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Warsame Mohamed Osman, Dr. Daniel Makori & [3]Bancy Muchira

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Credit Risk Management and Liquidity of Commercial Banks in Kenya

[1*]Warsame Mohamed Osman, [2]Dr. Daniel Makori & [3]Bancy Muchira

[1]Master of Science (Finance) at Kenyatta University

[2] Lecturer, Department of Accounting and Finance, School of Business, Economics and Tourism at Kenyatta University

[3] Lecturer, Department of Accounting and Finance, School of Business, Economics and Tourism at Kenyatta University

***Email of the Corresponding Author: warsamemohamedosman@gmail.com**

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Abstract

Liquidity has remained a challenge among commercial banks in Kenya. For instance, the ratio of loans against deposits of the said banks stood at 0.740969, 0.74092, 1, 0.713654 and 0.795822 with an average value being 0.798273 across the period 2018, 2019, 2020, 2021 and 2022 respectively. This implies that most of the commercial banks did not have adequate assets as compared to deposits needed to finance customer loan requests which provide evidence of liquidity concerns among commercial banks in Kenya. This study examined the effect of credit information sharing, loan loss provisioning, and lending requirements on the liquidity of commercial banks in Kenya. Guided by relevant financial theories, it adopted a positivist, explanatory approach using both primary and secondary data from 39 banks between 2018 and 2022. The questionnaire was pilot tested before data gathering process among 4 credit managers from commercial banks in Kenya. The reason for pilot testing was to determine reliability of questionnaire while its validity was ensured by supervisor and two experts in the field of finance. Processing of the gathered data was done descriptively and inferentially and presented in tabular and graphical forms. Multicollinearity, normality was conducted as diagnostic tests before regression analysis to test its assumptions. The ethical issues that were considered in this study included appropriate citation and referencing of the information reviewed to avoid plagiarism and voluntary participation by respondents. The findings were that credit information sharing ($p<0.05$), loan loss provisioning ($p<0.05$) and lending requirements ($p<0.05$) had significant effect on liquidity of commercial. The study concluded that credit risk management and liquidity of commercial banks in Kenya are significantly related with each other. It was recommended that Credit Managers working among commercial banks in Kenya should invest in latest technologies for carrying out timely credit information of customers with the licensed Reference Bureaus. The loan officers working with commercial banks in Kenya should diversify into loan portfolio in order to remain stable and have meaningful contribution to the growth of an economy. Managers working with commercial banks in Kenya should effectively invest in lending requirements like land title deeds and logbooks in order to improve on their credit risk management which in turn can allow them achieve optimal and required liquidity levels.

Key words: *Credit risk management, liquidity, credit information sharing, lending requirements and loan loss provisioning*

1.0 Background to the Study

Liquidity is an important construct that is of great concern to policy makers and regulators (World Bank, 2023). By nature, commercial banks are required to maintain adequate liquidity so as to finance short term by depositors (IMF, 2023). Adequate liquidity is sufficient predictor of financial stability of commercial banks at large (Chodorow-Reich, Darmouni, Luck & Plosser, 2022). However, too much liquidity may represent tied up capital that could have otherwise been used to finance projects which would maximize the wealth of shareholders of the institution. Balancing liquidity positions implies that commercial banks should strike equilibrium between its current assets and liabilities (Ali, Shah & Chughtai, 2019).

The lending operations and information asymmetry between lenders and borrowers are key forces that increase credit risk among commercial banks. Information asymmetry creates moral hazard and adverse selection that in turn pose challenges for lenders to effectively appraise borrowers during loan application process (Chen, Chen & Huang, 2021). All these forces contribute towards credit risk among commercial banks. Since lending is the major activities undertaken by financial institution like commercial banks, credit risk from these activities is the most pronounced risk exposure by these institutions (Orichom & Omeke, 2021). However, as observed by Li (2019), too much exposure to credit risk can threaten overall liquidity position and thus stability of commercial banks.

The interaction between credit risk management (CRM) of commercial banks determines the strength of corporate governance mechanisms in an institution (Ekinci & Poyraz, 2019). Existence of strong corporate governance mechanisms in an organization is expected to provide a check and balance role in the implication of credit risk and liquidity position of the financial institution (Aldhamari, Mohamad-Nor, Boudiab& Mas'ud, 2020). Existence of a weak credit risk board committee as an important aspect of corporate governance may fail to effectively dispense its oversight role thus contributing negatively to liquidity position of a financial institution (Boateng, 2019). In the present study, corporate governance was considered as a moderator variable.

There exists some empirical evidence supporting credit risk management and liquidity. Borrowing evidence from Ukraine, Cai and Zhang (2017) documented that banks with high exposure to credit risk as demonstrated by an increase in non-performing loans (NPLs) may face liquidity constraints making it hard for them to meet the withdrawal demands of depositors. Among commercial banks in Europe, Golubeva, Duljic and Keminen (2019) were of the view that liquidity and thus profitability of a bank increases with an improvement in liquidity risk management endeavor of the financial institution.

Evidence from Middle East and North Africa (MENA) region by Ghenimi, Chaibi and Omri (2017) indicate that credit risk and liquidity in the context of financial institution are significantly linked with each other. Related evidence in MENA region indicates that liquidity risk negatively affects liquidity and thus profitability position of a bank (Abdelaziz, Rim & Helmi, 2022). In Nigeria, Ayinuola and Gumel (2023) indicated that credit risk has negative implication on financial stability and thus liquidity position of commercial banks.

Credit risk arises when borrowers are not in position to pay the advanced loan facilities on time as specified in terms of the contract (Ekinci & Poyraz, 2019). It is defined as the inability of the borrower to service the interests and principal amount of loan on time (Cai & Zhang, 2017). Credit

risk management on the other hand is a set of practices that are embraced by the financial institution limit exposure to poor loan quality (Orichom & Omeke, 2021). CRM can be achieved through credit information sharing, loan loss provisioning and lending requirements (Cai & Zhang, 2017). Siddique, Khan and Khan (2021) indicated that credit risk management can be measured through capital adequacy and cost efficiency ratio. The measures of credit risk management adopted by Owning's (2017) include loan loss provisioning, capital adequacy and NPL ratio. Kabugu and Wamiori (2022) used credit referencing and collateral requirement as measures of credit risk management. Olobo, Karyeija, Sande and Khoch (2021) used credit risk identification, assessment and control as measures of credit risk management. This study adopted credit information sharing, loan loss provisioning and lending requirements as the key measures of credit risk management.

Credit information sharing occurs at the initial stage of the customer appraisal process, where lenders obtain borrowers' credit history from Credit Reference Bureaus (CRBs) to inform lending decisions (Van-Greuning & Bratanovic, 2020). This process simplifies loan application by enabling financial institutions to assess repayment patterns and creditworthiness based on detailed reports provided by CRBs (Bowen & Makokha, 2021). In Kenya, CRBs such as Metropol and TransUnion offer services including credit scores, reports, histories, and clearance certificates for defaulted clients, playing a key role in evaluating borrowers' financial behavior (Mungiria & Ondabu, 2019). On the other hand, loan loss provisioning refers to the expense recorded in a bank's income statement to cover potential loan defaults and uncollected payments (Danisman, Demir & Ozili, 2021). It ensures that commercial banks present a true and fair view of their financial position by accounting for non-performing loans and associated risks (Nugroho, Arif & Halik, 2021). Common measures of loan loss provisioning include the ratio of loan loss provision to gross loans and the ratio of total provisions to total loans (Okeyo, Odoyo & Omboi, 2023; Ozili & Outa, 2017).

Lending requirements are specific documents that borrowers are required to submit to lenders to support their loan appraisal process. These requirements include the national identity cards, official pay-slips and log books or land title deeds among others (Fraisse, Lé & Thesmar, 2020). Other common lending requirements that commercial banks require from borrowers during the loan appraisal process include their identification requirements like the passports, their levels of income and the amount of their collaterals (Golubeva, Duljic & Keminen, 2019).

In a lending institution like a commercial bank, such short-term obligations including customer borrowing and creditors (Ghenimi, Chaibi & Omri, 2017). Low liquidity position of the financial institution mat signal possibility of financial distress (Li, 2019). Persistent financial distress concerns may in turn transform into insolvency and possible bankruptcy proceeding of a financial institution (Waweru & Oribu, 2023). Regulators are more interested in the liquidity position of commercial banks since liquidity constraints of these institutions and possible financial distress may put the deposits of customers at greater risk. On this account therefore, liquidity is an important parameter and particularly in lending institutions like commercial banks (Golubeva, Duljic & Keminen, 2019). In the context of commercial banks, liquidity is measured through different indicators; these include current assets against current liability, deposits to asset (DTA) ratio, loan to deposit (LTD) ratio and loan to asset (LTA) ratio (Chen, Chen & Huang, 2021). DTA ratio is used to provide measurement of how assets of the bank can be used to finance deposits.

LTD ratio indicates how the financial institutional leverages its deposits to fund loans. LTA ratio represents the adequacy of the assets of the bank to finance loans demanded by customers (Abuga, Wamugo & Makori, 2023). The present study measured liquidity using LTD.

Commercial banks are institutions established to mobilize deposits from customers which are then used as capital to finance loan applications by customers (Abuga, Wamugo&Makori, 2023). These institutions are regarded as financial intermediaries since they link borrowers and depositors resulting into financial intermediation process (Otiende, 2021). The implication of the said financial intermediation process to the long-term growth of an economy cannot be underscored since the same supports savings and investments as well as capital creation. Besides achieving financial intermediation, commercial banks also contribute towards financial inclusion in an economy (Abuga, Wamugo & Makori, 2023). Kenyan banks are classified into three tiers based on their relative market share, customer deposits and assets. In the last 5-years, liquidity has presented the greatest challenge for most commercial banks in Kenya. There are three broad tiers of banks in Kenya, tier I, II and III (Abuga, Wamugo & Makori, 2023). These tiers are established on the basis of the assets, customer base and total deposits of the respective commercial banks in country. While tiers I and II are more stable explaining a significant proportion of their market shares with greater asset bases and customer deposits, their tier III counterparts are relatively unstable accounting of much of the liquidity issues (Malit, Scholastica & Nelson, 2023).

1.1 Statement of Problem

Banks play an integral role towards the gross domestic product of Kenya at large and in terms of facilitating financial intermediation. For instance, the contribution of Kenya's banking sector to the entire GDP of the country in terms of their assets has always hovered around 60% for the period 2018-2022 (Malit, Scholastica & Nelson, 2023). Despite this importance, liquidity has remained a challenge among commercial banks in Kenya (Otiende, 2021). For instance, the ratio of loans against deposits (LTD) of the said banks stood at 0.740969, 0.74092, 1, 0.713654 and 0.795822 with an average value being 0.798273 across the period 2018, 2019, 2020, 2021 and 2022 respectively (CBK, 2022). This implies that most of the commercial banks did not have adequate assets as compared to deposits needed to finance customer loan requests which provide evidence of liquidity concerns among commercial banks in Kenya. Although CBK has played an instrumental role in ensuring that commercial banks in Kenya are well capitalized and that corporate governance mechanisms are strengthened to safeguard their stability, it remains unclear if all these efforts have materialized (Abuga, Wamugo & Makori, 2023). Thus, urgent measures need to be undertaken to improve liquidity position of commercial banks in Kenya failure to which possible financial distress and ultimate bankruptcy is inherent and depositors would lose significant amount of their deposits.

The existing studies include Cai and Zhang (2017) who focused in Ukraine and determined how credit and liquidity risk were connected with each other. The analysis of findings indicated that banks with high exposure to credit risk as demonstrated by an increase in non-performing loans (NPLs) may face liquidity constraints making it hard for them to meet the withdrawal demands of depositors. The focus of the study conducted by Ayinuola and Gumel (2023) in Nigeria was on determining the implication of liquidity and credit risk on stability of banks. It was noted that credit risk has negative implication on financial stability and thus liquidity position of commercial banks.

There are evident gaps from the studies reviewed as Cai and Zhang (2017) and Ayinuola and Gumel (2023) were conducted in Nigeria and not in Kenya implying different regulatory frameworks hence contextual gap. The study by Ayinuola and Gumel (2023) and Ghenimi*et al.* (2017) focused on financial stability as the dependent variable and not liquidity and thus creating conceptual gap. According to Waweru and Oribu (2023), liquidity is more critical to a financial institution like commercial banks that require adequate cash to fund loan requests so as to achieve financial liquidity. This assertion was buttressed by Golubeva, Duljic and Keminen (2019) who indicated that regulators like central banks are keener to ensure commercial banks are more liquid in order to achieve financial stability. Thus, the empirical evidence linking credit risk and specifically liquidity in the context of commercial banks in Kenya is scanty. Similarly, the role played by political risk in credit risk and liquidity interactions both from global, regional and local perspectives has not received adequate attention thus the need of carrying out the proposed study. Hence, against these gaps, the present study seeks to establish the effect of credit risk management on liquidity of commercial banks in Kenya.

1.2 Objectives of the Study

i. To establish the effect of credit information sharing on liquidity of commercial banks in Kenya
ii. To determine the effect of loan loss provisioning on liquidity of commercial banks in Kenya
iii. To analyze the effect of lending requirements on liquidity of commercial banks in Kenya

1.3 Research Hypotheses

H_{01}: Credit information sharing has no significant effect on liquidity of commercial banks in Kenya

H_{02}: Loan loss provisioning has no significant effect on liquidity of commercial banks in Kenya

H_{03}: Lending requirements have no significant effect on liquidity of commercial banks in Kenya

2.0 Literature Review

2.1 Theoretical Review

The study was guided by the information asymmetry, transaction cost and liquidity preference theory.

2.1.1 Information Asymmetry Theory

The theory of information asymmetry, advanced by Stiglitz (1961), Akerlof (1970), and Spence (1973), explains the imbalance of information between lenders and borrowers, where one party—often the borrower—holds more information and may exploit it, increasing credit risk (Chan, Siegel & Thakor, 1990; Bester, 1987). In real-world markets, accessing complete credit information involves costs, making information incomplete from the lender's perspective (Izquierdo & Izquierdo, 2007). Information sharing, therefore, plays a key role in reducing this asymmetry, making the theory relevant in anchoring the variable of information sharing in the current study.

2.1.2 Transaction Cost Theory

The proponent of this theory was Coase (1937) where transaction costs are classified and categorized to include are defined as the expenses that are incurred in entering negotiation agreements, monitoring as well as in enforcement of the exchanges between parties in a given transaction. The theory is underpinned on two issues: bounded rationality as well as opportunism. Bounded rationality is established on the fact that it is not possible to predict all possible contingencies related with a given situation and particularly those linked with opportunism. Hence, no contract can arise before some aspect of commitments that may cover the said contingencies. Contracts exist because of opportunism and the same cannot be abandoned (Krüger, Rösch & Scheule, 2018).

Transaction cost theory highlights the costs arising from asset specificity and information asymmetry in lending relationships. Lending requirements and loan loss provisioning serve as mechanisms to manage these costs and mitigate credit risk (Athari & Irani, 2022). Thus, the theory supports the role of these practices in safeguarding the liquidity and financial stability of lending institutions.

2.1.3 Liquidity Preference Theory

Keynes (1936) developed the Liquidity Preference Theory, which outlines three primary motives for holding cash: transaction, precautionary, and speculative. The theory posits that at low interest rates, an increase in money supply has minimal impact on investment but reduces cash balances, while higher interest rates encourage individuals and firms to hold less cash to maximize returns. According to Elgar (1999), individuals hold money to finance planned expenditures, manage uncertainty, or speculate on future interest rates. At the enterprise level, cash is held to facilitate transactions, cushion against unforeseen emergencies, or seize investment opportunities. This theory was relevant to the present study as it anchored liquidity, the dependent variable.

2.2 Empirical Literature Review

Past empirical studies and gaps are identified and illustrated in the subsequent sections:

2.2.1 Credit Information Sharing and Liquidity

Hung-Son, Gia –Khanh and Thanh-Liem (2020) conducted a study on credit information sharing, corruption and financial development. The information gathered and analyzed through panel regression indicated that private credit bureaus and financial development are negatively related with each other. On the other hand, public credit registries were insignificantly linked with financial development. However, financial development and not liquidity was adopted as the dependent variable thus creating conceptual gap.

In a study conducted by Iakimenko, Semenova and Zimin (2022), the link between information sharing and credit risk was explored. Credit risk in this study was adopted and used as a proxy of bank stability. The analysis indicated an existence of a nonlinear nexus between information disclosure and credit risk. The analysis further indicated that an increase in depth of credit information disclosure decreases credit risk. This study created conceptual gap by viewing bank

stability in terms of credit risk which is conceptually different from liquidity which was covered in the proposed study.

Bonomo, Bruschi and Schechtman (2020) carried a study on sharing of public and positive information and the implication on personal loans in Brazil. It was hypothesized that credit information sharing had potential to improve credit repayment history of the borrowers. Information was gathered with aid of primary sources as guided by the questionnaire. It was noted after analysis that was done through ordinary least square that information asymmetry was a key factor shaping and influencing the interest rates charged by lenders. It was further evident that an increase in access to positive credit information enhances the credit market level of efficiency which in turn create benefits to timely borrowers. However, this study was conducted in Brazil that is more developed to Kenya which is still developing hence require more research like the present one to achieve liquidity and thus stability of the banking sector.

Onsarigo (2018) provided an indication that credit information sharing allowed lenders of funds to have access to reports linked with previous credit history and repayment patterns of borrowers. In this study, the effect of credit information sharing was determined through comparison between before the period after and before the bill requiring information sharing was enacted and put into practice in Kenya. The adopted design was descriptive and the analyzed findings showed that SACCOs registered greater financial performance after the credit information bill was enacted than before when the same was passed. However, the study was done among registered deposit taking SACCOs that operate under a different regulator as compared to commercial banks in Kenya hence contextual gap.

2.2.2 Loan Loss Provisioning and Liquidity

De-Araujo, Cohen and Pogliani (2021) focused on the COVID-19 pandemic and explored its implication on loan loss provisioning. The study hypothesized that this pandemic necessitated the need for re-evaluation of the assets of the banks in uncertain conditions. The study did note that the said pandemic created uncertainty that required regulators to grant banks opportunities for implementing international standards on loan loss provisioning. However, this was a mere desk review study that focuses largely on review of related literature while relevant literature is reviewed in the present study to inform conceptualization of variables and design of the data collection instruments which supported the analysis, conclusion and recommendations on credit risk management and liquidity.

Zheng, Perhiar, Gilal and Gilal (2019) placed focus on commercial banks in Pakistan and did an exploration of loan loss provisions and the risk-taking behavior of banks in the country. The specific focus of the study was on establishing key determinants of loan loss provision covering 22 banks in a period from 2010-2017. In this study, credit risk was measured as a proxy on sustainability and the risk-taking behavior of banks. The approach adopted in this study was quantitative and panel data was adopted. The study noted that inflation, lending interest rates and capital adequacy ratio were key determinants of loan loss provisioning. However, the focus of this study was on commercial banks in Pakistan while those in Kenya were explored as the context of the present study.

In a study that was done by Wil and Chau (2022) efficiency assessment was done through stochastic frontier analysis in 22 frontier market countries. After gathering and analysis of

information through regression, it emerged that an inverse nexus exists between loan loss provisioning and efficiency. The implications drawn from these findings were that an expansion in loan loss provisioning strategies can enhance bank performance. However, the study covered efficiency as dependent variable and not liquidity thus the conceptual gap.

Magomere and Otinga (2019) analyzed the effect of loan loss provisioning capital adequacy, operating costs and their implication on financial performance with main focus on microfinance entities in Kakamega County in Kenya. More broadly, the determinants of financial performance of these institutions were explored using a survey design where 122 senior managers from 17 institutions were targeted. The analysis showed that loan loss provisioning, operating costs and capital adequacy were predictors of financial performance of the microfinance institutions. It was recommended that efforts to enhance competitiveness of these institutions require them embrace viable loan loss provisioning practices like debt financing, providing for doubtful debts, loan loss reserves and adequate provisioning expenses. However, the study was done focusing on financial performance as the dependent variable that is conceptually different from liquidity which was used in the present study.

2.2.3 Lending Requirements and Liquidity

Sansa (2019) carried out an investigation in Tanzania with an analysis of loan conditions and access to loans by SMEs. The effect of bank loan extension procedures and access to loans was explored in this study leveraging qualitative as well as quantitative approaches. Respondents covered the customers of the banks and loan officers and their sampling was purposively done. Documentary reviews, interviews and questionnaires aided ion data gathering. It was noted that bank established covenants that had an effect on ability of small firms to access loans. Besides, strict loan extension procedures affected access to loans by borrowers. This study however used interviews to support qualitative approach while the present study was purely quantitative in methodology.

Kiai et al. (2019) documented that collateral requirements negatively affected financial performance of small enterprises. However, the focus of the study was on financial performance as the dependent variable which is conceptually different from liquidity hence the gap. Zakayo and Ondabu (2022) indicated that lending had positive and significant effect on financial performance of listed banks in Kenya. The gap arising from this study however that is its focus was on listed banks which were only 12 in total while all the commercial banks in Kenya were covered in the proposed study.

Rithaa, Munene and Kariuki (2019) conducted an investigation into the nexus between loan collateral requirements by banks and performance of small firms in Maua Town. While 250 enterprises were targeted, 153 were sampled and included in the analysis. Gathering of the information was supported by questionnaire. The analyzed and presented results were that loan collateral requirements had negative effect on financial performance of small firms.

3.0 Research Methodology

This study adopted a positivist research philosophy, which emphasizes objective analysis and hypothesis testing using quantitative data (Sardinha & Pinto, 2019; Siedlecki, 2020). An explanatory research design was used to investigate causal relationships among variables without

manipulation (Adams & McGuire, 2022; Dawson, 2019). The study employed Ordinary Least Squares (OLS) regression models, including both direct and moderated effects, to analyze the relationships between credit information sharing, loan loss provisioning, lending requirements, and liquidity (Rose, McKinley & Baffoe-Djan, 2019). The target population comprised all 39 commercial banks in Kenya as of December 2022, with credit or loan managers serving as the unit of observation. A census approach was adopted due to the accessible population (Thanem & Knights, 2019). Data was collected using questionnaires for primary data and data collection sheets for secondary data from CBK reports, bank financial statements, and World Bank reports, covering the period 2018–2022. Instrument validity was ensured through expert review, while reliability was tested through a pilot study involving 10% of the sample, and Cronbach Alpha values exceeding 0.7 confirmed internal consistency (Strijker, Bosworth & Bouter, 2020). Data was analyzed using SPSS, with descriptive and regression techniques applied. Diagnostic tests included VIF for multicollinearity (Harris et al., 2019), the Shapiro-Wilk test for normality (Bougie & Sekaran, 2019), and Levene's test for heteroscedasticity (Liamputtong, 2019), all confirming that assumptions for regression analysis were met.

4.0 Findings

4.1 Descriptive Statistics

The findings of descriptive statistics determined through means and standard deviations were established and summarized as shown in the subsequent sections.

4.1.1 Credit Information Sharing

The findings in Table 1 indicate descriptive statistics on credit information sharing which was the first independent objective variable that guided the study.

Table 1: Credit Information Sharing

Statements on Credit Information Sharing	Min	Max	Mean	Std. Dev
Credit scores of customers	2.00	5.00	3.71	.750
Internal credit reports	1.00	5.00	3.69	1.116
Credit history of customers	2.00	5.00	3.68	.847
Credit reports from Credit Reference Bureaus (CRBs)	2.00	5.00	3.65	.764

Source: Research Data (2024)

Table 1 indicates that respondents were in agreement that credit scores (M=3.71), credit reports (M=3.69), credit history (M=3.68) as well as credit reports from Credit Reference Bureaus (CRBs) (M=3.65) were all established as critical components of credit information sharing. This implies that credit scores, credit history and CRBs were important elements of credit information sharing that had been adopted by commercial banks. These findings agree with Bowen and Makokha (2021) who noted that credit information sharing provide mechanisms where lenders have an opportunity of assessing borrowers' reports from the Credit Reference Bureaus that provides more information on repayment patterns of customers. In Kenya for instance, some of the CRBs include

Metropol as well as TranzUnion among others and they provide such services as the credit scores, credit reports and credit histories as well as the clearance certificates for the defaulted clients.

4.1.2 Lending Requirements

The findings of descriptive statistics on lending requirements were determined and presented as shown in Table 2

Table 2: Lending Requirements

Statements on Lending Requirements	Min	Max	Mean	Std. Dev
National identification cards of the loan applicants	2.00	5.00	3.88	.932
Passport photographs	2.00	5.00	3.60	.881
Logbooks	3.00	5.00	3.94	.5915
Land title deeds	2.00	4.00	3.65	.683

The findings in Table 2 indicate that logbooks (M=3.94), national identification card (M=3.88) as well as land title deed (M=3.65) and passport photos (M=3.60) were important lending requirements in the studied institutions. These findings imply that financial institutions in deed relied on a number of items as collaterals before advancing credit facilities to loan applicants. The finding agree with Fraisse, Lé and Thesmar (2020) who noted that lending requirements include the national identity cards, official pay-slips and log books or land title deeds among others. Other common lending requirements according to Golubeva, Duljic and Keminen (2019) that commercial banks require from borrowers during the loan appraisal process include their identification requirements like the passports, their levels of income and the amount of their collaterals.

4.1.3 Loan Loss Provisioning, Political Risk and Liquidity

Descriptive statistics on secondary data that was gathered in this study were computed and summarized as indicated in Table 3.

Table 3:Loan Loss Provisioning, Political Risk and Liquidity

Statements on Loan Loss Provisioning, Political Risk and Liquidity	Min	Max	Mean	Std. Dev
Loan Loss Provision	.00	.53	.1767	.13556
Political Risk Index	.10	.38	.1804	.05473
Liquidity	.00	.04	.0078	.00897

Source: Research Data (2024)

The findings in Table 3 indicate values as follow: loan loss provision (M=0.1767), political risk index (M=0.1804) and (M=0.0078) respectively. This means that loan loss provisioning had been set aside by the studied financial institutions. This loan loss provisioning is setting of an expense

in the income statement of the financial institution that cushions the uncollected loans and payments Danisman, Demir & Ozili, 2021). In order to present an accurate picture of the financial status, commercial banks are mandated to provide an account of all expenses and loan defaults hence the need for loan loss provisioning in the financial statements (Nugroho, Arif & Halik, 2021).

4.2 Regression Results

The subsequent sections detail the findings of regression analysis testing the direct and moderating effect between the study variables. The findings from model summary results are as presented in Table 4.

Table 4: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.886[a]	.786	.757	.00609

From Table 4, the value of adjusted R-square 0.757, this means that 75.7% change in liquidity management among commercial banks can be explained by their credit risk management. This means that there are other additional factors aside from credit risk management that have an effect on liquidity of these institutions and the focus of future studies should be on establishing these factors. The findings of ANOVA were determined and presented as shown in Table 5.

Table 5: ANOVA Findings

ANOVA	Sum of Squares	df	Mean Square	F	Sig.
Regression	.004	4	.001	27.523	.000[b]
Residual	.001	30	.000		
Total	**.005**	**34**			

From Table 6, the p-value is 0.000 which is less than 0.05; this means that on overall, the regression model that was adopted in this study was significant. Table 6 is a breakdown of the results of beta coefficients and significance:

Table 6: Beta Coefficients and Significance

Variables	Unstandardized Coefficients		Standardized Coefficients		
	B	Std. Error	Beta	t	Sig.
(Constant)	-.294	.083		-3.542	.000
Credit Information Sharing	.110	.018	.111	6.111	.032
Loan Loss Provision	.127	.021	.119	6.048	.020
Lending Requirements	.121	.012	.964	2.327	.000

From Table 6, the following regression model is predicted and fitted between credit risk management and liquidity of commercial banks in Kenya:

$$\mathbf{Y_{it} = -0.294 + 0.110X_{1i} + 0.127X_{2it} + 0.121X_{3i} + ę} \quad \textbf{(i)}$$

Where:

Y_{it}= Liquidity of bank i at time t

β_0 = Constant term

$\beta_1 – \beta_3$= Regression coefficients

X_{1i}= Credit information sharing of bank i

X_{2i}=Loan loss provisioning of bank i at time t

X_{3i}= Lending requirements of bank i

ę= error term

The constant term (-0.294) is statistically significant (p = 0.000), indicating the base level of liquidity in the absence of the three predictors. All three independent variables recorded positive and statistically significant coefficients (p < 0.05), indicating a direct and meaningful contribution of credit risk management practices to the liquidity levels of the sampled commercial banks.

Specifically, the coefficient of credit information sharing (B = 0.110, p = 0.032) suggests that a one-unit increase in credit information sharing—such as timely reporting to or querying CRBs—improves bank liquidity by 0.110 units, holding other factors constant. This confirms the critical role that transparent credit history and reporting mechanisms play in supporting informed lending decisions and reducing the risk of default, ultimately enhancing a bank's liquid asset position. These findings contrast with Hung-Son, Gia–Khanh and Thanh-Liem (2020), who found insignificant effects of public credit registries on financial development. However, the current study aligns with Bonomo, Bruschi and Schechtman (2020), who reported that greater access to borrower information lowers lending risks and improves credit allocation efficiency.

The coefficient of loan loss provisioning (B = 0.127, p = 0.020) implies that a one-unit increase in provisioning for potential loan defaults significantly increases liquidity by 0.127 units. This underscores the importance of prudent provisioning policies in maintaining financial buffers to absorb credit losses and protect liquidity. The findings support those of Zheng et al. (2019), who emphasized the significance of macroeconomic and institutional determinants in loan provisioning decisions, and are consistent with Wil and Chau (2022), who demonstrated that effective provisioning enhances operational resilience and bank efficiency.

Furthermore, lending requirements recorded the highest standardized beta coefficient (Beta = 0.964, B = 0.121, p = 0.000), indicating a strong and statistically significant effect on liquidity. This means that strict and well-structured lending prerequisites, such as collateral documentation and borrower verification, contribute substantially to mitigating default risks and safeguarding liquidity. This aligns with Sansa (2019), who found that rigorous loan conditions influence borrower access and institutional risk exposure. Similarly, Zakayo and Ondabu (2022) found that improved lending controls were positively linked to bank performance in Kenya.

The adjusted R^2 value of 0.757 indicates that approximately 75.7 percent of the variation in liquidity among commercial banks in Kenya can be attributed to the combined influence of credit information sharing, loan loss provisioning, and lending requirements. The significance of the overall model, as evidenced by a p-value of 0.000 from the ANOVA results, confirms that the regression model is statistically valid and well-suited for explaining the relationship between credit risk management and bank liquidity.

The results provide strong evidence to reject all three null hypotheses formulated in the study. Credit information sharing was found to have a statistically significant effect on liquidity, with a p-value of 0.032, suggesting that increased access to accurate borrower information enhances liquidity management. Loan loss provisioning also showed a significant positive effect on liquidity, with a p-value of 0.020, indicating that setting aside adequate provisions for potential loan defaults contributes to maintaining a stable liquidity position. Similarly, lending requirements exhibited a highly significant relationship with liquidity, with a p-value of 0.000, highlighting the critical role of stringent loan appraisal criteria in managing credit exposure and safeguarding liquidity.

These findings affirm that well-structured credit risk management practices are vital for enhancing the financial health and operational stability of commercial banks. In the Kenyan banking context—where liquidity remains a persistent challenge due to growing credit risk exposures—these practices are particularly crucial in ensuring institutions maintain adequate liquid resources to meet their obligations and support ongoing lending operations.

5.0 Conclusion

The study concludes that credit risk management practices—specifically credit information sharing, loan loss provisioning, and lending requirements—have a significant and positive effect on the liquidity of commercial banks in Kenya. Credit information sharing enhances transparency and supports better credit decisions, thereby improving liquidity. Loan loss provisioning plays a critical role in cushioning against potential defaults, which strengthens a bank's ability to meet its short-term obligations. Similarly, stringent lending requirements help minimize credit exposure and contribute to maintaining adequate liquidity levels. Collectively, these findings underscore the

importance of robust credit risk management in promoting financial stability within the Kenyan banking sector.

6.0 Recommendations

The study recommends that commercial banks in Kenya strengthen their credit risk management practices to enhance liquidity. Specifically, credit managers should invest in modern technologies to facilitate timely access and sharing of customer credit information through licensed Credit Reference Bureaus, leveraging credit scores, reports, and histories to support informed lending decisions and promote financial stability. Additionally, loan officers are encouraged to diversify loan portfolios and adopt robust loan loss provisioning strategies to cushion against potential defaults and sustain liquidity levels. Lastly, bank managers should reinforce lending requirements by prioritizing reliable collateral such as land title deeds and logbooks, thereby reducing credit exposure and contributing to a more stable liquidity position.

7.0 Areas for Further Research

The present study covered all commercial banks in Kenya. Thus, there is need for further studies to be done covering other financial institutions like microfinance banks, Savings and Credit Cooperatives among others in order to improve on representativeness and applicability of the findings. Apart from covering the banking and financial sector, future studies should be conducted on other institutions like manufacturing firms or the non-financial firms. This will provide the basis for generalization of findings.

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