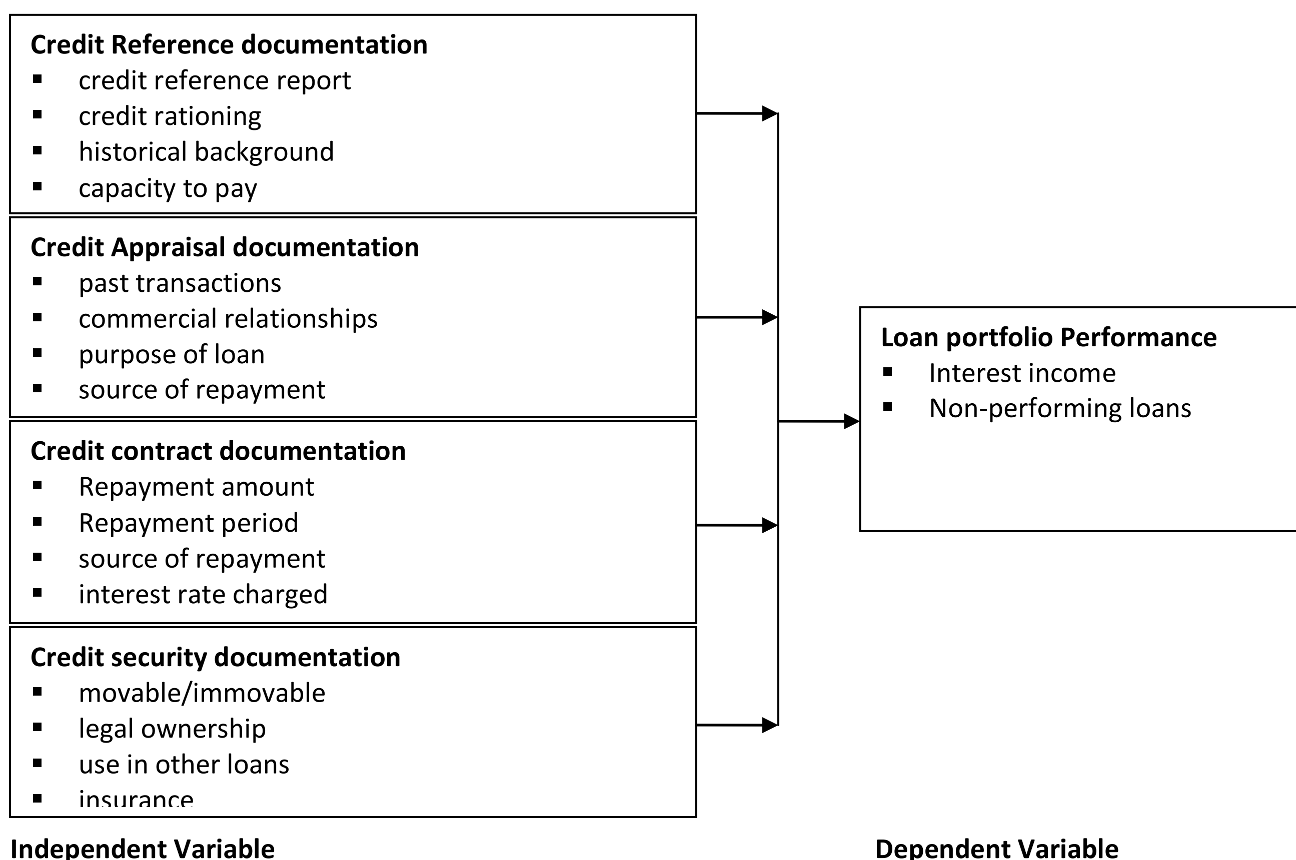

Figure 1: Conceptual Framework

According to Benmelech and Dlugosz (2016), Credit referencing is an appraisal of the credit worthiness of an individual client, business entity or government agency. This assessment is made by a credit rating agency on the account holder's capacity to pay back a loan facility when it is due and the likely probability of default. Credit rating is one of the most critical procedures in banks and other financial institutions' credit management decisions. There exists varying relationships between the credit rating practices and its effects on the loan book performance in commercial banks. The desired relationship between a good credit rating policy and the value of the loans is directly proportionate to each other such that the higher the application of a good credit rating method, the higher the amount of loans disbursed (Benmelech & Dlugosz, 2016).

Credit appraisal techniques are methods that are employed by commercial banks when assessing the credit worthiness of a prospective borrower (Florin, 2014). These techniques usually vary, depending on determinants such as the size and maturity of the loan, the operating record of the business, security offered and previous relations with the borrower. Assessing the creditworthiness of a borrower by a lender before granting the credit is termed credit appraisal. The process includes the collection of related information of customers and projects or business to undertake, assessing the risk involved before providing any loans. The process also assesses the technical, economic and financial feasibility of the anticipated project. It considers the borrower's character, collateral capability and capacity. Credit appraisal considers the applicant's income, his dependents, expenditure, repayment capacity, employment history, number of years of work and other factors affecting the credit rating of a borrower. The appraisal process also verifies the collateral security accessible for recovery of the credit facility in the event of default (Mishra & Naidu, 2016).

Credit contract is an important concept for all the lending institutions. It is a measure of whether loans are settled up in full according to the loan contract or not. The higher loan repayment performance leads to the higher probability of the collecting interest revenues and lower loan losses in a lending institution (Okurut & Kinyondo, 2011). On the other hand, the poor loan repayments have a harmful impact on institutions capital, earning as well as in realizing its objectives and may even lead to a financial institution collapse. For instance, failure to manage loan repayment performance results in losses and high delinquency management costs (Ledgerwood, 2010). The higher expenses are for closer monitoring, more frequent portfolio and legal fees for pursuing seriously delinquent loans. Such costs adversely affect the generated income, and, in general, the operations of the lending institution, thus, the institution becomes unsustainable (Njanike, 2012).

Credit security can generally be described as a defined asset issued by the borrower to the lender, in a show of commitment towards repaying the loan advanced. If the counterparty fails to honor his repayments, the collateral is liquidated and the value of the loan recovered from such proceeds. Credit security involves contractual arrangements revolving around the defined asset which are generally difficult to implement in developing and least developed countries that have diverse and weak legal and regulatory systems. Globally, there exist several forms of Credit security accepted by banks for the purpose of guaranteeing the recovery of loans like personal guarantors, receivables, fixed deposit accounts among others. Credit security is a regular ingredient of risky lending. Accordingly, collateral is part of many if not most (business) loan contracts in mature markets (Steijvers & Voordeckers, 2011). Due to opaque information and weak enforcement, theory suggests that the request for collateral is even higher in less developed markets.

Empirical Review

Regionally, George (2016) studied credit appraisal process and repayment of loan at GN Bank in Nigeria. The study found that the relationship

between loan officers and customers had no effect on loan repayment and that number of customers who defaulted on loan repayment had no relationship with the attitude of loan officers. Lagat, Mugo and Otuya (2015) studied the effect of credit risk management practices on lending portfolio among savings and credit cooperatives in Kenya. The purpose of this study was to examine the effects of credit risk management practices on lending portfolio among Sacco's in Nakuru County, Kenya. Data on risk identification, risk analysis, risk monitoring, risk evaluation and risk mitigation obtained from 59 Sacco's sampled from among SACCOs in Nakuru County were analyzed using regression models to identify its effect on lending portfolio. Results indicated a significant effect of all the risk management practices on lending portfolio except risk evaluation which did not register a significant effect on the lending portfolio of the SACCOs. The findings further showed that majority of the SACCOs have largely adopted risk management practices as a means of managing their portfolio.

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Nyakeri (2015) conducted a study on the effect of credit management practices of financial performance in saving credit cooperatives in Nairobi. The specific objectives for the study were credit scoring, loan portfolio, credit risk analysis and credit approval process. The study established that credit risk analysis improves the loan portfolio, profitability and returns of the microfinance institution.

Chepkoech (2016) studied the effect of credit assessment process on repayment of bank loans in commercial banks in Kenya and found weaknesses in credit appraisal policies, which allowed rogue bank staff to award loans to non-qualifying applicants. Thisika and Muturi (2017) studied the effects of credit risk management on loan performance in Kenyan commercial banks and found a statistically significant relationship between credit appraisal and non-performing loans. Kithinji (2017) assessed the effect of credit risk management on the profitability of commercial banks in Kenya. 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.

METHODOLOGY

This study adopted descriptive research design. The target population was management staff drawn from corporate division, retail division, Mortgage and Credit Divisions of the bank. The study, therefore, targeted 76 management staff of the Kenya Commercial Bank. Stratified random sampling was used to select 64 respondents. The sample was calculated using the mathematical approach developed by Miller and Brewer (2003). Primary data was collected using structured questionnaire. The study employed a structured questionnaire to collect data from the participants. Secondary data was obtained from commercial bank reports and financial statements, published journals and past studies. The researcher used secondary data because they use already existing information which saves time and money (Kothari, 2018). The data collected was coded and analyzed using the Statistical Package for Social Sciences

(SPSS version 25) tool. Both descriptive and inferential analyses were generated. Regression analysis was conducted to test whether the strength of the relationship between the independent variables and the dependent variable are statistically significant. The regression analysis was guided by the following model:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta 4 X_4 + \varepsilon$$

Where: Y = Loan portfolio performance

X_1= Credit appraisal documentation

X_2 = Credit security documentation

X_3 = Credit reference documentation

X_4 = Credit contract documentation

ε = Error term/Erroneous variables

FINDINGS

Descriptive Analysis

The study main objective was to investigate the effect of credit documentation on loan portfolio performance. The study looked at four conceptualized variables, that is, credit appraisal documentation, credit security documentation, credit reference documentation and credit contract documentation.

Credit Appraisal Documentation

The first objective of the study was to investigate the effect of credit appraisal documentation on loan portfolio performance in commercial banks. The responses were rated on a Likert scale and the results presented in table 1. It was rated on a 5 point Likert scale ranging from; 1 = strongly disagree to 5 = strongly agree. The scores of ' strongly disagree' and 'disagree' have been taken to represent a statement not agreed upon, equivalent to mean score of 0 to 2.5. The score of 'neutral' was taken to represent a statement agreed upon, equivalent to a mean score of 2.6 to 3.4. The score of 'agree' and 'strongly agree' was taken to represent a statement highly agreed upon equivalent to a mean score of 3.5 to 5.

Table 1: Credit Appraisal Documentation

	Mean	Std. Dev
We usually find out the customer's past transactions with us before authorizing any loan	4.96	0.935
Past transactions determine the amount of loan issued	4.29	1.193
We usually research on the customers' commercial relationships with other entities before giving them loans	4.63	0.485
The purpose of the loan has to be with explained with documentary evidence before any loan is issued	4.12	1.033

The result in table 1 revealed that majority of the respondent with a mean of (4.96) agreed with the statement that they usually find out the customer's past transactions with us before authorizing any loan. The measure of dispersion around the mean of the statements was .933 indicating the responses were varied.

The findings revealed that majority of the respondent as indicated by a mean of (4.29) agreed with the statement that Past transactions determine the amount of loan issued. The Standard Deviation for comments for the past transactions determine the amount of loan issued was 1.193 showing a variation.

The result also revealed that majority of the respondent (4.63) agreed with the statement that the bank usually research on the customers' commercial relationships with other entities before giving them loans. The results were varied as shown by a Standard Deviation of 0.485. Finally, the findings showed that that majority of the respondent (4.12) agreed with the statement that the purpose of the loan has to be with explained with documentary evidence before any loan is issued. The results were varied as shown by a

Standard Deviation of 1.033. The findings agree with George (2016) who studied credit appraisal process and repayment of loan at GN Bank in Nigeria. The study found that the relationship between loan officers and customers had no effect on loan repayment and that number of customers who defaulted on loan repayment had no relationship with the attitude of loan officers.

Credit Security Documentation

The second objective of the study was to investigate the effect of credit security documentation on loan portfolio performance. The respondents were asked to comment on statements regarding credit security documentation effect on loan portfolio performance.

Table: 2: Credit Security Documentation

	Mean	SD
We usually find out the type of collateral (movable/immovable) before issuing any loans	4.52	1.036
We usually find out the legal ownership of any collateral before giving out loans	4.64	0.945
We usually investigate whether collateral has been used to secure other loans before	4.15	0.743
Service Innovative responses can enable judiciary to either position itself within an attractive niche or to meet a larger proportion	4.62	0.838

The results in table 2 revealed that majority of the respondent with a mean of (4.52) agreed with the statement that the bank usually find out the type of collateral (movable/immovable) before issuing any loans. The measure of dispersion around the mean of the statements was 1.036 indicating the responses were varied. The findings also revealed that majority of the respondent as indicated by a mean of (4.64) agreed with the statement that the bank usually find out the legal ownership of any collateral before giving out loans.

The result revealed that majority of the respondent (4.15) agreed with the statement the bank investigate whether collateral has been used to secure other loans before. The results were varied as shown by a Standard Deviation of 1.025. Finally, results indicated bank's demand for the proof to show that the security has been insured. The mean for this comment was 4.62 accompanied by a varied response of 0.838. These findings were consistent with Kisaka (2016) who studied the effect of credit rating practices on loan book performance of commercial banks in Kenya and indicated a positive relationship between credit rating practices and performance of the loan book in commercial banks of Kenya.

Credit Reference Documentation

The third objective of the study sought to investigate the effect of credit reference documentation on loan portfolio performance in commercial banks. The responses are indicated in table 3.

Table 3: Credit Reference Documentation

	Mean	SD
We always require the customer to provide us with a credit reference report	4.96	0.784
My organization always researches the customer's credit history before issuing loans	4.27	0.720
We always determine the customer's ability to pay before authorizing any loans	4.63	1.128
Financial innovations increase efficiency in the courtroom	4.68	1.002

The results in table 3 revealed that majority of the respondents (mean=4.44) agreed with the statement that bank always require the customer to provide us with a credit reference report. The measure of dispersion around the mean of the statements was 0.784 indicating the responses were varied. The findings revealed that majority of the respondent as indicated by a mean of (4.27)

agreed with the statement that the bank always researches the customer's credit history before issuing loans. The Standard Deviation for comments for poor performance was 0.720 showing a variation. The results also revealed that majority of the respondent (4.63) agreed with the statement that the bank always determine the customer's ability to pay before authorizing any loans. The results were varied as shown by a Standard Deviation of 1.128.

The results revealed that majority of the respondents (mean = 4.68) agreed with the statement that the bank usually ration credit to customers as a way of reducing risks. The measure of dispersion around the mean of the statements was 1.002 indicating the responses were varied. The results mirrored those of Kisaka (2016) studied the effect of credit rating practices on loan book performance of commercial banks in Kenya and the results indicated a positive relationship between credit rating practices and performance of the loan book in commercial banks of Kenya.

Credit Contract Documentation

Fourth objective of the study sought to examine the effect of credit contract documentation on loan portfolio performance in commercial banks. The results are indicated in table 4.

Table 4: Credit Contract Documentation

	Mean	SD
The repayment amount is important for us when issuing loans	4.58	0.495
The repayment amount is an important determinant of our portfolio performance	4.08	0.814
The repayment period is an important determinant of our loans performance	4.19	1.481
We first find out the source of loan repayments before authorizing loans	4.58	0.495

The findings revealed that majority of the respondent as indicated by a mean of (4.58.) agreed with the statement that loan repayment amount is important for us when issuing loans. The Standard deviation for comments for showing a variation was 0.495. The results revealed that majority of the respondent (mean=4.08) agreed with the statement that repayment amount is an important determinant of our portfolio performance. The results were varied as shown by a standard deviation of 0.814. Findings also showed that that majority of the respondent (4.19) agreed with the statement that the repayment period is an important determinant of the bank's loan portfolio performance. The results were varied as shown by a standard deviation of 1.481.

Finally, the results indicated that the bank first find out the source of loan repayments before authorizing loans (4.58). The Standard Deviation for this comment was accompanied by a varied response of 0.495.

The study findings seem to draw a similarity with those of Cheng and Lin, 2017; Shan and Jolly, (2017) who suggest that to sustain in the encountering rapidly changing environments, technological change and globalization, Courts require recurring technological innovation to continuously retain their competitiveness in dispensing justice fast and be able to face new challenges.

Correlation Analysis

Correlation analysis was used to determine both the significance and degree of association of the variables and also predict the level of variation in the dependent variable caused by the independent variables.

Table 5: Bivariate Pearson Correlations

		CAD	CSD	CRD	CCD	Loan portfolio performance
Credit appraisal documentation	Pearson Correlation	1				
	Sig. (1-tailed)					
Credit security documentation	Pearson Correlation	.419**	1			
	Sig. (1-tailed)	.018				
Credit reference documentation	Pearson Correlation	.197**	.398**	1		
	Sig. (1-tailed)	.027	.001			
Credit contract documentation	Pearson Correlation	.381**	.246**	.314**	1	
	Sig. (1-tailed)	.000	.000	.000		
Loan portfolio performance	Pearson Correlation	.517**	.492**	.278**	.355**	1
	Sig. (1-tailed)	.000	.000	.000	.001	
	N	62	62	62	62	62

**. Correlation is significant at the 0.01 level (1-tailed).

CAD – Credit Appraisal Documentation, CSD – Credit Security Documentation, CRD – Credit Reference Documentation, CCD – Credit Contract Documentation

The correlation summary shown indicated that the associations between each of the independent variables and the dependent variable were all significant at the 95% confidence level. The correlation analysis to determine the association between credit appraisal documentation and loan portfolio performance indicated that there was a positive moderate relationship (r= .517). In addition, the correlation results were statistically significant at 5% level (p=0.000, <0.05). The correlation analysis to determine the association between credit security documentation and loan portfolio performance indicated that there was a positive relationship (r= .492). In addition, the researcher found the relationship to be statistically significant at 5% level (p=0.00, <0.05).

The correlation analysis to determine the association between credit reference documentation and loan portfolio performance indicated that there was a weak positive relationship (r= .278). In addition, the researcher found the relationship to be statistically significant at 5% level (p=0.00, <0.05). The correlation analysis to determine the association between credit contract documentation and loan portfolio performance tested at 5% significance level indicated that there was a moderate positive relationship (r= .355).

Regression Analysis

The study conducted a multiple linear regression analysis in order to investigate the effect of credit documentation on loan portfolio performance. In this model, coefficients of determination explain the extent to which changes in dependent variable can be explained by the changes in the independent variables or percentage of variation in dependent variable that is explained by all four independent variables.

Table 6: Overall Model Summary results

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.758[a]	.575	.526	1.8523

a. Predictors: (Constant), Credit appraisal documentation, Credit security documentation, Credit reference documentation, Credit contract documentation

The independent variables reported R value of .758 indicating that there was strong correlation between dependent variable and independent variables. The coefficient of determination (R^2) is

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0.575 which indicated that 57.5% of the corresponding variation in the loan portfolio performance can be explained by the four independent variables. This indicated that the model fits the study data. The remaining 42.5% can be explained using other factors not included in our model.

Regression Coefficients

This is an extension of simple linear regression. It is used to predict the value of a variable based on the value of two or more variables.

Table 7: Overall Regression Weights

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	5.413	1.348		4.016	.000
	Credit appraisal doc	.392	.116	.539	3.379	.000
	Credit security doc	.418	.198	.436	2.111	.031
	Credit reference doc	.257	.089	.109	2.887	.024
	Credit contract doc	.121	.047	.287	2.574	.028

a. Dependent Variable: Loan portfolio performance

Regression equation takes the form:

$Y=5.413 + 0.392X_1 + 0.418X_2 + 0.257X_3 + 0.121X_4$

Based on the regression findings, all the independent variable showed a positive coefficient indicating a positive effect on loan portfolio performance. The regression equation above has established that taking all factors into account (Credit appraisal documentation, Credit security documentation, Credit reference documentation, Credit contract documentation) constant at zero, loan portfolio performance would be 5.413.

Regression analysis further formed a basis for testing the hypothesis adopted in this study. This was done by considering the p values corresponding to each variable of interest. The benchmark for this study for failure to reject or failure to accept the null hypothesis was a level of significance of 5 percent. If the p-value was less than 5 percent the null hypothesis failed to be accepted and the alternate hypothesis would fail to be rejected. Also, if the p-value was greater than 5 percent the null hypothesis failed to be rejected and the alternate hypothesis failed to be accepted, that is.

Reject H0: $\beta x = 0$; if $p < 0.05$,

Otherwise fail to reject the H0: $\beta x = 0$

Discussion and Hypotheses Testing

The first objective of the study was to establish the effect of credit appraisal documentation on loan portfolio performance in commercial banks. The regression results indicated that the coefficient for credit appraisal documentation was 0.392, t-statistics was 3.379 with a corresponding p-value of 0.031 (p-value < 0.05) which implied that the relationship with the dependent variable is significant. It was concluded that, holding all things constant, a unit change in credit appraisal documentation would lead to 0.392-unit change in loan portfolio performance. Therefore, the null hypothesis is rejected.

The second objective was to investigate the effect of credit security documentation on loan portfolio performance in commercial banks. The results of the regression indicated that the coefficient for credit security documentation was 0.418, t-statistics of 2.111 and a corresponding p-value < 0.05 which indicated that the relationship was significant. It was concluded that holding all other factors constant, a unit change in credit security documentation would lead to 0.418 units of change in loan portfolio performance. Therefore, the null hypothesis was rejected implying that credit security documentation has significant effect on loan portfolio performance.

The third objective of the study was to investigate the effect of credit reference documentation on loan portfolio performance in commercial banks. The regression test result obtained indicates that the coefficient for credit reference documentation was 0.257; t-statistics was 2.887 with a corresponding p-value of 0.024 (p-value < 0.05) implying that the relationship is significant. The study concluded that a unit change in credit reference documentation leads to 0.257 units of change in loan portfolio performance. Therefore, the null hypothesis was rejected.

The fourth objective of the study was to investigate the effect of credit contract documentation on loan portfolio performance in commercial banks. The regression test result obtained indicated that the coefficient for credit contract documentation was 0.121; t-statistics was 2.574 with a corresponding p-value of 0.007 (p-value < 0.05) implying that the relationship is significant. The study concluded that a unit change in credit contract documentation leads to 0.121 units of change in loan portfolio performance. Therefore, null hypothesis was rejected in favour of the alternate hypothesis which holds that credit contract documentation has significant effect on loan portfolio performance in commercial banks.

CONCLUSIONS AND RECOMMENDATIONS

The study concluded that in order to minimize on non-performing loans, the bank usually searches for customer's past transactions before authorizing any loan to the customer. This was done by checking the historical data of the customer from credit bureau. It was concluded that the amount of loan given to the applicant is dependent on the individuals past transactions and the bank usually research on the customers' commercial relationships with other entities before giving them loans. Finally, the study concludes that loan applicant is required to produce documentary evidence on the loan purpose before been advanced with the loan.

The study concluded that the bank usually finds out the type of collateral (movable/immovable) before issuing any loans and the bank usually find out the legal ownership of any collateral before giving out loans. The study also concluded that the bank investigates whether collateral has been used to secure other loans before and bank's demand for the proof to show that the security has been insured.

The study concluded that the bank has a policy towards credit applicants which requires them to produce credit reference report before any consideration for the loan. Also the bank always researches the customer's credit history before issuing loans and the bank always determine the customer's ability to pay before authorizing any loans and the bank usually ration credit to customers as a way of reducing risks.

The study concluded that the most important element of loan issuance process is the amount to be repaid by the customer since it was established that repayment amount is an important determinant of our portfolio performance while loan repayment period is an important determinant of the bank's loan portfolio performance. Finally, the study concludes that the bank has mechanism to justify the source of loan repayment prior to any loan authorization.

The study recommended that the bank management should search for the customer past transactions before issuing loan so as to minimize on non-performing loans. Also the bank should only issue credit to customers in tandem with their past transactions with the bank and it should extent customer information search to other lenders so as to identify the customer history.

The study recommended that the bank should establish the customer's collateral prior to loan issuance so as to determine whether the security is adequate. Also the bank should stretch further to establish the legal ownership of any collateral before giving out loans. The study also recommends

that the bank should investigate whether collateral has been used to secure other loans before.

The study recommended that the bank should develop a policy towards credit applicants which requires them to produce credit reference report before any consideration for the loan. Also, the bank should always research the customer's credit history before issuing loans and the bank always determine the customer's ability to pay before authorizing any loans and the bank usually ration credit to customers as a way of reducing risks.

The study recommended that should issue loans based on the amount to be repaid by the customer since it was established that repayment amount is an important determinant of our portfolio performance while loan repayment period is an important determinant of the bank's loan portfolio performance. The bank should come up with a mechanism to justify the source of loan repayment prior to any loan authorization.

Areas for Further Research

The study was limited to investigating the effect of credit documentation on loan portfolio performance in commercial banks. However, the study focused on credit appraisal documentation, credit security documentation, credit reference documentation and credit contract documentation which only explained 57.5% variation in loan portfolio performance. This calls for other studies to be undertaken to incorporate the other factors not considered in the current study.

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