

CREDIT PRUDENTIAL GUIDELINES AND LOAN PERFORMANCE OF MICROFINANCE BANKS IN KENYA

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ABSTRACT

The credit prudential guidelines comprise interventions promulgated by Central Bank of Kenya aimed at mitigating credit risk faced by the banking sector. When they were issued, these guidelines which include: loan classification criteria, loan provisioning guidelines, loan write-off procedures and loan renegotiations were said to be key pillars in combating the non-performing loans menace that dogged the banking sector since independence in Kenya. Nonetheless, a review of studies carried out to evaluate the effectiveness of credit prudential guidelines in meeting this objective have provided conflicting results. It is this inconclusive situation that has motivated a follow-up study to establish an accurate empirical position. The study therefore sought to investigate the relationship between credit prudential guidelines and loan performance among the Kenyan microfinance banks by determining the influence of loan classification criteria, loan provisioning guidelines, loan write-off procedures and loan renegotiation policy on loan performance among the licensed microfinance banks in Kenya. The study was anchored upon the regulatory capture theory and the Laffort and Tirole Model. The study adopted descriptive survey research design and targeted 14 microfinance banks registered and licensed to operate in Kenya as of 31st December 2021. Structured questionnaires were used to collect primary data on the independent variable in all the 14 MFBs. A data collection sheet was used to collect secondary data on the dependent variable over a 10-year period (2012 - 2021). Respondents comprised the branch managers and credit officers. Both descriptive and inferential statistical analysis techniques were employed to obtain the results. Results showed that all the four credit prudential guidelines used in the study had a negative and significant influence on loan performance among Kenyan microfinance banks; implying that their implementation led to lower NPL ratio. Consequently, it is recommended that management of the microfinance banking institutions should continuously institutionalize the four credit prudential guidelines as primary tools for managing credit risks. Further, the Central Bank of Kenya should strengthen the credit supervision function to negate the growing trend in non-performing loans among the lenders by instituting appropriate sanctions

Keywords: *Credit Prudential, Credit Risk, Banking Sector, Loan Classification Criteria, Loan Provisioning Guidelines, Loan Write-Off Procedures and Loan Renegotiations*