A STUDY ON CREDIT RISK MANAGEMENT OF BANKING INSTITUTIONS IN KENYA

By

Ngatia Irene Wangui- X74/3718/2008
Mwangi Naomi Nyambura- X75/3789/2008
Marangu Winnie Karwitha- X74/3650/2008
Nganga Christine Wanjira- X74/3685/2008
Ndung’u Maureen A. Wanjiku- X75/3775/2008

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ABSTRACT

Banking institutions in Kenya are prone to significantly high levels of credit risk, particularly due to non-performing loans. The purpose of this study is to establish various ways of managing these risks in order to lessen the high levels of non-performing loans. This is crucial in situations where there are changes in macroeconomic variables and bank specific variables. This paper will discuss the importance of adopting the main principles of credit risk management that are set out by the Basel Committee on Banking Supervision. In addition to this, the study attempts to find out the effect of reduced levels of non-performing loans on the economy of the country.

The econometric model used for the purpose of this study is a multiple regression model. The independent variables used are inflation rates, lending interest rates, banks liquidity ratios and real GDP growth rates. The dependent variable is the ratio of gross non-performing loans to gross loans. The hypothesis to be tested is whether the ratio of gross non-performing loans to gross loans is affected by independent variables or not. Data used was from the year 2000 to 2010, and was obtained from secondary sources. The finding obtained is that indeed, the proportion of gross non-performing loans to gross loans is affected by the independent variables. The trend of the proportion of gross non-performing loans to gross loans was also found to be decreasing in nature over the period of data collected.

Towards the end of the study, recommendations and suggestions of policy adjustments have been made in order to alleviate the problem of high levels of non-performing loans. Banks and other financial institutions will find this study particularly useful as a tool for effective credit risk management. The study will also be useful to the Central Bank of Kenya, since it points out what factors lead to an increase in the level of credit risks in banks and suggests policies on how to tackle them.