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# An Assessment Loan Policy and Its Influence on Financial Performance of Commercial Banks in Eldoret Town

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***Abstract:*** *The purpose of this study was to examine the Loan policy and its influence on financial performance of Commercial Banks in Eldoret town, Uasin Gishu County. To achieve this the study sought to find out the effects of liquidity management on financial performance of commercial banks in Eldoret town and to investigate the influence capital adequacy requirements as a determinant financial performance of commercial banks in Eldoret town, The study was guided by the two theories that is transactions cost theory and asymmetric information theory. The target population was 156 respondents drawn from the various banks and comprises of branch managers and credit officers. To get a representative sample, the study used purposive sampling method to sample branch managers of the commercial banks licensed by central bank of Kenya and for the case of selecting credit officers the study used simple random sampling technique. Data was collected using questionnaires and analyzed using descriptive and inferential statistics. The relationship between variables was done using multiple linear regression models. Tables were used to present the results. Based on the findings of the study, the study findings indicated that all the variables of the study, liquidity management, capital adequacy, governance adoption and shares savings and deposits are predictor variables for financial performance of commercial banks. The study suggests that further study should be undertaken in order to investigate the determinants of loan performance in commercial banks in Kenya.*

***Keywords:*** *Liquidity management, Capital adequacy and financial performance.*

## I. Introduction

### 1.1 Background

Commercial banks might supply lending on short, medium and long-run basis jointly of the various services rendered by commercial banks to their customers (Athanasoglou, 2005). Commercial banks offer loans and advances to numerous people, business organizations furthermore as government thus enabling them to begin investment and numerous development activities as a mean of aiding their growth particularly causative toward the economic development of a country normally (Han, 2008). Bank plays a very important role of savings, mobilization and monetary resource allocation to varied establishments. These roles create them a very important contribution towards economic process and development. By performing arts this role, commercial banks have the ability, prospects and scope to mobilize monetary resources and allocating them to productive investments. regardless of the sources of the generation of financial gain or the economic policies of the country, industrial banks would be additional willing to offer out loans and advances to their numerous customers bearing in mind, the principles that guide their operations that embrace, profitableness, liquidity and financial condition (Mutesasira, 2007).According to Chantapong (2005) commercial banks choices on whether or not to lend out loans are influenced by numerous factors which are the prevailing rate, volume of deposits, level of domestic and foreign investment, the liquidity magnitude relation, status and public recognition. Lending practices round the world may be back derived from the amount of amendment in industries that enlarged the rate of production activities thereby transfer regarding the necessity for big capital to fund comes. Several leaders of business at this era were notable to converge with the explosion within the monetary needs and so they turned to the banks for finance (Athanasoglouetal, 2005).Yaron, (2007) argues that disposition is that the integral a part of commercial banks business. Therefore, their administration needs considerable quantity of skills and sleight on the management half. once the bank is irrevocably committed to paying interest on deposits it's mobilized from numerous sources, their ability to articulate loan ready avenues wherever deposits is also place to form financial gain. Maintaining liquidity and guaranteeing safety needs improved pragmatic policy formulation and applications. a lot has modified in terms of disposition activities of varied industrial banks. Opinions deliberated on factors that are answerable for banks temperament to lend a lot of credit to varied sectors of the economy, and a few highlighted the results of extension of credits on productivity and output (Mutesasira, 2007).. This might flow from to poor receiver behaviour and lack of relationship disposition as proved by unfavourable loan policies. Dang (2011) found a positive relationship between policy on loans and monetary performance in Ghanaian commercial banks (Njiru, 2006).

According to Mutesasira, (2007), loan underwriting policies and also the written documentation that sets forth these standards, as determined by loan committee of the bank. A bank's loan strategy may produce low standards of credit in taking different loans, procedures in thought of the past-due and delinquent loans.

There exist systems in place and procedures that banks have in places so as to secure payment from their customers once payment becomes due. Systems are began, the follow up and late payment chasing procedures similar to letter and telephone calls. They are available in to operations once customer’s account becomes delinquent. it's only payment has been obtained from a client that the sale is complete (Wei, 2007). collection policy is a very important part of the general credit risk management method among commercial banks. a good assortment policy is essential in dominant the investments in debtors and additionally reducing the danger of monetary loss and illiquidity through slow payment (Kabiru, 2002). If the collection policy is incredibly demanding, it's going to create customers get different suppliers and this could need putting a balance thus on guarantee business continuity. It’s a reality that there'll be late payers in client base. Once payments square measure thought to be late varying of procedures and ways is also adopted to get payments.

How best a company is seen to be performing may be analysed at in form of profits and returns. Performance is measured by the end result of a firm’s policies and operations in financial terms. Lending is risky to most banks as a result of reimbursement of loans will rarely be absolutely secured. According to Brown (2006), implicit contracts between lenders and borrowers, thus, banking relationships will encourage high effort and timely repayments. Foluso (2008), additionally make sure that long-run relationships area strong tool.

Markets of credits are subject to short interactions, borrowers might solely be actuated to repay if they understand that, because of reporting of credit, their current behavior is seen by different lenders. Foluso (2008), in his study shows the role of reporting on loan pattern of reimbursement and performance of market on credit depends on the effort of relationship integrate banking. Hence, once mutual relationships are not possible, the credit market primarily collapses within the absence of acceptable customer behavior. As repayments are not third-party enforceable, several borrowers default and banks might not fruitfully offer credit contracts to customers (Brown et al, 2006).

Commercial banks in Kenya play a vital role in mobilizing financial resources for investment by extending credit facilities to many companies and investors. Loans however expose the banks to the greatest level of risk. There are 43 licensed commercial banks in Kenya, one mortgage finance company and one credit reference bureau. Of the 43 financial institutions, 32 are locally owned and 11 are foreign owned. The Credit Reference Bureau of Africa was the first to be registered in Kenya by the Central bank of Kenya that aims to enable commercial banks to share information about borrowers to facilitate effectiveness in credit scoring (CBK, 2012).

**1.2 Statement of the problem**

Loan policies and procedures are designed to guide lending and ensure prudent lending operations. Recently, issuing of loans has become an issue of concern for commercial banks. It’s difficult for businesses and individuals to fulfill the banks requirements to receive loan, this is because small and growing firms often operate in new unexplored business locations that are prone to higher risk (Bruns, 2004). It is further argued that commercial banks have difficulties in giving loans to customers because of asymmetric information, which is in a higher level than for big firms that are public. It is hard for financial institutions to acquire valuable information about small businesses, because of less and uncertain information (Binks, Ennew& Reed, 1992).

Commercial banks heavily depend on the customer’s and organization’s credit history in borrowing to award certain amount of loans, that account movement is seen to be a vital element in taking into account approval of loans. Commercial banks consider borrower's personal behavior as an important factor in approving loans sought from the banks. The type of the credit policies used by the commercial banks influence the number of the loans procured by the financial institutions and thus the competitiveness of the commercial banks in credit facilities and thus the performance in the banking sector (Sangmi, 2010).

Locally few studies have been done on loan policies, among them includes on credit risk management in commercial banks in Kenya and found out that despite the fact that commercial banks have put in place strict measures to management of credit risk, recovery of loan is still an issue to many commercial banks.

The study by Akinlo and Ogo-Temi (2002) indicated that effective loan policies lead to better bank performance. The result of the study by Adebisi & Oloyede (2004) is supported by the study by Hosna et al (2009) in Sweden and Flamini et al., (2009) in Sub-Saharan Africa commercial banks. To improve this banks tend to reduce interest rate but are not willing to lend and yet people are willing to borrow .Therefore this leaves a gap that this study sought to fill this gap by assessing loan policy and its influence on financial performance of Commercial Banks in Eldoret town.

### 1.3 Objectives of the study

The main objective of the study was to assess loan policy and its influence on financial performance of Commercial Banks in Eldoret town. The study was guided by the following specific objectives;

i. To determine the effect of mobile banking on customer loyalty among commercial banks in To identify the effects of liquidity management on financial performance of commercial banks in Eldoret town.
ii. To investigate the influence of capital adequacy requirements as a determinant financial performance of commercial banks in Eldoret town.

### 1.4 Research Hypotheses

**$H_{01}$:** There is no significant relationship between liquidity management requirements and financial performance in commercial banks in Eldoret town.

**$H_{02}$:** There is no significant relationship between capital adequacy requirements and financial performance in commercial banks in Eldoret town.

## II. Literature Review

### 2.1 Theoretical review

The theoretical framework of a research project relates to the philosophical basis on which the research that is done, and becomes a link between the theoretical aspects and the practical components of the investigation undertaken. The study was guided by the two theories that is transactions cost theory and asymmetric information theory.

### 2.1.1 Transactions Cost Theory

This study was guided by Transactions Cost Theory developed by Schwartz in the year 1974; this theory conjectures that financial institutions can also have an advantage over conventional creditors in checking the actual financial situation or the creditworthiness in their clients. Financial institutions actually have a higher ability to display and force compensation of the credit score. These kinds of superiorities may additionally provide providers a cost advantage when in comparison with monetary establishments. Three resources of fee benefits have been cataloged with the aid of Rajan and Petersen (2007) benefit in information acquisition, in controlling the consumer and in salvaging value from present assets.

The first supply may be even by the very fact that financial institutions will get data regarding consumers quicker and at lower price as a result of its obtained during a traditional course of business. That is, the frequency and also the quantity of customer orders offer providers an idea of the customer’s condition; the client use of cost reduction for early payment might serve to alert the supplier of a weakening within the credit-worthiness of the buyer, and sellers typically visit customers a lot of typically than lenders. Smith (1987) in his model concludes that during a two-part credit with high rate, those consumers that don't value more highly to make the most of the discount may be understood as high risks, as a result of they'll be having financial difficulties. Counting on penalties for later payers, straightforward web terms will turn out an identical sign.

The ability of the financial institutions to save values from assets that exist is that the third supply of cost advantages.. Within the case of purchaser default, the financial institutions will seize the products that are provided, of course, financial institutions will reclaim the firm’s assets further. The distinction between them is that as corporation’s commercialism are fairly often from identical business, the provider already contains a network to sell the products and consequently repossessing and marketing prices would bellower. Two interesting approaches related to this cost advantage were made by Petersen androgen (2007). the higher collateral they supply and also the bigger the credit offered by the suppliers. The latter show that the extent to that the purchasers rework the merchandise is additionally important. The less they're reworked, the better it'll be for the supplier to repossess and sell the quality victimization identical channel. Another study associated with transaction cost theory was created by mineral (1987), and hypothesizes that there's a positive relation between credit offered and demand variability. This analysis intends to find out how transaction cost theory has affected financial performance of commercial banks.

### 2.1.2 Asymmetric Information Theory

Financial institutions, commonly, do now not understand the actual credit-worthiness in their consumers and additionally customers do now not have information obout their quality of service. To remedy this problem, Smith (2007) developed a model in which financial institutions provide two part credit terms, to enable them apprehend potential defaults faster than financial intermediaries. Smith also proposed that with asymmetric information about product great, financial institutions provide change credit score to permit customers to verify product high-quality earlier than charge. The motive that leads financial institutions to increase this credit is that they've a huge interest in a purchaser’s achievement, on account that they count on the

purchaser to shop for more items and carrier from them in the destiny. even though success of the customer is crucial, the quality of the product bought is also essential, and could determine new purchases (Deloof, 2006).
As a consequence, corporations fairly often supply money-back guarantees as warranties further. Trade credit has some advantages in comparison with money-back guarantees and warranties. First, in a very case of money-back or warranties, if the vendor isn't in business any longer, the clients are often broken. Second, once payment is created at the time of sale, a client, seeking the benefits of the money-back system, could attempt to persuade the vendor that the standard of the merchandise isn't as secure (Wei, 2007).

According to Lee and writer (2003) small corporations tend to supply a lot of trade credit than massive corporations, since tiny corporations still got to establish their name concerning product quality corporations with longer production cycles prolong their assortment amount, since they turn out high-quality product corporations marketing product whose quality is tough to live extend long credit periods as a result of customers should have enough time to assess quality. Sellers of caliber product could attempt to pass them off as high-quality product during this case, because the price of extending trade credit will increase, these corporations can have less incentive to delude the data on quality. This analysis intends to find out how asymmetric information theory has affected financial performance of banks.

**2.2 Empirical Review**

Performance of finances is the initiative of management to improve the accuracy and timeliness of the financial institution to meet the required standard while supporting day to day operation (Bessis, 2008). Financial performance key measures are driven by three critical issues as follows profitability, size of the business, and growth of the business overtime. On the other hand, financial performance measures profitability assess, size, and growth rates are essential to monitor overall financial performance and progress (Ronald, 2011).

According to James and John (2005) liquidity ratios are defined as a firm’s financial ability to pay back short-term obligations. Much insight can be obtained into the present solvency of cash of an organization and the ability of an organization to stay solvent.Liquidity ratios can be viewed as a measure of current ratio and quick ratio. Steve et al. (2006) defined current ratio as a measure of an entity’s liquidity. Current ratio can be calculated as current assets divided by the current liabilities. The higher the current ratio, the greater ability of the firm pays its bills. Liquidity measures the ability of managers in firms to fulfill their immediate commitments to shareholders without having to increase profits on underwriting and investment activities and liquidate financial assets (Adams and Buckle, 2003).

Jose (2010) defined total asset turnover (asset utilization ratio) as the ratio measure the efficiency of a firm to get incomes or revenues by using its assets. This ratio also indicates pricing strategy. Businesses with low profit margin which ought to be high turnover in assets, and with high profit margins tend to have a low asset turnover.

They are meant to measure an organization long-term financial obligation to meet its obligations. When a firm has debt, it has the obligation to repay the interest. Holding debt will increase the firm’s riskiness. The level of financial leverage shows the ability of listed firm to manage their economic exposure to unexpected losses (Adams and Buckle, 2003). According toJohnson & Scholes (2007) managers of an organization establish a process for developing a useful set of performance indicators for the organization. One reason for this is that many indicators give useful but only partial view of overall picture .The evaluation of earnings performance depends upon key profitability to industry bench mark and peer group norms (Federal Reserve Bank, 2002).

Analyst use metrics like cash conversion cycle, the return on assets ratio and fixed asset turnover ratio to compare and assess a company annual asset performance, an improvement in asset performance means that that accompany can either earn a higher return by use of the same amount of assets or is efficient sufficient to create same quantity of return through the use of less assets (Adams and Buckle, 2003).

There has been limited research or scholarly studies about Loan Policy since most critics believe loan recovery consume much of the companies time by going to look for clients and auction assists so as to recover the loans. Studies like that of Mwenda, (2005) that showed worrying trends in the loan defaults among banks. Further bank specific factors like, , terms of credit, interest margin, size, credit orientation, rapid growth of loan, guidelines on borrower admittance, risk assessment and monitoring are observed to be having significance on the occurrence of non-performance due to loan defaulting. Malla, (2013) in his study to establish the effect of loan default on financial performance of commercial banks in Kenya However none has been done on loan policy and its influence on financial performance of Commercial Banks in Eldoret town.

The factors that determine performances of banks can be categorized into bank specifically internal and external factors (Al-Tamimi, 2010; Aburime, 2005). Internal factors are bank’s features that affect the institution’s performance. The determinants are affected by internal decisions of management and the board. The external factors are widely spread that are beyond organization’s control and determines the profits of financial institutions.

**2.2.1 Liquidity management and financial performance**

Oretha (2012) established that business banks throughout the pre-liberalization amount weren't effective in managing their credit risk in distinction to the post-liberalization amount. Variations within the credit policies by seven of the 9 business banks replicate financial and financial policy actions, wherever expansionary economic policy partially accrued inflationary pressure and also the financial authority. Throughout the post-liberalization amount, most banks used the services of a specialist to build their credit risk management policies that reduced the danger exhibit by defaulting on loans. Business banks in Liberia ought to focus additional attention on capability building and special coaching of bank managers whose perform relate to credit and loans to function a passage of giving them ample information on a way to upset credit problems and mitigate credit risk two-faced by these banks.

A study by Pollio and Obuobie (2008) in African nation on Microfinance Default Rates complete that the chance of default decreased with the frequency of observation, the quantity of guarantors and whether or not the consumer was a primary time receiver. Yaron, Benjamin, and Piprek (2007) according that one in every of the challenges Sacco's in Bharat face is that in election years and even at alternative times, there insignificant info from political platforms for the postponement of loan reimbursement or pressure on the credit establishments to grant extensions to avoid or delay loan reimbursement. A second challenge according by was that there's a risk of a cooperative society turning into a scheme if the regulative framework fails, giving rise to questionable management, that doesn't observe standard monetary management practices. this is often a malpractice that has since occurred within the country, deed several investors desolated by loss of their cash.

Wakuloba (2010) studied the causes of loan default in African country Trade Development Joint Loan Board (UGTDJLB) theme. consistent with the findings, the theme had high and rising default rates over the amount. the most causes of default were poor business performance, diversion of funds and domestic issues. The recommendations were that the board be strong through capability building in pc applications to hurry transfer process and guarantee timely disbursements.

Keitany (2013) discovered that there's sturdy negative relationship between the loan default and also the gain of SACCOs in Nairobi, Kenya. The tests showed that the regression model could be a smart fit the info because the independent variables statistically and considerably predict the variable. The regression model could be a smart match of the info. Personality varieties square measure susceptible to loan default why credit markets could fail. The study recommends that nihilist should; endlessly review credit policies, establish lost loan provision policies, and character of loan candidates.

Makanda (1986) additionally commented on the potential role of cooperative in agro-business of cooperative movement and reasons for poor performance in African country. but the on top of studies have taken key interest on cooperative have centered in the main on agricultural cooperatives although agricultural cooperative square measure several ,the role of nihilist within the movement ought to be recognized particularly within the monetary sector, this paper focuses thus fills the gap in literature.

Njiru (2006) carried a study on a listing of non-performance of credits with all particulars ought to be assessed on a case by case basis to see if the case is reversible. Precisely what will be done to enhance reimbursement capability and whether or not or not discovered or assortment plans are used. Provision level ought to be thought of to see the nihilist capability to resist loan defaults.

Mwaura, (2005) lack of credit analysis, credit follow-ups moreover as hostile disposition square measure the key factors that contribute to poor performance in loan disposition by nihilist societies in Kenya. Mwangi (2010) study discerned that there exist a relationship between finance performance and management of credit risk. Monetary performance measures square measure driven by 3 important problems gain, size of the business, and also the growth of business overtime (Ronald, 2011).

**2.2.2 Capital Adequacy Requirements and Financial Performance of commercial banks**

Effects of Capital Adequacy necessities on money Performance of economic banks Capital provides buffer against losses and so it ensures safety and soundness of the money establishments. it's necessary to make sure that the banks have spare capital. Capital rules square measure thus place in situ to make sure that the banks meet the minimum capital necessities expected of them. Capital adequacy refers to a relative measure: it establishes the most level of leverage that a financial organization is allowed to succeed in on its operations (Johnson, 2007). it's measured by the magnitude relation of risk-weighted assets relative to restrictive equity, that has been internationally suggested to be capable twelve.5 times, or unremarkably referred to as a capital adequacy magnitude relation of V-day (Johnson, 2007).

Njiiru, (2003) asserts that the Kenyan industry is comparatively a replacement development having begun with many agencies concerning twenty years past. Since then there has been a gradual shift in interest and resources allocation towards helping the informal sector in an exceedingly sort of ways that. within the 1970's the most organization providing credit to the informal sector were church based mostly organizations. The programs purpose to innovations like cluster loaning contracts because the keys to their success. cluster loaning effectively create a receivers neighbors co-signers to loans mitigating issues created by data asymmetries between borrower and loaner. Neighbours can then have incentives to watch one another and to exclude risky borrowers from participation prompting repayments even within the absence of collateral necessities (Modurch, 1999). cluster loaning mechanism permits a gaggle of people typically known as commonality to supply collateral or loan guarantee through a gaggle reimbursement pledge. The repayments square measure created daily, weekly, monthly, or when four weeks.

Nonetheless, it's to be remembered that this prudent customary planned by the urban center Committee was supposed to be applied to international and enormous banking establishments from developed countries, which it's been translated to many money systems in developing countries despite the well-known variations in institutional risk profile, scale of operations and national economic environments (Guidotti et al, 2004; Jansson, 2007).

It seems that capital adequacy necessities might have an effect on the extent of potency as a result of they act as mounted inputs within the production method. Estrada and Osorio (2004) provide one choice by expressly permitting restrictive value factors to work out the extent of potency. This specification directly captures the restrictive burden borne by the banks and helps perceive the dynamics of hidden prices which can be troublesome to watch in observe. maybe, tighter capital restrictive necessities meant to safeguard the industry might manufacture some fortuitous adverse consequences on behavior of the bank, and with resources allocation analysis done by Fare et al. (2004) found that risk-based capital standards had a big impact on profit potency. Hughes and Mester (2003) conjointly argue that a rise in reserve necessities raises the chance value of funds and acts as a tax on the value of deposits, thereby impairing banks' deciding. However, most researchers would opt for the necessity to implement policies on capital requirement, the question remains: what's the proper benchmark to enforce rules while not jeopardizing the power of banks to service the economy expeditiously. To properly address this question, it's become necessary to totally analyze the result of capital rules, particularly the capital adequacy magnitude relation on banks potency.

The goal of economic regulation is to change banks to enhance liquidity and financial condition. Stricter regulation could also be sensible for bank stability, however not for bank potency. Barth, Caprio and Levine (2006) study what affects bank regulation and the way banking regulation works. Their analysis on most countries shows that sturdy regulators and capital adequacy standards don't improve bank potency. Barth et al. (2004) proposes varied reasons for and against proscribing bank activities. However, overall their results indicated that proscribing banks might not solely lower bank potency butalso increase the likelihood of a banking crisis. From the long-run purpose of read, as African nation economic process is very keen about credit offer, the banks got to grow their loan scales at sure rates therefore on support the sustained economic process. Therefore, they'll be two-faced with the requirement for capital supplementation so as to stay up with the restrictive necessities on Capital

Adequacy magnitude relation (CAR). Pasiouras (2008) mentioned that stricter capital adequacy, powerful oversight and market discipline power promote technical potency. However, solely the latter one is critical. insufficient capital will increase the danger of failure while excessive capital impose spare prices on banks and their customers and will cut back the potency of the banking industry. moreover, theory provides conflicting predictions concerning the impact of restrictive and higher-up policies on banks performance (Barth et al., 2004; 2007a).This analysis intends to seek out out the results of Capital Adequacy necessities on money Performance of economic banks.

## III. Research Methodology

### 3.1 Research Design

This study adopted a descriptive survey research design. This was design was appropriate because the study sought to describe the characteristics of certain groups, estimate the proportion of people who have certain characteristics and make predictions.

### 3.2 Target Population

The target populations of this study was all the 30 licensed commercial banks in Eldoret (Central Bank of Kenya, 2016).The target population was 156 respondents drawn from the various banks and comprises of branch managers and credit officers.

### 3.3 Sample Size and Sampling Procedures

According to Kothari (2004) a sample of 30% of the target population is usually representative and generalizable. Therefore, the sample size for the study was 30% of the total commercial banks, which are 9 banks. The study used sample random technique to sample 9 banks in Eldoret for the study. Therefore, the study used stratified random sampling technique to obtain a sample size of 9 commercial banks from a target population of 30 commercial banks in Eldoret Town To get a representative sample, the study used purposive sampling method to sample branch managers of the commercial banks licensed by central bank of Kenya, the process which involves selecting a sample based on level of experience or knowledge of the group to be sampled. For the case of selecting credit officers the study used simple random sampling technique as follows:

$$n = \frac{N}{1 + N(e)2}$$

Whereby;
n refers to the sample size,
N refers to the population size, (147)
e is the level of precision (0.05).
n= 147

$$n = \frac{147}{1 + 147(0.05)2}$$

n= 107
Therefore, 9 respondents were sampled from branch managers and 107 credit officers making a total of 116 respondents

**3.4 Research Instruments**

To carry out the research, questionnaires were used. The questionnaire allows measurement for or against a particular view point. A questionnaire has ability to collect a large amount of information within a very short time. The questionnaire had both open-ended questions and closed questions. Open-ended questions sought in-depth information while the closed ones was easily analyzed an understood.

**3.5 Data Analysis and Presentation**

Completed questionnaires was checked for completeness and coded Descriptive statistics (Frequencies, means The study is expected to generate both quantitative and qualitative data. Descriptive statistics data analysis method was applied to analyze numerical data gathered using closed-ended questions. This was done using Statistical Package for Social Sciences (SPSS) computer software. SPSS was considered appropriate since it allowed the study to follow clear set of quantitative data analysis procedures that leads to increased data validity and reliability and demonstrates the relationship between the research variables. Descriptive analyses provided the foundation upon which correlational studies emerge; they also provide clues regarding the issues that should be focused on leading to further studies (Kothari, 2005). Descriptive statistics assisted in computing measures of central tendencies and measures of variability in order to determine how independent variables affect the dependent variable

Inferential statistics were applied through correlation analyses which were used to establish with statistical significance, the nature of the existing relationship between the dependent variable and the independent variables. The study further employed multivariate regression model to study the determinants of loan policy in the banking sector. The research chose regression method because of its ability to test the nature of influence of independent variables on a dependent variable. Regression was able to estimate the coefficients of the linear equation, involving one or more independent variables, which best predicted the value of the dependent variable, although Multivariate analysis has the following assumptions; Linear relationship, Multivariatenormality, No or little multicollinearity, No auto-correlation and Homoscedasticity. Therefore, the study used linear regression analysis to analyze the data. The regression model was in the form:
$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \varepsilon$
Where Y=Loan Policy and;
$X_1$= Liquidity management
$X_2$= Capital adequacy requirements
$\alpha$=constant value
$\varepsilon$ =error term

The regression analysis tested the variation of the dependent variable explained by the variation in the independent variables by calculation of the R2 and adjusted R2 statistics. ANOVA for regression was also used to determine the goodness of fit. Bivariate regression models was first fitted to determine the influence that each of the independent variables had on the dependent variable. A multiple regression model was then fitted to determine the combined effect that the independent variables had on the dependent variable when acting jointly. Qualitative data drawn from open-ended question in the questionnaire was analyzed through summarizing the set of data drawn from the respondents in frequency tables. The data was assigned numerical value and entered into the SPSS computer system. The study findings were presented in form of frequency tables, pie charts and bar charts.

## IV. Data Analysis, Findings And Interpretation

### 4.1 Correlation analysis

From the study Karl Pearson's coefficient of correlation was used to check the linear relationship between the variables, The Pearson correlation coefficient is a very useful way to measure the statistical relationship that exists between independent and dependent variables. The evaluation of the correlation was in accordance to Saunders (2003) who indicated that r=1 shows a Perfect linear correlation, 0.9 < r < 1 indicates Positive strong correlation, 0.7 <r < 0.9 Positive high correlation 0.5 < r < 0.7 Positive moderate correlation, 0< r < 0.5 Weak correlation r=0 No, relationship and -1 <r = < 0 Negative relationship.

#### 4. 1.1 Correlations between Liquidity management and financial performance

**Table 4.0** Correlations between Liquidity management and financial performance

| | | Liquidity management | Financial performance |
|---|---|---|---|
| Liquidity management | Pearson Correlation | 1 | .798** |
| | Sig. (2-tailed) | | .000 |
| | N | 106 | 106 |
| Financial performance | Pearson Correlation | .798** | 1 |
| | Sig. (2-tailed) | .000 | |
| | N | 106 | 106 |
| **. Correlation is significant at the 0.01 level (2-tailed). | | | |

The table 4.0 is giving the relationship between liquidity management and financial Performance of commercial banks in Eldoret town whereby the respondents N is 106 and the significant level is 0.01, the results indicate that liquidity management has positive high correlation to financial performance (r=0.798 p=0.000) which was less than the significant level of 0.05. When p-value is less than significant level of 0.05, it is can be concluded that variables are correlated and null hypothesis is rejected and the alternative hypothesis is adopted (Saunders, 2003). This indicates that that there is a significant association between liquidity management and financial Performance of commercial banks in Eldoret town. This implies that liquidity management contributes to positive financial Performance of commercial banks.

#### 4.1.2 Correlations between Capital adequacy requirements and financial performance

The table 4.1 is giving the relationship between capital adequacy and financial Performance of commercial banks in Eldoret town whereby the respondents is 106 and the significant level is 0.01, the results indicate that capital adequacy has positive high correlation to financial performance equal to r=0.868 and the p-value is .000 which is less than 0.05., thus the variables are correlated and null hypothesis is rejected and remains with alternative. This means that there is a significant relationship between capital adequacy and financial Performance of commercial banks in Eldoret town. This implies that capital adequacy contributes to positive financial Performance of commercial banks.

**Table 4.1** Correlations between Capital adequacy requirements and financial performance

| | | Capital adequacy | Financial performance |
|---|---|---|---|
| Capital adequacy | Pearson Correlation | 1 | .868** |
| | Sig. (2-tailed) | | .000 |
| | N | 106 | 106 |
| Financial performance | Pearson Correlation | .868** | 1 |
| | Sig. (2-tailed) | .000 | |
| | N | 106 | 106 |
| **. Correlation is significant at the 0.01 level (2-tailed). | | | |

### 4.2 Regression analysis

The study employed multivariate regression model to study the determinants of loan policy in the banking sector.

#### 4.2.1 Test of Linear assumption

The linear regression analysis tests the relationship between the independent and dependent variables and if the relationships are liner in nature. From the study test of assumption of linearity was done using the Pearson product moment as shown in table 4.2 below

| | | Liquidity management | Capital adequacy | Financial performance |
|---|---|---|---|---|
| Liquidity management | Pearson Correlation | 1 | . | |
| Capital adequacy | Pearson Correlation | .768** | 1 | |
| Financial performance | Pearson Correlation | .798** | .868** | 1 |

**4.2.2 Test of Homoscedasticity assumption**

Homoscedasticity assumes that the dependent variable show an equivalent level of variance across the range of predictor variable. Homoscedasticity is one of the assumptions required for multivariate analysis. The study used Durbin-Watson statistic to test the assumption of Homoscedasticity, the Durbin-Watson statistic should be between 1.5 and 2.5.the results in table 4.16 indicated that The Durbin-Watson statistic is 1.987 which is between 1.5 and 2.5 and therefore the data is not auto correlated.

**Table 4.3** Test of Homoscedasticity assumption

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate | Durbin-Watson |
|---|---|---|---|---|---|
| 1 | .931[a] | .866 | .861 | .26636 | 1.987 |
| a. Predictors: (Constant), liquidity management, capital adequacy | | | | | |
| b. Dependent Variable: financial performance | | | | | |

**4.2.3 Test of Normality assumption**

Normality is one of the assumptions for multivariate analysis. This study used skewness and kurtosis to test normality of data. Skewness is used to describe how symmetrical the distribution of data is on the other hand kurtosis is used to describe how flat or peaked the distribution of data is. According to Hair *et al., (*2010) skewness and kurtosis should be between ±1.96. Table 4.17 shows all variables with corresponding skewness and kurtosis values. Clearly, most of the variables were between ±1.96 indicating that the data is normal.

**Table 4.4** Test of Normality assumption

| | | Liquidity management | Capital adequacy | Financial performance |
|---|---|---|---|---|
| N | Valid | 106 | 106 | 106 |
| | Missing | 0 | 0 | 0 |
| Skewness | | -.873 | -1.267 | -.971 |
| Std. Error of Skewness | | .235 | .235 | .235 |
| Kurtosis | | .028 | 1.564 | .097 |
| Std. Error of Kurtosis | | .465 | .465 | .465 |

**4.2.4. Regression analysis between Liquidity management and financial performance**

From the study multivariate regression model was used to find out the determinants of loan policy and also measure the relationship between the dependent variable financial performance and independent variable liquidity management. The results are shown in the section that follows

**Table 4.5** Model Summary of Liquidity management and financial performance

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate |
|---|---|---|---|---|
| 1 | .798[a] | .637 | .633 | .43258 |
| a. Predictors: (Constant), liquidity management | | | | |

Table 4.5 illustrates the model summary used in this study, Adjusted R squared is coefficient of determination which tells us the variation in the dependent variables of the study due to changes in the independent variables, from the findings in the above table the value of adjusted R squared was 0.637 an indication that there was variation of 63.7% on financial performance of commercial banks in Eldoret due to changes in liquidity management. This show that 63.7% changes in financial performance of commercial banks in Eldoret could be accounted for by liquidity management is the correlation coefficient which shows the relationship between the study variables, therefore, the study indicated that there was a strong positive relationship between liquidity management and financial performance of commercial banks in Eldoret town as shown by 0.637.

**Table 4.6** ANOVA of Liquidity management and financial performance

| Model | | Sum of Squares | df | Mean Square | F | Sig. |
|---|---|---|---|---|---|---|
| 1 | Regression | 34.124 | 1 | 34.124 | 18.361 | .000[b] |
| | Residual | 19.461 | 104 | .187 | | |
| | Total | 53.585 | 105 | | | |
| a. Dependent Variable: financial performance | | | | | | |
| b. Predictors: (Constant), liquidity management | | | | | | |

Table 4.6 illustrates the Analysis of Variance (ANOVA) which assesses the overall significance of the model. According to the table $p < 0.05$, (0.000), indicating that there was sufficient evidence that the model is useful in explaining the financial performance of commercial banks in Eldoret town.

**Table 4.7** Coefficients of Liquidity management and financial performance

| Model | | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. |
|---|---|---|---|---|---|---|
| | | B | Std. Error | Beta | | |
| 1 | (Constant) | .849 | .244 | | 3.474 | .001 |
| | Liquidity management | .804 | .060 | .798 | 13.504 | .000 |
| a. Dependent Variable: financial performance | | | | | | |

From the data in the above table the established regression equation was Y = 0.849 + 0.804X1

From the above regression equation it was revealed that liquidity management is statistically significant in influencing financial performance of commercial banks in Eldoret town with a p value less than 0.05, the study also reveals that, a unit increase in liquidity management would lead to increase in performance of commercial banks in Eldoret town by a factor of 0.804.

This concurs with the findings of Mwangi (2010) who discerned that there exist a relationship between finance performance and management of credit risk. Monetary performance measures square measure driven by three important problems gain, size of the business, and also the growth of business overtime. Further Mwaura, (2005) states that lack of credit analysis, credit follow-ups moreover and hostile disposition as the key factors that contribute to poor performance in loan disposition by cooperative societies in Kenya

### 4.2.5 Regression analysis between Capital adequacy requirements and financial performance

From the study multivariate regression model was used to find out the determinants of loan policy and also measure the relationship between the dependent variable financial performance and independent variable Capital adequacy. The results are shown in the section that follows

**Table 4.8** Model Summary of Capital adequacy requirements and financial

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate |
|---|---|---|---|---|
| 1 | .868[a] | .753 | .750 | .35703 |
| a. Predictors: (Constant), capital adequacy | | | | |

Table 4.8 illustrates the model summary used in this study, Adjusted R squared is coefficient of determination which tells us the variation in the dependent variables of the study due to changes in the independent variables, from the findings in the above table the value of adjusted R squared was 0.750 an indication that there was variation of 75.3% on financial performance of commercial banks in Eldoret due to changes in capital adequacy. This show that 75.3% changes in financial performance of commercial banks in Eldoret Town could be accounted for by capital adequacy, R squared is the correlation coefficient which shows the availability of relationship between the study variables, and therefore, there was a strong positive relationship between capital adequacy and financial performance of commercial banks in Eldoret town as shown by 0.753.

**Table 4.9** ANOVA of Capital adequacy requirements and financial

| Model | | Sum of Squares | df | Mean Square | F | Sig. |
|---|---|---|---|---|---|---|
| 1 | Regression | 40.328 | 1 | 40.328 | 31.375 | .000[b] |
| | Residual | 13.257 | 104 | .127 | | |
| | Total | 53.585 | 105 | | | |
| a. Dependent Variable: financial....performance | | | | | | |
| b. Predictors: (Constant), capital adequacy | | | | | | |

Table 4.9 illustrates the Analysis of Variance (ANOVA) which assesses the overall significance of the model. According to the table (p=0.000), indicating that there was sufficient evidence that the model is useful in explaining the financial performance of commercial banks in Eldoret town.

**Table 4.10** Coefficients of Capital adequacy requirements and financial

| Model | | Unstandardized Coefficients | | Standardized Coefficients | T | Sig. |
|---|---|---|---|---|---|---|
| | | B | Std. Error | Beta | | |
| 1 | (Constant) | .943 | .181 | | 5.214 | .000 |
| | Capital adequacy | .786 | .044 | .868 | 17.787 | .000 |
| a. Dependent Variable: financial performance | | | | | | |

From the data in the above table 4.10, the established regression equation was Y = 0.943 + 0.786X2

From the above regression equation it was revealed that capital adequacy to a constant zero, financial performance of commercial banks in Eldoret town would be 0.786, such that a unit increase in capital adequacy would lead to increase in performance of commercial banks in Eldoret town by a factor of 0.786. The study also found that all the p-value=0.000 was less than 0.05 an indication that capital adequacy is statistically significant in influencing financial performance of commercial banks in Eldoret town.

These findings are supported by Johnson, (2007) who stipulated that the effects of capital adequacy necessities on financial Performance of commercial banks and provides buffer against losses and so it ensures safety and soundness of the money establishments. It's necessary to make sure that the banks have spare capital. Capital rules square measure thus place in situ to make sure that the banks meet the minimum capital necessities expected of them. Further Caprio and Levine (2006) states that the goal of economic regulation is to change banks to enhance liquidity and financial condition.

**Table 4.11:** Summary of Results for Hypotheses Testing

| Hypotheses | Results | Effect of Test |
|---|---|---|
| $\mathbf{H_{01}}$: There is no significant relationship between liquidity management and financial performance of commercial banks in Eldoret town. | P=0.000. | $H_{01:}$ Rejected |
| $\mathbf{H_{02}}$: There is no significant relationship between capital adequacy requirements and financial performance in commercial banks in Eldoret town. | P=0.000 | $H_{02:}$ Rejected |

## V. Conclusion

Based on the study findings on the effects of liquidity management on financial performance of commercial banks in Eldoret town, the study concluded that, loan applications are taken by individual lenders or assigned by the chief lending officer. Each lender in the commercial banks is responsible for recommending an improvement or decrease of a mortgage in customers portfolio at the time that pertinent facts is acquired. The mortgage policy ought to honestly speak the strategic desires and goals of the bank, further it was concluded that commercial may choose to enter into participations. And lastly commercial banks loan policy should establish the desired mix of the loan portfolio and limits on individual loan types.

Regarding the effects of capital adequacy requirements on financial performance of commercial banks in Eldoret town, the study concluded that, Capital adequacy provide an effective monitoring and control of credit risk, Further it ensures the institution's stability and soundness, it also establishes authority and lastly controls lending risk.

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