

EFFECTIVENESS OF CREDIT REFERENCE BUREAU ON  
ENHANCING FINANCIAL PERFORMANCE: A CASE EQUITY BANK  
IN NAKURU COUNTY.

Presented by  
Ruthwinnie Munene  
KABARAK UNIVERSITY

# INTRODUCTION

All over the world, financial institutions face enormous risks of non-performing loans (NPLs). To overcome this challenge, an institution is required to monitor the behavior of borrowers. Thus, the idea of establishing Credit Reference Bureau (CRB) was conceived in order to enable financial institutions to determine credit worthiness of their borrowers and to reduce the loan default risk (Epure and Lafuente, 2012).

# Role of Credit Reference Bureau, CRB

CRB is a company that collects information from various sources and provides consumer credit information on individual consumers for a variety of uses.

It provides detailed information on a person's credit history including information on their identity, credit accounts and loans, bankruptcies and late payments and recent inquiries. Other information shared include:

- proven frauds and forgeries;
- cheque kiting;
- false declarations and statements;
- receiverships,
- liquidations;
- credit default and late payments;
- use of false securities;
- and misapplication of borrowed funds.

# CRB and Financial Performance

CRB assists in

- sharing information on default among banks;
- eliminating corrupt borrowers,
- to provide commercial professional credit reference to prospective foreign investors;
- identify credible borrowers based on known history and character.

This has significantly revolutionized lending and contributed to the improved financial performance of many financial institutions in Kenya

# Statement of the Problem

The high financial cost of borrowing generally reduces the borrowers' repayment capacity thus resulted in credit risk. An increase in credit risk is a critical source of economic distortion and stagnation which must not only be monitored but also controlled. In response, credit reference bureau has been used to manage credit risk in the financial sector. However studies have not been done to find out its effectiveness on addressing credit access and financial performance in financial institutions. This research sought to investigate this problem in Equity bank Nakuru.

# Objectives of the Study

To find out whether CRB enhances risk identification in financial performance in Equity Bank.

To establish whether CRB influences the rate of credit repayment enhancing financial performance in Equity Bank.

Identify the influence of CRB on credit access in enhancing financial performance at Equity Bank and to

Identify the rate of reduction on moral hazard in enhancing financial performance in Equity Bank.

# Significance of the Study

The findings of this study may help financial institutions in formulating effective policies related to credit access in FI institutions

The findings of the study may also be used by policy makers, researchers and microcredit professionals to understand and control the impact of increasing non-performing loans from the economy due to credit risk.

The findings of the study may provide rich data for further research by university students specializing in finance and the general public interested in understanding the dynamics in the financial sector.

# Scope of the Study

The extent of this study was restricted to analyzing the effectiveness of credit reference bureau on credit control and credit access in FI Equity in Nakuru Town



# Limitation of the Study

Some respondents were not able to give relevant information because information on finance may be regarded as sensitive and confidential.

# Adverse Selection Theory

Stiglitz and Weiss (1981) originated the concept of adverse selection. The theory rests on two main assumptions: that lenders cannot distinguish between borrowers of different degrees of risk, and that loan contacts are limited.

It assumes that borrowers repay loans when they have the means to do so

# Credit Rationing Theory

For banks to exist they have to screen and monitor borrowers more efficiently than other investors (Allen and Santomero, 1998).

# Overview of Development of Credit Reference Bureaus

According to World Bank Survey (2009) about 60 countries have Public Credit Registries (PCRs). PCRs contain information on the performance of borrowers in financial systems and are administered and maintained by the central bank.

The operations, establishment, governance and management of CRBs is provided through the banking (Credit Reference Bureau) regulations of 2008. Establishment and licensing of credit reference bureaus in Kenya, is through an entity incorporated as a limited company under the companies Act and application for a license is made through the Central Bank of Kenya

# RESEARCH METHODOLOGY

The study used a case study research design. The case study design was used because it gives a description behind the results by capturing whatever happens and gives opportunity to highlight and bring attention to particular challenges (Neale et al, 2006). The population of the study involved the staff of Equity bank Nakuru because they have adequate knowledge on CRB as a credit risk management strategy. Equity Bank targeted population would be the credit officers of whom were involved in the study

# Data collection

To collect primary data, questionnaire was used because they were valuable methods of collecting a wide range of information from a large number of respondents and they are usually straightforward to analyze.

# DATA PRESENTATION AND ANALYSIS

## **CRB AND CREDIT RISK IDENTIFICATION AND MONITORING**

### **FAILURE TO MEET TERMS OF CONTRACT**

Out of the 32 respondents 29 responded of customers having failed to meet the terms of the contract which constitute 91% while only 3 responded of customers never failing to honor the contract which is only 9%.

## CONSIDERATION OF PAST AND FUTURE REPAYMENT

Of the questionnaire administered 30 staff responded having to consider past and future performance in loan repayment which constitute 94% while the remaining 2 which is 6% responded not having to consider past and future performance before awarding a loan .



# INDICATORS OF LOAN REPAYMENT

From the response received 72% of the respondents state that despite the importance of a good repayment history, it does not come with rewards during the loan process. 94% of the respondents concur that credit reporting allows banks to distinguish between good and bad borrowers. 84% of the respondents state that CRB is the best way to determine credit worthiness of a prospective borrower. 69% of the respondents concur that CRB enables customers repay their loan promptly probably due to fear of listing. Of the 32 respondents who responded 25 responded of the bank having to rely on credit reports which constitute 78% while 7 responded of the bank not relying on credit reports which is 28% .

# CRB AND MORAL HAZARD

## Influence of CRB on rate of moral hazard

67% (22 out of 32) of the respondents agreed that indeed it influenced the rate of moral hazard.

# Disclosure of all material information and CRB influence before disbursement

Of the 32 respondents who responded the highest percentage of 63% agreed that all information is revealed and 48% also agreed that CRB influences bank decision before disbursement whereas 19% strongly agreed on the first parameter of revealing all information 31% strongly agreed on CRB influence before disbursement. 2 % did not have information whether the bank reveals information whereas 1% also did not have information on whether the CRB influences the bank decision before disbursement 9% disagreed on first parameter whereas 9% disagreed on the CRB influence before loan disbursement. Of the total 9% strongly disagreed on revealing of information in the contract while 9 % also strongly disagreed on the CRB influence before disbursement of the loan.

# FINDINGS DISCUSSIONS, CONCLUSIONS AND RECOMMENDATIONS

From the findings it shows that CRB has had a significant impact on credit risk identification and monitoring at Equity bank it has also had a positive influence on the rate of loan repayment in addition to ensuring that access to credit has improved this also result to high rate of moral hazard at Equity bank Nakuru.

# First objective

The researcher wanted to find out the influence of CRB on risk identification and monitoring at Equity Bank Nakuru. 94 % of the respondents stated that the bank considers the credit history of the prospective borrower with an aim of carrying out due diligence on the borrower

For the second objective,

The researcher used a Likert scale to ascertain whether CRB has influenced the rate of credit repayment at Equity Bank Nakuru. 69% of the respondents felt that CRB has enabled clients promptly repay their loans while a further 84% argued that CRB is the best way to determine credit worthiness.

# The third objective

was interested in determining whether or not CRB has influence on the rate of credit access in Equity Bank Nakuru. 88% of the respondents felt that CRB has led to increased access to credit.

## Fourth objective focused on moral hazard

That is, has CRB influenced the rate of moral hazard in Equity Bank Nakuru? 88% of the respondents stated that they understood the concept of moral hazard and a further 67% of the respondents stated that indeed CRB has had positively influenced the rate of moral hazard in Equity Bank Nakuru.

This phenomenon can be attributed to the fear of getting listed and the consequences thereof that is prevalent among clients.



# Conclusions

CRB has played a significant role in as far as risk identification and monitoring is concerned. Moreover, CRB has significantly helped reduce the rate of loan default in the economy as well as increasing credit access. Lastly, it has led to a reduction in the level of moral hazard in Equity Bank Nakuru.

# Recommendations

From the study, it has been deduced that clients are not getting appropriately rewarded for having a good credit repayment history. Measures need to be put in place to ensure that clients get an advantage for promptly repaying their loans in terms of the interest rate they pay.

This is what is envisioned in the recently introduced annual percentage rate (APR) method of pricing loans where one Kenya Bank's Reference Rate (KBRR) currently capped at 9.13% is applicable for all commercial banks. It is hoped that this will help cushion those with a good credit rating from CRB hence increasing efficiency in the banking sector. Moreover, more needs to be done in as far as updating client data by CRB.

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