Journal of Entrepreneurship & Project Management

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Davies Kibet & Dr. Mary Kamaara

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[*1]Davies Kibet & [2]Dr. Mary Kamaara

[1]Postgraduate Student, Jomo Kenyatta University of Agriculture and Technology

[2]Lecturer, Jomo Kenyatta University of Agriculture and Technology

*E-mail of Corresponding Author: davies.kibet@gmail.com

Abstract

Africa is widely known to have a hybrid of markets that have little or no transparency. The financial institutions have minimal non-stringent disclosure requirements coupled with a public which has scanty levels of financial literacy. Change of interest rate has an effect on distorting the market thereby generating adverse selection. When this happens, the lenders will usually prefer to minimize their risk by offering debt to clients with higher collateral. The effect of this is a situation where financial intermediation is hampered. Throughout the year, the Private sector credit growth has been declining to close at an 8-year low of 4.3% in 2016, compared to 20.6% in 2015, not picking up even after the interest rate was changed. This was below the CBK's recommended 12-15% growth required to support economic growth and stable job creation. Once the change of the interest rates was effected, banks in Kenya have increasingly preferred to provide debt to the public sector more; the lending recorded a 10.9% increase in 2016. This study purposed to examine the factors influencing effective project financing by financial institutions in Kenya. The specific objectives of the study were to establish the impact of credit risk, credit policy, credit management practice and collateral security on the effective project financing by financial institutions in Kenya. The study utilized descriptive survey research approach. The study focused on commercial banks registered in Kenya. The target population was the top-level chief credit executive, mid-level chief credit executives and credit managers of the 44 financial institutions in Kenya which brought to a total of 132. Since the population of this study was small, census approach was used. The response rate was 91.67% representing a total number of 121 respondents out of 132 questionnaires that were distributed. SPSS was used to code and analyze the data. Correlation result of the study revealed that credit risk, credit policy, credit management and collateral security had a positive and significant association with effective project financing. A multivariate regression model was used for purposes of testing the significance of the impact the independent variables had on the dependent variables and therefore credit risk, credit policy, credit management and collateral security related factors were

computed into single variables per factor by obtaining the averages of each factor. Results of regression revealed that credit risk had a positive and significant effect on project financing due to interest rate. (β=0.115, p=0.000); credit policy had a positive and significant effect on project financing. (β=0.17, p=0.000); credit management had equally a positive and significant effect on project financing. (β=0.073, p=0.025.). Finally, collateral security had a positive and significant effect on project financing (β =0.149, p=0.000). The study concludes that Credit Risk, Credit policy, Credit Management and Collateral Security had a positive and significant effect on effective project financing. The study recommends that commercial banks should adjust their credit policy models which are resulting in declining financial intermediation thus directing their lending in favour of large corporate borrowers and Government thus shunning small and risky borrowers. This will ensure plain playing field for both small and large borrower's hence smooth running of projects.

Key Words: *Credit Risk, Credit Policy, Credit Management, Collateral Security, Project Financing*

1.1 Background of the Study

Africa is widely known to have a hybrid of markets that have little or no transparency. The financial institutions have minimal non-stringent disclosure requirements coupled with a public which has scanty levels of financial literacy (Maimbo & Henriquez, 2014). Getting finance alludes to the capacity to get subsidizing from accessible sources to finance projects or any business improvement which incorporates extending tasks; putting resources into new staff or creation offices (Haron *et al.,* 2013). There are a couple of financing choices for Private Finance Initiative (PFI) plans, for example, bank advances, value, bonds and mezzanine finance. Duffield and Clifton (2009) and UN ESCAP (2011) portray financing choices as pursues: bank credits are reserves loaned by business banks and other budgetary organizations and for the most part securitized by the PFI project's hidden resources. Value is long haul capital given by a financial specialist in return for offers speaking to proprietorship in the organization or project. Bonds are commonly long haul (more noteworthy than 1 year), present moment and possibly garbage bonds (extremely a type of theoretical speculation). Mezzanine finance is set somewhere close to value and obligation in the capital structure of a PFI project, once in a while alluded to as none (or restricted) response finance.

Institutions have a tendency to a great extent of giving loans to customers who have a low credit chance while having monstrous security. Along these lines makes wasteful aspects in the availability of funds. Private sector credit growth has been declining throughout the year to close at an 8-year low of 4.3% in 2016, compared to 20.6% in 2015, which can be attributed to interest rate change (Mbua, 2017). Miller (2013) suggested that change of interest rates can be a handy tool to facilitate a sector to such a time that it is grown enough to sustain itself. Change of interest is also accepted as a means to protect clients from exploitation by lenders where they use high interests especially to low income earners, introducing interest rate ceilings thus assures

availability of credit at affordable and reasonable interest rates. It helps easily prosecute lenders who would deceive clients.

Another rationale suggests that since lenders can set prices at their discretion where the price would be higher than the actual cost they incur while lending. This then may mean that even with the changed interest rate, the lenders would still be able to make profit. The government has the mandate to ensure that consumers are not exploited. Lenders who freely regulate the interest rates especially in countries where the lenders are considered to have high power in the market (Dewatripont & Tirole, 2004). There exists empirical evidence that showed change of interest rate between 1956 and 1994 in the Republic of Korea. The evidence showed that liberalizing the financial market did not offer much help to increase financial depth.

As with the law of demand where if price of credit goes down then demand for credit would drastically increase, it is possible to retain the actual amount of credit due to more stringent credit standards. Even in the face of interest changes, it is still feasible for financial institutions to be profitable though it would reduce the affinity to venture in new markets. Financial institutions are generally unwilling to provide long-term financing for private finance initiative projects, as they suffer from both limited liquidity and visibility (Ismail, 2012). Galindo, Schiantarelli and Weiss's (2007) provided evidence that argued against the utilization of interest rate change saying that it could not be used as an efficient tool to reduce the interest rates, more especially in the long run. The evidence showed that such measures not only lowers the access to credit but also reduce transparency as well as leading to decreased product diversity and competition.

Countries like El Salvador, the Kyrgyz Republic, and Zambia between 2012 and 2013 introduced interest rate ceilings on loans. They opted to do this after the financial crisis. Japan applied more restrictive interest rates. Studies have been conducted that analyzed the impact of interest rate ceilings on loans in the United States of America. It was seen that changing the interest rate impacted the small and medium enterprises to get finances. Marker (2016) was able to show evidence that consumers actually moved to states that were considered to have less stringent lending measures. It was shown that there was a positive correlation between interest rate change and increase in illegal lending. There was also an increase in the average size of each loan (Bodenhorn, Guinnane & Mroz, 2017). The study further showed that with high interest rate changes, the consumers who were considered to be high risk borrowers. This means that with higher return lenders were willing to take up more risk since the return was higher. The higher the interest rate also meant that the probability of default went up.

Through the Capital Subscription law Japan joined other countries in the 2006 Act to reduce the interest rate ceiling. The interest rate went down all the way from 29.2% to the 20%. Some countries have had to use the Supreme Court to make decisions compelling banks to lower interest rates. Japan is an example where the ruling was made at the start of 2006 (Kozako, Soeda, Yoshimitsu, Arima, Kuroki, Hirata & Soeda, 2016). With that move, the financial institutions protested claiming that such a move would make their businesses unprofitable and push them off the market. It emerged from a report given by the Financial Services Agency in

2004 that the lenders were able to get capital from each other at a rate of just 2% yet would still over charge their clients with interest rates going to as high as 27% and 29%. All these lenders still managed to make profits of about 1 billion yen. This largely led to low sympathy for the financial institutions following the uncovering of that information.

The impact of microfinance in the economic growth and development of a state cannot be overemphasized and they play a significant role in the economy, through reduction of poverty by providing financial services to the active poor (Osemene & Abdulraheem, 2011). Marker (2016) was able to establish a trait in Germany and France which specifically affected low-income households. The lenders in France opted to use revolving credit so as to make debt available to households whose income was low. A study by Capera, Murcia and Estrada (2011) observed that there was a negative correlation between restrictive limits on interest rates and financial depth. In Nicaragua, the setting of interest ceiling led the microfinance institutions to greatly reduce lending. Most of the microfinance institutions had to exit the rural area markets as it led to high and unsustainable operational costs as well as risks. The institutions also opted to take advantage of the fact that fees were not capped and therefore increased the fees including other charges to cater for their costs. In countries such as Colombia, the interest rate largely affected low-income firms due to their more transaction costs. However, the recent reduction of 12 caps led to rise in the actual amount that was disbursed by Microfinance institutions (Porteous, Collins & Abrams, 2010). For Bolivia, setting interest rate ceiling in 2004 led to sharp decline in the total number of financial lending institutions that were licensed. (Miller, 2013).

Due to the general tendency for financial institutions to set high interest rates on consumers and especially those that are deemed to be risky lenders, many countries in Africa have opted to change their interest rates in a bid to prevent their consumers from being exploited by banks. This comes as government measures as they respond to cultural as well as political pressures from its citizens who hold the voting rights. Africa is widely known to have a hybrid of markets that have little or no transparency. The financial institutions have minimal non-stringent disclosure requirements coupled with a public which has scanty levels of financial literacy (Dong, 2010). Governments that have introduced interest rate change usually will have good motives. There is a high likelihood that the growth of the institutions is going to be greatly hampered. This would also lead to a reduction in service delivery especially in rural areas as well as other costlier markets. They financial institutions then become less transparent in disclosing the overall cost of a loan. In the long run, this leads to exiting of the market entirely by the financial institutions. Maimbo and Henriquez (2014) were able to establish that the perception of investors will be that when introduction of interest ceilings would lead to a decline in the banks' income. To the investor, this is not a good sign as they infer that their investments in such securities would not generate for them wealth as the growth is limited. The investors would opt for other investment vehicles. Richard, Scott, and William, (2013), provided empirical data that would aid in questioning of the sensibleness of loan interest rates. Their study showed a decline of financing cost yield in Africa from 39% to 25% in between year 2004 and 2011. All these

were despite the fact that there was an increase in financial expenses as well as credit losses over the same duration.

A study conducted illustrated that Africa compared to other regions proved to have a huge continued decline in interest rate yield it was estimated to be at -2.5% between the year 2006 and 2011. The research clearly indicated that the operating expenses take up the biggest share in the components of the interest rate paid by the borrowers. The conducted study showed a decline of 11%. The operating expense ratio dropped from 28% to 19% between 2004 and 2011. Compared to all the other regions of the world, Africa is still leading with that ratio. An issue that needs to be taken into account is being able to clearly identify the variables that can be attributed to drive operating expenses in Africa. Once identified, there would be a need to come up with ways and measures that can be used to ensure that such costs are kept at an optimal minimum. This would make the financial institutions more sustainable in the long run. Djibril (2013) observed the Economic and Monetary community of central Africa which is comprised of 6 countries. The countries are Gabon, Cameroon, the Republic of Congo, Chad, the Central African Republic, and Equatorial Guinea. The countries created an interest change in 2012 October. According to the findings, the loan cost for the microfinance sector was calculated by applying a 33% margin to the recorded six month average (Black, 2011).

To come up with the annual interest rate, the Zambian Central opted to use the annual interest rate that was charged by non-bank financial institutions (NBFI) in the year 2013 to determine the interest rate. The result was that the highest effective yearly loaning financing cost for NBFI assigned as microfinance service providers by the Bank of Zambia would not surpass 42% and the most extreme effective yearly loaning rate that will be charged by all other non-bank money related organizations would not surpass 30%. Ellison and Forster (2006) found out that the NBFIs which were a group of microfinance institutions, credit institutions, forex bureaus and development banks were found to charge their clients very high rates. This they said was to prevent themselves from the high risks that they faced as they were running the businesses. The government intervened since a huge population which was in need of credit could not be able to access it and those who did could only access it at very high prices thus increasing the probability of defaulting. The change of interest rate was introduced so as to tame the exorbitant prices on interest. After sometime, it was found out that this method was not working as lenders did not want to offer credit to borrowers who were deemed to have high credit risk. The change of interest rate was done away with in 2015.

In South Africa, lenders found a loophole that helped them circumvent the interest ceilings that was set. They did this by asking consumer to pay for other services including the life insurance. This move by the institutions lowered the transparency as they would not disclose all the information to the clients. The clients ended up paying for more without their full knowledge. West African Economic and Monetary Union (WAEMU) countries refer to countries such as Benin, Burkina Faso, Cote d'Ivoire, and Guinea-Bissau among others. The financial institutions in the WAEMU countries, the setting of interest costing drove the microfinance organizations to exit from regions thought to be poor and more remote zones. In return, they expanded the

amount advanced to build proficiency and returns. They considered the interest rate that they were offering to be low to sustain their business. An examination by Porteous, Collins and Abrams (2010) discovered that interest rate ceilings in Japan prompted decrease in the acknowledgment loan applications, on the flipside, the unlawful loaning rose.

The Central bank of a given country has the mandate to set interest rates through the monetary policies, as a tool for controlling a nation's economy and controlling the rate of inflation in the economy. According to Taborda (2016), the interest in Kenya averaged at 14.16% between the years 1991 to 2017. In July 1993 it reached an all-time high of 84.61% while recording an all-time record low of 0.83% in September 2003 (Githaiga, 2015). Despite the fact that Kenya had for a long time operated on an interest rate spread of 11.4% which is higher than the world average of 6.6%, a lingering battle ensued to have interest change introduced. The Central Bank of Kenya acknowledged that rates that were being charged on clients were too high and that something had to be done. He however did not support the idea of interest change citing that the lenders would shy from lending to certain clients. (Njoroge, 2016). On the other hand the parliamentarians argued that the change was considered as a policy intervention to push down the cost of loans to the consumers thereby bringing relief to the population against high interest rates paid to the financial institutions.

The bill went through parliament and was signed into law by the Kenyan president on 14th September 2017. The interest rates ceiling was set between a minimum of 10.5% and 14.5% which was 4% points above the CBR (Central Bank Rate). This was a move that was widely celebrated however; the IMF Deputy Managing Director Zhang Tao argued that the monetary policy affected the banking sector's profitability due to the complication of the law. He argued that especially the small banks were hit the most. Another critic to the law was Alistair Gould CEO African Alliance Ltd.'s Nairobi- based unit who alleged that the newly introduced law would cause a drop in net interest margins by at least 200 basis points. He pointed out that banks would bypass the interest rate change by introducing other fees to clients so as to make up for the income they would have gained through higher rates (CBK, 2017).

A study conducted in 2017 states that setting the interest rate ceiling has negatively affected the yield banks earn on their assets, and also the cost of their funds, thus narrowing their net interest margin. This has negatively affected the growth of their funded income (Mbua, 2017). To remain afloat, Banks have resulted to other measures that include laying off staff as well as closing some branches. About 10 banks announced plans of downsizing. The Monetary Policy Committee (MPC) through a Market Perception Survey that was conducted in the year 2017 was able to establish that the private sector growth reduced in 2017 that was as a result of reduced growth in the private sector credit.

1.2 Statement of the Problem

The ideal situation is that every construction project needs to be regularly financed for its successful completion that is to be completed on time and of standard quality; they need to be funded by the financial institutions (Charles & Mori, 2016). Most of the projects are quite

expensive in terms of the material, labour costs and other indirect costs like supervision and monitoring costs. Therefore, project managers are forced to seek for financial assistance from the financial institutions so as to manage to cover up the construction costs (Taborda, 2016).

The real situation is that majority of the construction projects are not able to secure funds because of the tight requirements from the financial institutions. Most of the financial institutions demand very high collateral that scare away the project investors (Maimbo & Henriquez, 2014). Others charge very high interest rates which will take a longer period for the project to break-even in terms of the returns. Financial Institutions have a tendency to a great extent of giving loans to projects which have a low credit chance while having monstrous security. Along these lines makes wasteful aspects in the availability of funds. Private sector credit lending growth to projects has been declining throughout the year to close at an 8-year low of 4.3% in 2016, compared to 20.6% in 2015, which can be attributed to interest rate change (Mbua, 2017). Financial institutions are cutting lending to construction companies at the most sustained rate for seven years, highlighting the pressure on the sector as uncertainty around repayment. The total stock of loans fell by 0.5 billion over the period between 2017 and 2018, with contraction in house building, commercial construction and civil engineering projects (CBK, 2017). Financial institutions have raised concerns about several areas of the Kenyan sectors in 2018, but construction is the first sector to show concrete evidence of a sustained slowdown in lending as lenders become increasingly cautious.

It is because of the stated consequences that justify the examination of factors influencing effective project financing by financial institutions in Kenya. This study may be of great importance to various stakeholders for example, the financial institutions and foreign investors may be able to plan and determine the most appropriate time to make investments in financial sector concerning effective project financing.

1.3 Objective of the Study

i. To assess how credit risk influence effective project financing in Kenya

ii. To determine the impact of credit policy on effective projects financing in Kenya.

iii. To establish the influence of credit management practice on effective project financing in Kenya.

iv. To evaluate the influence of collateral security on effective project financing in Kenya.

1.4 Research Questions

i. How does credit risk influence effective project financing in Kenya?

ii. To what extend does credit policy influence effective project financing in Kenya?

iii. Do credit management practice influence effective project financing in Kenya?

iv. How does collateral security influence effective project financing in Kenya?

2.0 Literature Review

2.1 Theoretical Review

2.1.1 Credit Risk Theory

The Credit risk theory was proposed by Merton (1974). The basic tenet of the theory is that financial institutions aim to maximize their risk-adjusted rate of return by maintaining credit risk exposure within acceptable parameters. There are three quantitative techniques that can be utilized in the examination of credit chance: known as incomplete information, Structural approach and reduced form appraisal (Crosbie, *et al.,* 2003). Such models are ordinarily characterized the structural model and set up on factors related with a specific issuer. Cantor and Frank (1996) set that credit risk hypothesis is the principle uninhibitedly existing portfolio demonstrate for credit risk surveying. The credit risk technique permits gives space for an organization to consolidate credit risk over its entire organization, and gives a statement of value-at-risk (VAR). This is because of credit coming about because of redesigns, downsizes, and defaults. Credit risk model is useful to all organizations that are presented to credit risk amid their operations. This hypothesis is pertinent to credit risk variable since a firm should build up a way to deal with measure credit risk over various instruments. These instruments incorporate; responsibilities and letters of credit, traditional loans; settled salary instruments; business contracts for instance advertise driven instrument for example swaps and receivables and exchange credits (Padilla & Pagano, 2000).

Credit risk theory has a limitation in that internally developed credit scoring models often lack sophistication and usually has not been subjected to critical analysis of the statistical significance of the factors used to develop a credit score and a credit recommendation. This theory is relevant to the study as credit risk is one of the variables of the study. The theory describes how the financial institutions' managers understand the credit risk concept, how the loan defaulters fail to pay their loan leading to risk and thus the financial institutions' managers should find strategies to recover the loans.

2.1.2 The 5 C's Client Appraisal Model

The proponent of the 5 C's Client Appraisal Model is Olomola (2002). The basic tenet of the model is that the client cash flows can be established by examining projections in a futuristic manner and the existing statements of cash flows if available. Other statements that can help in appraising a client include the financial reporting statements including the statement of financial position and the income statement accounts as well as the business plan of the borrower. A list of items is created that provide a guided approach as to the item to focus on.

These include financial ratios. All these will jointly provide the much needed information to the financial institution to know the borrower's ability to repay the loan as well as the client's

expenditure as indicated by the profit and loss statement provided. Other areas to check include the personality of the borrower to the lender. These include the manner in which him/herself present themselves, the social behaviour, their economic standard as well as his/her culture all affects the credit worthiness of the client (Orua, 2009). When addressing the issue of man's psychology factor, the inner worth as opposed to the touchable accomplishments is considered.

The 5 C's Client Appraisal Model has been critiqued in that it has focused on only capacity, capital, conditions, character and collateral. There exist good borrowers who might not possess the 5Cs but they are good in repayment. This theory is relevant to this study since it informs the collateral security and credit policy which are the independent variables of the study. Watchful analysis of the cash flow can give the lender the data of whether the customer can support the loan repayment. Be that as it may, there exists a test in the examination of income which makes it hard on occasion to look at incomes and costs. To conquer this challenge, the solution is to utilize the financial ratios.

2.1.3 Asymmetric Information Theory

The asymmetric information theory can first be traced back to Akerlofs (1970). The basic tenet of the theory is that it paints a picture of where necessary information is not readily available both parties concerned in a transaction (Ekumah & Essel, 2003). Epp (2005) contended that both parties in a transaction are not sufficed with the relevant information regarding to the transaction. Edwards and Turnbull (1994) showed that this situation where there is scanty information to both the borrower and the lender regarding to the risks and returns that are intertwined with projects invested can be referred information asymmetry within the capital market. The lender in this case doesn't have sufficient information about the client. This theory states that the lender is faced by two main challenges which include the ability to monitor behaviour as well as adverse selection which leads to major errors while making the lending decisions as well as moral hazards.

This theory has a limitation in that, sometimes there exist asymmetric information which may have fraudulent consequences, such as adverse selection, which describes a phenomenon where an financial institution encounters the probability of extreme loss due to a risk that was not divulged at the time of policy agreement with the borrower. The information asymmetric theory was very relevant to the study variable which is credit management practices. Denis (2010), states that it is possible to achieve low default rates and higher aggregate lending by the reduction in information asymmetry (increase in shared information) between those who are borrowing and the financial institutions, Information from the other credit registries serves to allow extension of loans to customers priced out of the market previously. Information sharing regarding how worthy a client is ultimately helps to easily assesses the quality of those applying for credit.

2.1.4 Ex Post Theory of Collateral

Ex Post Theory of Collateral was authored by Brick, Kane and Palia (2004). The basic tenets of the theory are that it serves to test the adverse selection hypothesis; the factor is assigned the value one when a borrower defaults on any loan after it is made. An investigation by Inderst and Mueller (2007) argue that borrowers who are seen to be less secure borrowers guessed vow more guarantee. They additionally found that if perceptible borrower hazard stays steady at that point. Loans where collateral is pledged are more likely to default ex post.

Jimenez and Saurina (2004) and Berger, Frame, and Ioannidou (2011) supported the theory saying that either the delinquency or default was positively related to collateral pledges. Further, such suppositions are shared by Dennis, Nandy and Sharpe (2000) who strengthened the way that borrowers who are seen to be riskier appear to really pledge more security. This at that point abandons saying that controlling for recognizable borrower hazard, and additionally collateralized advances will eventually give off an impression of being less secure. Such credits were observed to be more in default (Jime'nez and Saurina, 2004; Jime'nez, Salas, and Saurina, 2006) besides having poor performance in terms of payments past due and non-accruals (Berger & Udell, 1990).

This theory has a limitation in that the ex-ante private information theories appear only to hold for borrowers that are relatively unknown to the lender (i.e., borrowers with short relationships). This theory agrees with the variable collateral security. The Ex-Post Theory of Collateral perceives collateral as a crucial component part of an optimal debt contract. This is done where the lender may invoke ex-post frictions. Just like moral hazard, a prediction is made through observation where the result is that the borrowers who are perceived to be riskier borrowers may be requested to pledge collateral.

2.2 Empirical Review

2.2.1 Credit Risk

Korir (2010) conducted an exploration study in Kenya on the effect of credit risk administration hones on the money related execution of Deposit Taking Microfinance organizations. The independent variable was credit risk management while the dependent variable was performance. The investigation utilized an elucidating research technique in gathering information from 36 staff who were all working in enlisted Deposit taking microfinance establishments in Kenya. The discoveries presumed that Deposit taking microfinance foundations were quick to utilize the credit chance administration practices to guarantee that credit dangers were kept at the very least. The associations adopted diverse strategies to screen and break down hazard before offering credit to any customer. This was done to limit operational loss.

Githaiga (2015) surveyed the impact of credit chance administration on the money related execution of business banks. The independent variable was CAMEL while the dependent was performance. Through a spellbinding examination approach, the investigation could get a top to

bottom investigation of acknowledge chance administration and in addition how the two factors were interrelated. This was done using optional information got from the Central Bank of Kenya distributions on keeping money segment review. Using multiple regressions, the discoveries were first rated in a classified way and in addition relapsed conditions. The discoveries were that there is a solid effect between components in the CAMEL model in relation to the financial performance of commercial banks. The examination likewise discovered that capital adequacy management efficiency and liquidity had a solid association with financial performance (ROA). In any case, it was found that there was a debilitated and negated relationship with money related execution (ROA).

Makori (2015) focusing on 80 respondents through an expressive report conveyed on effects of Credit Risk Management Practices on Profitability of Deposit Taking Sacco's In Nairobi County. Credit Risk Management Practices were the independent variable while profitability was the dependent variable. Utilizing a survey data was assembled and the discovering contribution to SPSS where it was discovered that there was a fundamentally positive connection between monetary gainfulness and credit chance administration rehearses. A report created from relapse examination results showed that the entire process ranging from credit checking, evaluation, obligation gathering rehearses credit chance administration Practices had a direct and positive implication on the money related benefit of SACCOs in Nairobi.

2.2.2 Credit Policy

Byusa and Nkusi (2012) conducted a study on the effects of credit policy on bank performance: Evidence from selected Rwandan Commercial banks. The independent variable was credit policy whereas the dependent variable was bank performance. The data that was relevant to support the fact that performance of banking industry in different fronts from profitability to efficiency during post-liberation policies. After the analysis the findings were that the banks within Rwanda had an increase in their accounts, as well as the customer base. This in turn led to high profitability. However, high spreads were witnessed in non- competitive banking system. It was recommended that Banks should enhance their lending policies as bad debts were still existent

Wanja (2013) using a descriptive research investigated Effects of credit policy used by commercial banks on performance. The independent variables were loan processing procedures, loan amount as well as the disposable credit information and length of credit relationship while the dependent variable was performance. Qualitative research method was used. The study found that the nature of loan terms and conditions had a strong impact on how banks were competitive. Furthermore, the research was able to establish that nature of loan policies, the credit history of the borrower when awarding the loan amount as well as borrower's personal behavior had a huge impact on the volumes of the loans procured by the banks.

Musyoki and Kadubo (2012) cited a study that was conducted by the bank of Jamaica on the execution of credit risk administration approaches and the credit strategies set up by commercial banks in that nation. The study involved 73 banks. The independent variable used was credit

policies while the dependent is policy implementation. The findings were that only 46% had implemented the policies in full. The study found that it was partly attributed to the poor manner in which the regulations had been communicated to them. To be effective, policies must be properly communicated in a good, they should be implemented through all levels of the organization. However, they should no stop at that but ensure that they are revised periodically in light of changing circumstances.

2.2.3 Credit Management Practice

Ntiamoah *et al.,* (2014) carried a study on the assessment of the relationship between credit management practices and loan performance among 400 microfinance using administered questionnaires in the Greater Accra region of Ghana. The study used credit management practices as the independent variable the loan performance as dependent variable. The examination which utilized both subjective and quantitative strategies set up that there was a high and positive relationship between the credit terms loaning, evaluation, credit investigation and credit risk control and awarding implementation.

Owizy (2013) utilizing optional information for the years 2004 to 2008 completed an investigation on the Impact of credit management on financial performance of Nigerian Banks, With Particular Reference to UBA Plc. Credit management was the independent variable while financial performance was the dependent variable. The study found that commercial banks develop credit management practices to govern their credit management operations. Financial ratios were created as a proportion of bank execution, investigations of backward, clear and relationships. The investigation's result was that there was an unmistakable impact on benefits in Nigerian banks due from administration of credits.

Geitangi (2015) conducted a study on the connection between credit risk management practices and the exhibition of advance arrangement of commercial banks in Kenya. Credit risk management practices were the free factor while execution of advance portfolio was the dependent variable. The investigation utilized illustrative overview inquiries about plan. The investigation embraced a statistics consider and gathered information for a long time from 2010 to 2014. Essential information was gathered utilizing semi-organized polls. The optional information was gathered from commercial banks money related reports and CBK supervisory reports. The examination utilized subjective and quantitative methods in breaking down the information. The investigation set up that commercial banks utilized credit risk control practices in credit risk management to an exceptionally extraordinary degree to limit credit misfortune. A direct relapse model was connected to inspect the connection between the variable. From the findings, the study indicated that commercial banks utilize credit risk distinguishing proof, as it were, which brought about decrease in default rates among bank customers. Thestudy presumed that there existed a critical negative connection between utilization of credit risk control and dimension of non-performing advances .Hence utilization of credit risk control practices, all things considered, prompted a diminishing in dimension of non-performing advances in commercial banks in Kenya. The investigation suggests that commercial banks should utilize

credit risk recognizable proof practices in risk management to an exceptionally extraordinary degree. This is because of its effect on decrease of the dimension of non-performing advances. The study likewise recommended that bank should utilize credit risk distinguishing proof to an exceptionally extraordinary degree as this came about into noteworthy decrease in default rates among banks' customers.

Sindani (2012) who conducted a studyon the efficiency of Credit Management System on Loan Performance: utilized observational proof from the small-scale back area in Kenya. She could find that that Credit expressions figured by the microfinance foundations did not influence the advance execution. She additionally discovered that the contribution of credit officers and clients in figuring the credit terms influenced the advance execution. The level of the financing costs charged affected the execution of the credits, as the loan fees went higher, the lower the advance execution was accomplished.

2.2.4 Collateral Security

Japhet and Memba (2015) conducted an investigation on the impact the collaterals on loan performance and specifically for the small and medium microenterprises within Kisii County. The independent variable was collaterals while the dependent variable was loan performance. The study utilized an engaging exploration outline. The examination led an enumeration to help in social event all pertinent data from the banks in the district. Using semi-organized polls, the information was broke down and the discoveries proposed that most banks wanted to utilize engine vehicles as security in order to lessen the danger of default. Further, larger part of the banks discouraged clients from using plot and buildings as collateral.

Charles and Mori (2016) conducted a study on the effect of collateral on loan repayment: evidence from an informal lending institution. The independent variable was collaterals while the dependent variable was loan repayment. The examination utilized a dataset involving 835 individual borrowers drawn from the casual Tanzanian loaning establishment. Using enlightening models of econometric nature, the discoveries recommended that portable collateral led to a rise in probability that borrowers found to be less reliable to acquire credit from informal sources and reimburse them. Another finding was that there was a little extent of customers who had promised steadfast resources as guarantee when obtaining from the casual banks. It additionally demonstrated the effect referral had on credits. It implied that relationship lending and social collateral was important to increased access to finance through informal lenders.

Liberti and Mian (2010) conducted a study on Collateral spread and financial development. The independent variable was collateral spread while the dependent variable was financial development. The investigation demonstrated that foundations that had the enthusiasm to advance budgetary improvement would ease loaning requirements through diminishing the security spread. The investigation utilized novel cross-country credit level information. The investigation evaluated that the insurance spread was the distinction in rates of collateralization among high and generally safe borrowers in a given economy.

2.2.5 Projects Financing

Kibobo (2017) conducted a study on the loan cost change and execution of monetary establishments in Kenya: A contextual investigation of value bank. The examination received utilization of an illustrative plan with a target population of 96 Equity bank staff and clients. Stratified sampling technique was utilized. Essential and optional information were gathered where meetings and polls framed the primary accumulation strategies. Clear examination included weighted midpoints, and rates and information was spoken to in recurrence tables, reference diagrams and pie graphs. The investigation discovered that banks are concentrating on portable banking and government loaning to counter the risk impacts, while KBA is trying to repeal the law; the national bank has been vocal on their readiness to hold the law. The investigation reasons that financing cost topping is certifiably not a long haul measure and suggests better strategies and other material measures.
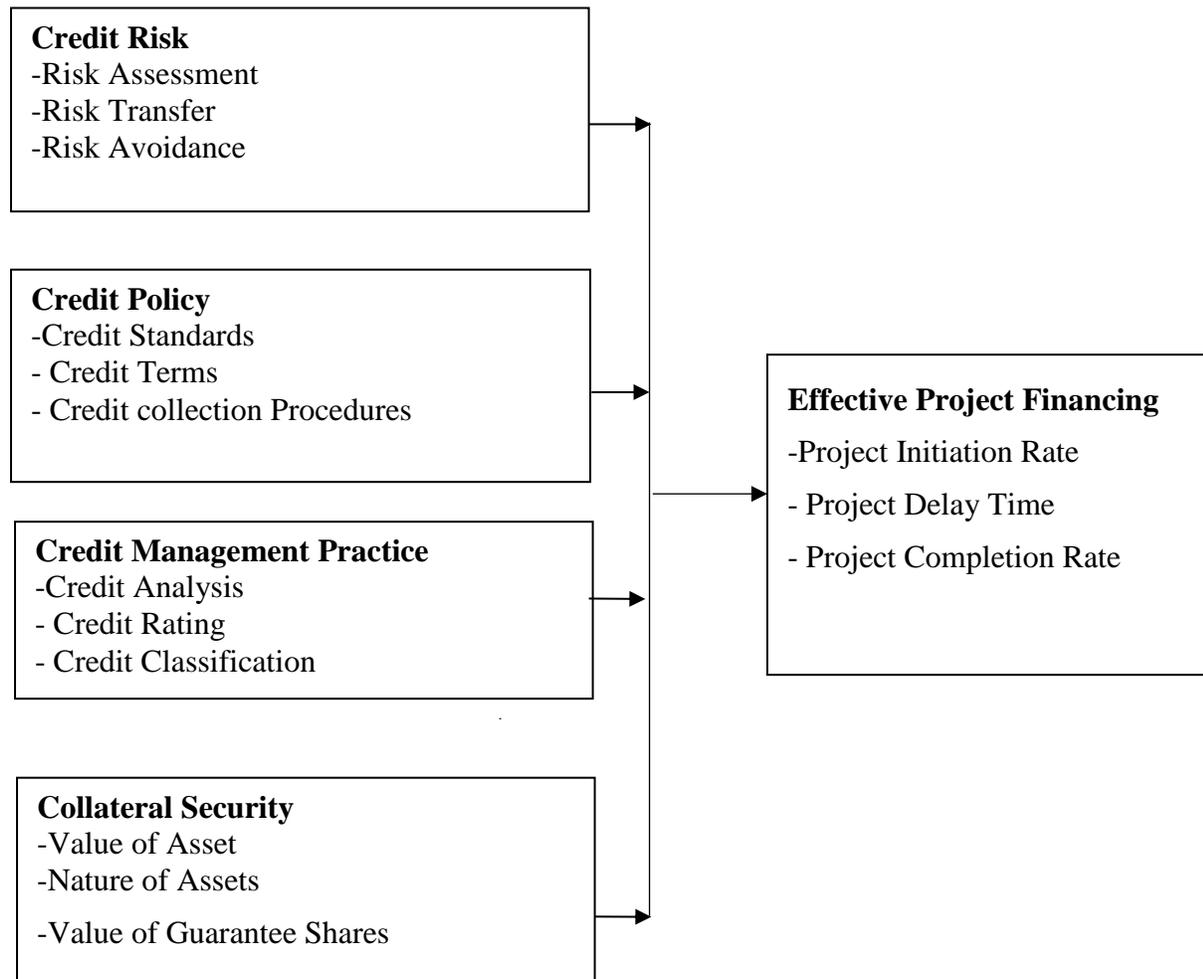
2.3 Conceptual Framework

Credit Risk
-Risk Assessment
-Risk Transfer
-Risk Avoidance

Credit Policy
-Credit Standards
- Credit Terms
- Credit collection Procedures

Credit Management Practice
-Credit Analysis
- Credit Rating
- Credit Classification

Collateral Security
-Value of Asset
-Nature of Assets

-Value of Guarantee Shares

Effective Project Financing

-Project Initiation Rate

- Project Delay Time

- Project Completion Rate

Figure 1: Conceptual Framework

3.0 Research Methodology

The study adopted a descriptive survey design. Descriptive survey design was suitable for this study since it enabled the researcher to collect data from the field and analyze it to obtain the opinion regarding to the factors influencing effective project financing by financial institutions in Kenya. The target respondents for the study were top-level chief credit executive, mid-level chief credit executives and credit managers who were 132 in total. The choice of the top-level chief credit executive, mid-level chief credit executives and credit managers was because they were the key individuals with the key information regarding to credit management in the institutions.

Since the population of this study was small, census approach was used and thus 132 respondents were the unit of observation. The study used structured questionnaires to collect primary data.

The study used multiple regression model as illustrated below:-

$$Y = \beta 0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \mathcal{E}$$

Where:

Y = Financing of Projects

$(\beta i; i=1,2,3,4)$ = The coefficients for the various independent variables

X_1= Credit Risk

X_2= Credit Policy

X_3 = Credit Management

X_4 = Collateral Security

$\mathcal{E}$ is the stochastic term which is assumed to be normally distributed with mean zero and constant variance.

4.0 Research Findings and Discussion

4.1 Correlation Analysis

Table 1: Multiple Correlation Analysis

		Project Financing	Credit Risk	Credit Policy	Credit Management Practice	Collateral Security
Project Financing	Pearson Correlation					
	Sig. (2-tailed)					
Credit Risk	Pearson Correlation	.438**				
	Sig. (2-tailed)	0.000				
Credit Policy	Pearson Correlation	.473**	0.16			
	Sig. (2-tailed)	0.000	0.079			
Credit Management Practice	Pearson Correlation	.424**	.228*	.312**		
	Sig. (2-tailed)	0.000	0.012	0.000		
Collateral Security	Pearson Correlation	.474**	.268**	0.075	.275**	
	Sig. (2-tailed)	0.000	0.003	0.414	0.002	

** Correlation is significant at the 0.01 level (2-tailed).
* Correlation is significant at the 0.05 level (2-tailed).

Results in Table 1 show that, there was a positive and a significant association between credit risk and project financing (r=0.438, p=0.000). The result indicated that there was a positive and a significant association between credit policy and project financing (r=0.473, p=0.000), subsequently the result revealed that there was a positive and significant association between credit management practice and project financing (r=0.424, p=0.000) and finally the results

showed that there was a positive and a significant relationship between collateral security and project financing due to interest change. (r=0.474, p=0.000).

The finding is consistent with that of Korir (2010) who found that store taking micro-finance establishments in Kenya received credit chance administration practices to counter credit risks they are presented to and it likewise by embracing different methodologies in screening and breaking down risks before granting credit to customers to limit on advance misfortune. Githaiga (2015) found that there is a strong impact between the CAMEL sections on the performance of business banks. The examination likewise settled that capital sufficiency the board productivity and liquidity had a solid association with financial performance (ROA) and that credit risk had a insignificant and negative association with financial performance (ROA). Based on the correlation results obtained in this study and the information gathered from the reviewed literature, it can be concluded that, the association between Credit Risk, Credit condition, Credit Management and Collateral Security and project financing is strong and positive meaning that, a change in Credit Risk, Credit condition, Credit Management and Collateral Security results into a change in project financing by the same direction.

4.2 Regression Analysis

Table 2: Model Fitness for the Regression

Indicator	Coefficient
R	0.712
R Square	**0.507**
Adjusted R Square	0.490
Std. Error of the Estimate	0.299

Table 2 presents result of model fitness used in regression to show the overall significance of the model. The coefficient of determination also known as R square shows how much the independent variables explains on the variation in the dependent variable. According to the result, R square was found to be 50.7% and this is an indicator that Credit Risk, Credit condition, Credit Management and Collateral Security explains 50.7% of the dependent variable which in this case is the project financing. The finding were found to be consistent with the findings of Ntiamoah *et al.* (2014) whose study found that there was a strong positive and significant relationship between the credit terms and strategy, loaning, credit analysis and evaluation, and credit risk control and advance execution. In addition, the results of this study were found to be consistent with the findings of Owizy (2013) which indicated that there was unmistakable impact on benefits in Nigerian banks due from the board of credits. Based on the findings of this study and the information obtained from the reviewed literature, it suffices to conclude that Credit

Risk, Credit condition, Credit Management and Collateral Security are satisfactory variables in explaining the variations in project financing.

Table 3: Analysis of Variance

	Sum of Squares	df	Mean Square	F	Sig.
Regression	10.696	4	2.674	29.866	.000[b]
Residual	10.386	116	0.09		
Total	21.083	120			

The result in Table 3 presents result of Analysis of Variance (ANOVA). The results showed that the overall model was significant. From the finding of the model after analyzing through SPSS indicates that F= 29.866 and p=0.000 which was less than α=0.05 significant level hence showing that the independent variables are good predictors of project financing. The finding were found to be consistent with that of Wanja (2013) who revealed that the nature of loan terms and conditions had a strong effect on the competitiveness of the banks. The nature of loan policies, credit history of the borrower in awarding loan amount and borrower's personal behavior had an influence on volumes of the loans procured by the banks. Based on the findings of this study and those of existing literature, it can be concluded that much as the variables used in this study are satisfactory in explaining project financing, they are not the only ones. Other factors which have influence on project financing include; credit history, nature of loan policies and personal behavior.

Table 4: Regression of Coefficients

	Unstandardized		Standardized		
	B	**Std. Error**	**Beta**	**t**	**Sig.**
(Constant)	1.015	0.181		5.598	0.000
Credit Risk	0.115	0.031	0.254	3.679	0.000
Credit Policy	0.17	0.033	0.356	5.162	0.000
Credit Management Practice	0.073	0.032	0.163	2.278	0.025
Collateral Security	0.149	0.031	0.334	4.811	0.000

From the regression model, taking all factors into account; (Credit Risk, Credit policy, Credit Management and Collateral Security) held constant at zero, project financing due to interest rate was 1.015. On the other hand holding other factors constant, a unit change in credit risk would lead to an improved project financing by a factor of 0.115; a unit change in credit policy when holding the other factors constant would lead to a 0.17 improvement in project financing due to interest rate; a unit change in Credit Management Practice when holding the other factors

constant would lead to a 0.073 improvement in project financing. Further, a unit change in collateral security when holding the other factors constant would lead to a 0.149 improvement in project financing.

Based on the results in Table 4 of regression of coefficients, credit risk had a positive and significant impact on project financing because of credit interest (β=0.115, p=0.000); credit policy was found to have a positive and significant effect on project financing. (β=0.17, p=0.000); the results showed that credit management practices had similarly a positive and significant effect on project financing (β=0.073, p=0.025). Finally, the results revealed that, collateral security had a positive and significant effect on project financing (β =0.149, p=0.000). The finding were found to be in agreement with the findings of Charles and Mori (2016) which demonstrated the constructive outcome of referral, which concluded that relationship loaning and social security is critical to expanding access to fund through casual banks. Japhet and Memba (2015) found that most banks incline toward the utilization of engine vehicles as security so as to lessen the danger of default. Further, greater part of the banks disheartens customers from utilizing area and structures as securities. Based on these findings, it suffices to conclude that an improvement in Credit Risk, Credit condition, Credit Management and Collateral Security leads to an improvement in project financing by 0.115, 0.17, 0.073 and 0.149 units respectively. The general model therefor became:

Project finance =1.015+ 0.17Credit policy + 0.149Collateral security+ 0.115Credit risk+ 0.073 Credit management practices

5.0 Conclusion of the Study

The main aim of the study was to examine the factors influencing effective project financing by financial institutions in Kenya**.** Based on the findings, credit risk, credit policy, credit management practices and collateral security has influence on financing of projects. The study concluded that credit risk has a positive and significant effect on project financing. The study revealed that commercial institutions tend to create a distortion in the market and consequently create market biases. The study concludes that the lending institution need not to be inclined in lending to clients exhibiting low risks only but also to all clients with genuine need thus avoid creating an insufficient market hence projects will be accomplished in time.

The examination infers that credit strategy has a positive and significant effect on project financing. Further, Customers' capability criteria and different systems ought to be so that ventures are not hampered and the financial foundation gets their contribution. The examination infers that credit the board has a positive and huge impact on undertaking financing. It tends to be inferred that the issue of advance default, which is come about because of poor credit the board, diminishes the loaning limit of a bank. It likewise denies new candidates' entrance to credit, as it is the bank's income the board issues. Finally the study concludes that collateral security had a positive and significant effect on project financing. It concludes that those who seek for financing of their projects are only attracted by the change in rate but find but find it hard to access the finances because of the collateral security.

6.0 Recommendations of the Study

The investigation makes recommendations dependent on the supports displayed in chapter one of the examination. The examination recommends the government of Kenya to control on the credit approach of the budgetary organization for instance topping on the loan cost with the goal that the money related foundations can't charge high financing costs that can drive off potential speculators in the nation. This may help in arranging and furthermore in approach improvement to fortify the accomplishment of advancement ventures.

In view of the discoveries, the investigation prescribes for the budgetary foundations to work inside well-characterized credit criteria. These criteria should unmistakably set out the organization target advertise, the borrower's accreditation necessities, reason and structure of credit, and the wellspring of reimbursement. The examination prescribes for money related foundations' top managerial staff, in a perfect credit chance condition, ought to include and assume the liability of intermittently looking into the credit chance strategies of their establishment. The strategy, as and when embraced by the board, ought to unmistakably express the establishment's resistance level for dangers, and furthermore the financing cost spread it requires for going out on a limb. The investigation recommends for budgetary foundations' to guarantee the presence of a particular Department of credit hazard the board, attempting to recognize, measure and screen credit chance, and the proficiency of the treatment and the substance of these hazard stools.

In conclusion, the investigation prescribes for the future analysts to present various factors other than credit chance, credit strategy, credit the board practice and guarantee security and test for balance or intervening impact of such factors. Studies utilizing other extra factors, for example, hierarchical size, as arbitrators or middle people can be completed to increase further bits of knowledge into the connection between the variables impacting successful venture financing and the adequacy of task financing. Future specialists could consider completing a comparable report in an alternate part or divisions to evaluate any variety in reactions. It is fascinating to investigate how the outcomes acquired when the strategies connected in this examination are connected in different settings for instance in different nations at higher or lower phases of improvement. It would be beneficial building up the degree to which the discoveries of this examination are generalizable to different enterprises, divisions or settings

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