CREDIT LENDING POLICIES AND FINANCIAL PERFORMANCE OF ISLAMIC BANKS IN KENYA

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ABSTRACT

Globally, banks play a critical role in mobilization of resources for economic development of their economies. In Kenya, the fully fledged Islamic banks have suffered poor financial performance over the last five years as they adhere to Sharia Law that does not allow them to charge interests instead, they charge profits. However, Some Islamic banks like Dubai Islamic Bank posted negative returns on asset of -32.15%, -16.6%, -8.8% and -5.22% for the periods 2017 to 2020 respectively. This study main objective was to determine the effect of credit lending policies on financial performance of Islamic banks in Kenya. Specifically, it looked at credit standards, loan processing procedures, credit collection policy and their effect on financial outcome measurement. Theories included: Agency theory, Power theory of Credit, Credit Risk Theory, and Information Theory of Credit. It adopted a descriptive design targeting three banks operating on exclusive Islamic principles in Kenya. The population was made up of 96 managers who included: credit managers, the analysts, debt collectors and legal advisors who make up credit departments in their respective banks. A Census study was used as the population was small. Primary data was collected and supported with secondary data drawn from published financials and other reports at the Central Bank of Kenya covering the period from 2010 all through to 2019. A pilot testing on the instruments was done to ensure they were valid and reliable. Cronbach Alpha was applied in determination of reliability. Means and standard deviation together with inferential statistics were used in the analysis. The study established that credit standards (β=.104, $p<0.05$), loan processing procedure (β=.119, $p<0.05$) and credit collection policy (β=.464, $p<0.05$) all had significant and positive effect on financial performance. In recommendation, debt collection managers and officers need to simplify the terms of the credit collection policy so as to significantly enhance financial performance. Loan managers and officers of the Islamic banks in Kenya should simplify the loan processing procedures so as to improve on financial performance. The credit managers need to work on improving the credit standards in place so as to enhance financial performance. The findings of the study are expected to be of value to a number of stakeholders including the management at the Islamic bank, the policy makers like the Kenya Bankers Association and academic fraternity.

Key Words: **Credit Lending Policies, Credit Standards, Loan Processing Procedures, Credit Collection Policy and Financial Performance**

INTRODUCTION

The lending function is considered as the most important function of any commercial bank since most of the banks' earnings are generated from interest income that is charged from credits offered to the clients (Abbas, Zaidi, Ahmad & Ashraf, 2014). As a function that contributes to the interest earnings of financial institutions and its final income earnings, it is important for these institutions to come up with policies that regulate the sector and ensure that all credits advanced are repaid for the financial institution to actually earn that income (Gizaw, Kebede & Selvaraj, 2015). This notion creates the idea of credit policies and regulations that are put in place to ensure that all monies advanced are recouped. According to Agola (2014) a credit policy outlines the structure and act as a guideline on all decisions which affect credit advancement within a lending institution. The structure outlines the key principles and procedure that the bank or financial institution will take to make sure that they get money back from the clients, noting that a good number of the customers will not pay back the borrowed money. The policy is structured so as to reduce the number of clients who default in payment (Marshal & Onyekachi, 2014).

Large numbers of non-performing loans, defaulting credit customers and late repayment from some clients have contributed significantly to low profits and even general poor performance of financial institutions (Dvouletý, 2017). Some of these financial institutions make huge losses which affect their performance and ability to survive and some end up closing shop or being placed under receivership or declare a state of bankruptcy. With such precedence, these financial institutions including commercial banks have set a process to review their credit risk portfolios using credit criteria approaches such as credit risk model that was established by the Basel Committee charged with the responsibility of supervising the way banks operate. This Committee aims at ensuring that the banking institutions improve their risk management capability by installing credit policies within their organizations. Some of the aspects of risk management capabilities installed by banking institutions include pricing products and services, installing operations control measures, reserves for losses incurred and reducing the bank's operational risk during the lending process (Chi & Li, 2017).

Islamic banks adhere to Sharia laws on finances; some of these policies include prohibition of charging interest (riba) on advances and credits (Soudi & Cherkaoui, 2015). As per Islamic finance dictates, there is no insurance on the loan facilities given to customers because of the huge effect it has on its provisions. This is not the case for conventional banking where all advanced credit and loans are insured against bad debts and to protect the banking infrastructure against losses, this goes against Sharia laws where risks and losses are shared between the financial institution and the customers (Narayan & Phan, 2017). Loan facilities for Islamic financial institutions are based on the assets and not the cash and returns; as such the loan approval committees in conventional banks analyses the financial statements of the customers, but in Islamic banking, the committee will look at the asset base and the returns expected from the projects to be financed. According to Abedifar, Ebrahim, Molyneux and Tarazi (2015), Islamic banks do not finance any venture that goes against their faith and belief system. Some of activities prohibited by Islam Religion that cannot be funded include any business activities dealing with selling and distribution of alcohol and drugs and pork products. These provisions are put into consideration when making credit policies and throughout the processes of credit application and approval processes (Soudi & Cherkaoui, 2015).

Operating under a sound credit granting framework, ensuring effective credit management including monitoring, processing and adequate controls on credit risk are some of the key policies that banks need to take into account. In Kenya, Kibor, Kwasira and Ngahu (2015) noted that any banking entity should have in place proper policy to guide the lending process. It is also important to ensure that banking entities have put in place credit policies that are customized in line with the creditworthiness of the borrowers. The models used in management of credit risk cover the entire process, the various procedures involved as well as the controls put in place by the business that ensure timely repayment. Most of the banking entities are faced with a challenge of higher NPLs, an indication that these entities are faced with a high level of credit risk. Karugu and Ntoiti (2015) opined that commercial banks should have strict credit assessment and debt collection policies, credit workers at all levels should work in collaboration to ensure that loans are collected in a timely manner, and banks should also follow credit risk governance mechanisms that can be accomplished by making the interaction mechanism between senior management and the Board more efficient. Lending in commercial banks is the key source of profit making hence it important for the industry to have good credit risk management practices. A study by Mercylynne and Omagwa (2017) suggested that banks need to maintain credit risk exposure within acceptable parameters to maximize a bank’s risk adjusted rate of return. Banks through the financial services they provide are important for economic development. Their role as intermediaries can be said to be a catalyst for economic growth. The Banking industry's efficient and effective output over time is an indicator of financial stability in any region. The degree to which a bank provides credit for productive activities to the economy accelerates the speed of economic growth for a nation and its long-term sustainability.

Credit lending policies include the terms and conditions of borrowing, collection policies, credit standards and processing procedures (Zambrano, Moral-Benito & Vegas, 2018). They describe the way the credit is to be created, administered and managed throughout its repayment period. They cover aspects of terms and conditions for the credit facility, period within which the credit is to be collected, standards to be observed by credit administrators, how credit facilities and relationship are to be created, and the closing off of the credit relationship. Credit terms provide a frame work for the entire management practices and also prevent credit from being extended to customers who cannot pay their accounts (Agola, 2014).

Credit standards are criteria that lending entities use to establish the type of client to advance the loan facility (Claessens, Law & Wang, 2018). Lending entities should ensure that their credit standards are informed by the credit application at the individual level through consideration of collateral and security requirements during the loan application process (Emekter, Tu, Jirasakuldech & Lu, 2015). It is through the processing procedures that the appropriate corporate or retail client to be approved for lending is approved. These procedures also help the borrower to determine the lender to avoid when extending credit as informed by the regulations and laws in place. According to Ntiamoah, Diana and Kwamega (2014), financial managers use the above variables to evaluate customer's borrowing capability, payment time and loan interest, methods of collection and steps to take in case of loan default.

For the Islamic banks, the policies they develop must be sharia compliant and adhere to the Quran, the hadith and Islamic jurisprudence, such as the prohibition of conventional ex-ante interest rate views as a tool for improving their financial performance (Caporale, Çatık, Helmi, Ali & Tajik, 2019). The profits are shared to all members of that financial institution and not charging prohibitive interest rates on their credit products. In Islamic banking, the main factor in determining whether an applicant will be given credit is based on the productivity index of their project and not on basis of their creditworthiness as is the case for conventional banks. According to Caporale and Helmi (2018), Islamic banks do not give credit to enterprises that engage in speculative transactions like gambling, derivatives and toxic assets and this may affect their financial performance position. The belief is that, funding such activities leads to financial crises and these Islamic banking entities only grant loans to ensure that viable investments are funded as opposed to speculative ones.

A report by the CBK indicates that a significant growth in the banking sector in various areas of performance, particularly the financial performance – market share, profits etc. (Kato, Otuya, Owunza, & Nato, 2014). Nonetheless, some of the foreign banks have been performing better than others triggering comprehensive research from other nation such as Singapore, Nigeria, the United Arab Emirates among others to pinpoint the factors contributing to the rapid growth. One of the factors that have accounted for observed improvement in performance outcomes among banks is mobile banking services (Samuel, 2015). The banking sector has undergone extensive revolution due to the advancement in technology which has presented an excellent opportunity for banks to utilize mobile banking technology. This banking approach provides accessible and effective banking services without time or location barriers.

Islamic bank shares have lessened which denotes increasing competition and declining concentration (Gatimu, 2019). The efficiency of the public sector banks as compared to private banks can be ascribed to the natural monopoly argument. Conventional banks acquired the advantage of the first movers as well as the economies of scale which they made use of – this has allowed them to have a fair performance than their competitors in the private sector (Kato, et al., 2014). The significant growth and performance of the banking sector in Kenya can also be attributed to increasing in the assets which are in turn brought about by profit retention and injection of capital. The Shariah compliant products offered by Islamic banks prohibit interest charges which forms a key income source generated by conventional banks.

Statement of the Problem

Islamic Banks, unlike conventional Banks do not charge interest on credit facilities. Nevertheless, they charge a profit. Since their registration, three fully fledged Islamic Banks have posted below average performance compared to conventional banks in terms of Return on Assets (ROA). For instance, Dubai Islamic Bank recorded Return on Assets (ROA) of -32.15%, -16.6%, -8.8% and -5.22% for the periods 2017, 2018, 2019 and 2020 respectively (CBK, 2020). For Gulf African Bank, ROA of 0.6% and 0.9% were recorded in 2019 and 2018 respectively (CBK, 2020). On the other hand, data on Non-Performing loans indicate that as at July 2019, the total non-performing loans (NPLs) increased to Ksh. 336.4 billion from Kshs. 308.8 billion in the same period in 2018. This trend if not reversed reduce the little interest income generated by banks. To reverse these trends, it is important that the credit policies are examined and ways on how NPL can be reduced be established.

Policies relate to lending to both insiders and outsiders are loose leading to loss of huge sums of money. This has in return negatively affected the performance of these banks and the entire banking sector in general. Financial performance in organizations is important in ensuring that the business units continue operating and make profits. Since all banks collect cash from their customers and use the same money to lend to its customers and charge an interest which translates to the performance of the firm (Chi & Li, 2017). As they give loans to its customers, sometimes some of the clients are unable to pay all or part of the loan which creates problems like non-performing loans and eventually the performance of the firm.

A number of studies have focusing on credit lending policies, for instance, Ayodele and Ajayi (2014) looked at credit policy and its interaction with Nigeria's banking entities to perform. It was shown that presence of sound credit policies is associated with improved performance of the lending entities. While focusing on SACCOs in Kenyan context, Maiti (2015) assessed credit policy interactions with entity ability to perform financially. SACCOs which are regulated were found to have put in place sound standards and policies to manage risks related to administration of credit. An inquiry into credit policy and its interaction with ability of the manufacturing entities in Kenya to perform was conducted by Kungu, Wanjau, Waititu and Gekara (2014). It was noted that firms have in place sound policies, terms, periods and standards guiding credit and these are important aspects of credit policy that were considered and how they affected the profitability. The above studies were based on different concepts and contexts; and failed looked at the credit policies on financial performance of Islamic banks in Kenya hence creating the need of carrying out the current study. Hence assessment of credit lending policies and performance outcomes among banks operating on Islamic principles in Kenya.

Research Objectives

The study's was guided by the following objectives:

i. To establish the effect of credit standards on financial performance of Islamic banks in Kenya
ii. To assess the effect of loan processing procedures on financial performance of Islamic banks in Kenya
iii. To determine the effect of credit collection policy on financial performance of Islamic banks in Kenya

LITERATURE REVIEW

Theoretical Review

Credit Risk Theory

Founded by Robert Merton in 1974 this school of thought states that in spite of the fact that individuals have been confronting credit chance as far back as early ages. According to Emekter, Tu, Jirasakuldech and Lu (2015), credit risk has usually not been focused on until late 30 years. Early writing using a loan utilizes usual actuarial credit risk methods, the true problem of which is their complete dependence on verifiable data. There are currently three quantitative methodologies for examining loan opportunity: an auxiliary approach, a reduced form review and a deficient information approach: auxiliary approach, lessened shape examination and deficient data approach (Imbierowicz, Rauch, 2014).

Merton (1974) presented the credit chance hypothesis generally called the auxiliary hypothesis which said the default occasion gets from an association's advantage advancement demonstrated by a dispersion procedure with steady parameters. Such models are defined frequently as "fundamental model" and a specific guarantor is linked to the factors. A development of this classification is spoken to by resource of models where the default-restrictive misfortune is specific (Fanta, 2016).

Numerous researchers including Bekhet and Eletter (2014) have highlighted the significance of utilizing Credit rating assessment models as a part of assessing credit risk. In any case, Bekhet and Eletter (2014) contend that there is no ideal technique. This demonstrates one kind of rating model may function but neglects to work in others for specific budgetary organizations. According to their reasoning, various factors used as part of choosing a client's reliability, e.g. to what degree is a client delegated large or awful, this can be measured using factual techniques. Washington (2014) explored the link between macro-economic issues and credit risk using this theory. This theory is relevant to the study because Islamic Banks just like their conventional banks face credit risk of loan beneficiaries failing to repay the principal and profit as agreed.

Information Theory of Credit

Information theories of credit allude to the measurement of credit to companies and individuals if banks could better predict their prospective customers ' probability of reimbursement (Fan, Lai & Li, 2015). On these lines, the deeper the credit markets would be the more financial foundations believe about the loan repayment record of scheduled borrowers. According to Love, Pería and Singh (2016), open or private loan registries that collect and provide expansive information on the reimbursement history of prospective clients to money-related institutions are essential to expand credit markets. The data that each party to a credit exchange transmits to the market will have imperative ramifications for the manner it receives credit; the ability of credit markets to skillfully match borrowers and credit experts, and the pretended enthusiasm rate for credit allocation among borrowers (Agarwal, Chomsisengphet, Liu, Song & Souleles, 2018). The way credit markets can prompt specific components for different kinds of money lenders and unique kinds of borrowers (Feenstra, Li & Yu, 2014).

When moneylenders understand more about borrowers, their record as a consumer, or different loan specialists to the firm, they are not as worried about the financing of non-practical activities, and in this manner augment more credit. Büyükşahin and Robe (2014) noted that speculators tend to focus on present earnings and ignore bookkeeping collections and proclamations of revenue while surveying a prospective applicant, despite the fact that these two disregarded elements may provide better information and have more prominent prescience than present gain. One way to improve decision-making is to learn from previous mistakes by providing precise data about each party (Edwards, Tan, Villeneuve, Meek and McQueen, 2016). This theory helps understand the loan processing processes and procedures which determine the repayment capabilities and amounts to be advanced.

Empirical Review

Credit Standard And Banks Financial Performance

Claessens, Law and Wang (2018) conducted an assessment of credit rating and the ability of the banks to lend out under constraint capital. It was shown that credit standards are criteria that help in determining and deciding the customer to be given a loan facility. The decision to loan out the credit facility is pegged on a number of factors including the available securities and collaterals and the ability of the client to repay the loan facility. A firm should not have in place credit standards that are so tight as this may lower the available customers. At the same time, the credit standards should not be too loose as customers may take advantage of this to slow down on repayment which may adversely affect the cash flow position of the firm.

Bergbrant and Hunter (2018) analyzed how the credit market conditions affecting the hedging activities in the firm. It was shown that having in place standards of lending increases the exposure of the firm if they are not adhered to. Proper consideration should be given to maximum credit policy and this would reduce the challenges related with weak and tight credit standards that a firm may adopt. The quality of balance sheet of the firm determines the lending conditions in the firm. Zambrano, Moral-Benito and Vegas (2018) did a study on lending standards adopted in major banking entities. It was shown that credit standards are simply criteria used in determining the types of customers to give credit facilities. Credit standards are seen to play a key role as far as management of accounts receivable is concerned. Credit standards mainly seek to ensure that there is consistency in the operations of the firm besides making sure that proper credit risk practices are adhered to. It is important to ensure that credit risks are uniform fort all and that every decision made is guided by these standards. A good credit standard involves effective initiation, analysis, credit monitoring and evaluation to ensure that the bank's interest is taken care of.

Loan Processing Procedures And Banks Financial Performance

Aiyar, Calomiris, Hooley, Korniyenko and Wieladek (2014) did a study on lending requirements in the banking sector focusing on UK context. It was shown that the lending policy of the bank is simply viewed as guidelines which staff needs to adhere to before being granted with loan facilities. They are these procedures that determine the type of customers at the corporate level which should be approved when demanding for loan facilities. Commercial banks help in growth and development of the economy as they offer credit facilities to customers. Trönnberg and Hemlin (2014) conducted a study on lending decision making in banks. The banks frequently suffer from poor lending procedures. It is important to have in place sound monitoring systems so as to reduce the exposure on risks in the banking sector. Banking entities should ensure that procedures are in place for processing of loan facilities to customers.

Owino and Otieno (2013) looked at the policies observed by banks in lending contracts and their effects on NPLs with focus on Kenyan banks. Lending policies and non-performing loans relate to each other. Loan processing procedures detect the portfolio of an individual's financial institution. The portfolios reflect the financial lending procedures used by a bank or any other financial institution. The lending procedures are guided by the size of the lending institution as it determines the amount of the loan to be issued, economic conditions which reflect the surrounding economic activities in which the financial institution operates and credit analysis which plays a key role in assessing the likelihood that a borrower will default on a given loan.

However, this study was undertaken in 2013 focusing on conventional banks and non performing loans and not Islamic banks and their Returns on Assets hence the need to undertake the current study.

Sudhakar and Reddy (2016) examined the role played by models of assessing and evaluating credit risks with key emphasis on retain banks. Loan processing procedures involves the evaluation of a borrower's need s and financial conditions which include; the character of the person like integrity, ethical consideration and honesty which are based on the borrower's past behavior in both banking and repayments of loans that had been borrowed earlier. Loan procedures also determine the capacity of the borrower which focuses on whether the borrower has the ability to generate sufficient funds to liquidate the loan ad still stay financially healthy. Loan processing procedures involve processing of the manager's ability, policy documents of the firms, investment policies, strategic plans, and credit statements as well as judging the potentiality of a market. The judgment should be based on both the liquidity and the ability of the borrower to pledge specific assets to secure a loan.

Credit Collection Policy and Banks Financial Performance

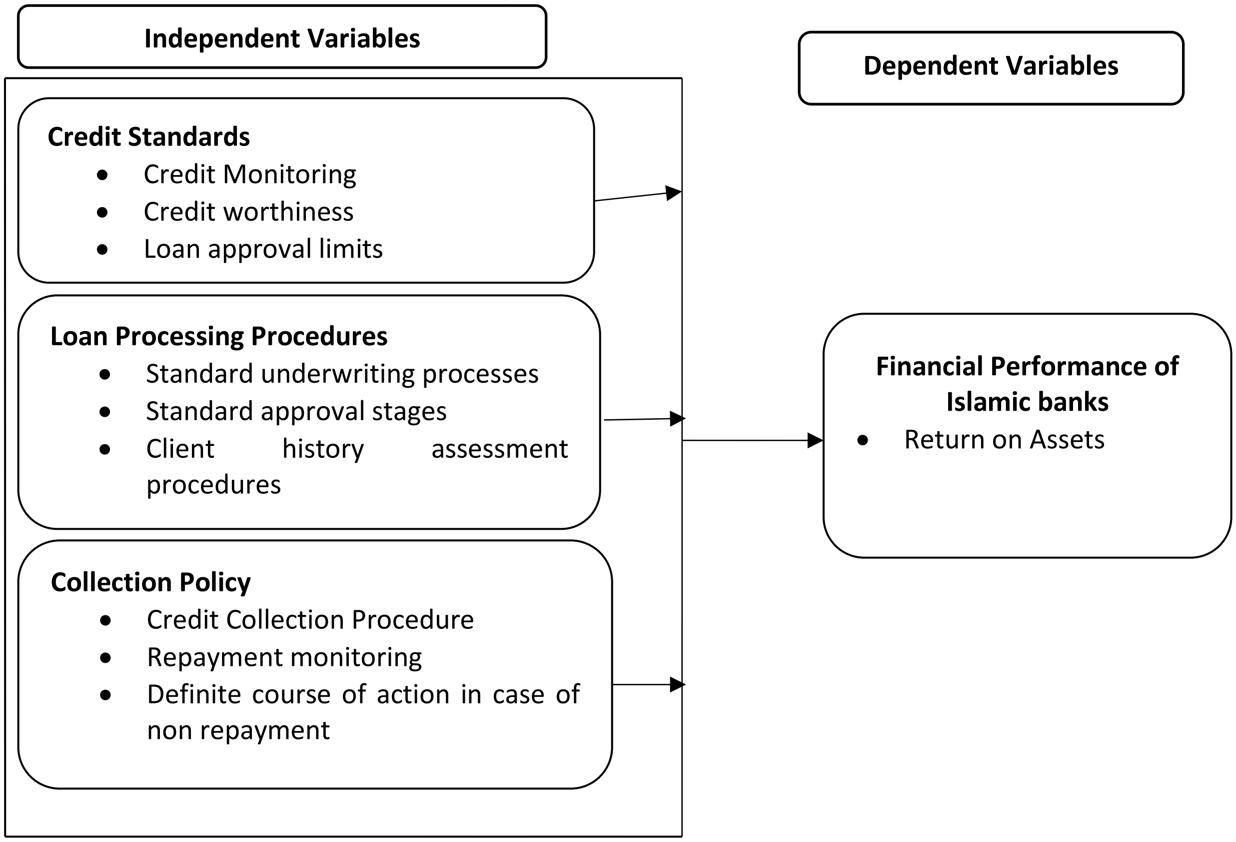
Obeng (2017) looked at delay in repayment of credit facilities as explained by financial crisis in companies operating in European Union. The essence of credit collection policy is to promote efficient loan management of disbursed funds. Also, make sure that the level of yields for banks and microfinance organizations outweighs the price of loan delivery. The existence of an efficient strategy for collecting credit within the institutional framework enables loan officers to be effective and timely in collecting client funds. Emphasis must be placed on borrowers ' assessment and loan oversight. Banks need to adopt policies to allow clients to recover their loans efficiently before they become overdue.

Chehrazi, Glynn and Weber (2019) sought to determine the best way to dynamically optimize collection of credit facilities. The study findings suggest that the optimal policy significantly reduces the default loss of a bank while ensuring that efforts to collect loan facilities are improved. It is important to ensure that credit collection policy is organized to enhance the soundness and stability of the lending institution. Geer, Wang and Bhulai (2018) studied the role played by technology in collection of credit facilities from borrowers. Reduction of the late repayment risk and possible non-payment by customers require that a firm strives to implement and adhere to a credit collection process. The firm should begin by defining their credit goals and ultimately their credit collection policy. The credit collection team should constitute the decisions to offer credit facilities through reliance on methods of reducing risks, effectively screening the loan applicants, ensuring that accounts receivables are well monitored and collection all the debts that are due within a particular time.

Buabeng, Adams, Samuel, Bernardbonnah and Kusi (2016) looked at credit policies and their interaction with operations to collect debt. The study used a case of customers and staffs of multicredit savings and loans limited. The findings reveal that; cash discount, collection procedure, credit payment period and skills of debt collection staff have positive impact on the management of debt collections. Efficient implementations of the above policies would help in the recovery of all debt advanced to various customers. Credit collection involves a transaction between a supplier and buyer that allows the delay of payment for goods or services that have been supplied. But if the payment is not received as per the agreed date, this gives rise to late payment. Thus late payment will occur when the credit collection period exceeds the allowed or agreed period that was granted to the customer.

Fonseca, Strair and Zafar (2017) investigated on the effect of debt collection in accessing credit and financial health. It is possibility that an organization will have stability when the credit collection policy is organized and effectively implemented. A credit policy that is repeated ensures that customers and employees are well versed with the values of the firm. It ensures that no misunderstanding exists between the departments of sales as well as credit. It also improves on the customer care services in place of the entity. Ngonyani and Mapesa (2019) looked at credit collection policy and its interaction with portfolio risk with reference to microfinances operating in Tanzania. It was noted that collection of credit can be done in a number of ways for instance issuance of letters, use of telephone calls, physically visiting premises of the customers, sending out reminders and use of legal means including the court systems.

Conceptual Framework



RESEARCH METHODOLOGY

The design was descriptive as this was important in determining the interaction between credit policy and financial performance. It was used to describe things the way they exist in their original state (Tetnowski, 2015). On the other hand, correlational design helped in testing the formulated hypotheses to establish the relationship between bank credit lending policies and financial performance. The target population of the study was 3 fully fledged Islamic Banks operating in Kenya. A census was applied thus all the 3 Islamic banks were included. The rationale for use of census is that the population is small to carry out sampling. For the purposes of examining credit lending policies, purposive sampling was conducted for respondents from each bank. The researcher conducted credit collection managers, credit administrators, credit analysts and credit managers.

The information for the study was obtained by use of questionnaire (appendix ii) as well as data collection sheet (appendix iii) as tools. Questionnaire was appropriate in this study because large number of respondents could be reached relatively easily and economically. Besides questionnaires, information from auxiliary sources was also gathered with aid of data collection sheets. Data collection sheet (appendix iii) was used in collecting secondary data on financial performance of the banks.

Inferential statistics (multiple regression) was used to determine the degree of association between the study variables. Panel data methods were adopted in conducting analysis of the results with the model as specified below:

$$Y_{it}=a+\beta_1X_{1it} + \beta_2X_{2it} + \beta_3X_{3it} + \varepsilon \text{...(i) Equation 3.1}$$

Where:

Y_{it} = Financial Performance of firm i at time t

X_1 = Credit Standards of firm

X_2 = Loan Processing Procedure of firm

X_3 = Credit Collection Policy of firm

α=regression coefficient

$\beta_1, \beta_2, \beta_3$ Coefficients of various independent variables

ε =error term

Results and Findings

General Information

The researcher administered 96 questionnaires to three Islamic Banks out of which 66 of them were dully filled and returned giving a response rate of 69%. On the period worked, 40.9% of the respondents had worked in their institutions for over 4 years, 37.9% had worked for 2-4 years and 21.2% for less than 2 years. This shows that the respondents of the study had generally worked in their Islamic banks for a relatively longer period of time and thus they were knowledgeable on the subjects sought by this study. On the highest level of education attained, 59.1% of the respondents had degrees, 21.2% had masters, 12.2% had diplomas and 7.6 had certificates. It can be inferred that the respondents were learnt and probably understood the key issues of lending as sought by the study. On the positions that respondents held in their banks, 16.7% of the respondents were credit administration Managers, 13.6% were corporate facility analysts, 15while the least represented were credit collection manager and legal advisors at 9.1%. It can be deduced that the respondents of the study held different positions and thus had diverse knowledge on lending as sought by the study.

Credit Standards

Table 1: Credit Standards

Statement	No Extent	Little Extent	Moderate Extent	Great Extent	Very Great Extent
The bank monitors the credit period of customers regularly	0.0%	27.9%	2.4%	60.0%	9.7%
Our Bank evaluates all applicant's collateral pledged before issuance of loans	0.0%	3.0%	17.0%	72.7%	7.3%
The bank carries out credit evaluation on a regular basis	2.4%	17.0%	15.8	40.0%	24.8

Our Bank observes loan maturity limits when appraising credit applications	0.0%	15.2%	7.3%	67.3%	10.3%
Our Bank adheres to set interest rate limits when giving out loans to applicants	0.0%	2.4%	23.0%	61.8%	12.7%
Our Bank monitors repayment performance of borrowers on a regular basis	0.0%	0.0%	17.0%	68.5%	14.5%
We evaluate creditworthiness of customers before approving loans to customers	0.0%	20.0%	9.7%	65.5%	4.8%
Our Bank applies uniform practices when evaluating clients for loan applications in each category	0.0%	12.7%	10.3%	60.0%	17.0%
We carry out monitoring to decide the type of client to whom loans should be extended	0.0%	22.4%	27.3%	26.1%	24.2%
Our Bank has set various loan limits for various categories of customers	0.0%	14.5%	7.3%	61.2%	17.0%
Our Bank factors in customer characters in administration of credit	0.0%	0.0%	20.0%	54.5%	25.5%
Our bank takes into account the capital strength of customers in processing credit facilities	0.0%	17.0%	3.0%	60.0%	20.0%
Our Bank takes into account the condition of loan applicants in its credit administration	2.4%	10.3%	5.5%	64.8%	17.0%
Overall Score	0.4%	12.5%	12.7%	58.6%	15.8%

The results in Table 1 indicate that on overall, 58.6% of the respondents said that credit standards had been adopted in their respective banks to a great extent. Claessens, Law and Wang (2018) said that a firm should not have in place credit standards that are so tight and this may lower the available customers. Most of the respondents, 72.7% said that their Bank evaluated every applicant's collateral pledged before issuance of loans to a great extent although only 26.1% of the respondents said that their institution carried out monitoring to decide the type of client to whom loans should be extended. Zambrano, Moral-Benito and Vegas (2018) said that credit standards mainly seek to ensure that there is consistency in the operations of the firm besides making sure that proper credit risk practices are adhered to.

Loan Processing Procedures

Table 2: Loan Processing Procedures

Statement	No Extent	Little Extent	Moderate Extent	Great Extent	Very Great Extent
Our bank evaluates the needs of the borrowers before giving out a loan	2.4%	12.7%	10.3%	61.8%	12.7%
Our Bank has a standardized loan processing flow of events	0.0%	24.2%	15.2%	58.2%	2.4%
Our Bank has a uniform loan repayment plans for all its customers	0.0%	17.0%	7.9%	72.7%	2.4%
Our Bank uses third parties to collect outstanding loans from customers	0.0%	0.0%	27.3%	48.5%	24.2%
Our Bank has uniform criteria on enforcing law suits on customer defaults	2.4%	26.1%	12.1%	44.8%	14.5%
The bank has competent staff to evaluate the needs of the borrowers before giving out credit facilities	0.0%	17.6%	24.8%	25.5%	32.1%
The needs of the borrowers determine the amount of loan we extent to them	0.0%	29.7%	15.2%	45.5%	9.7%
The bank has customized its credit facilities based on the needs of the borrowers	0.0%	24.8%	17.0%	50.9%	7.3%
The bank evaluates the needs of borrowers before giving out loans to reduce chances of default	0.0%	0.0%	12.1%	68.5%	19.4%
Our Bank conducts an assessment of the cash flow history of all loan applicants	2.4%	25.5%	12.1%	35.8%	24.2%
Our loan approvals are based on satisfactory assessment of the cash flow history of all loan applicants	0.0%	20.0%	15.2%	57.6%	7.3%
Our Bank offers different rates for different credit products	0.0%	23.0%	5.7%	47.1%	24.1%
Overall Score	**0.6**	**18.4**	**14.6**	**51.4**	**15.0**

The results in Table 4.5 indicate that 51.4% of the respondents were of the view that loan processing procedures had been adopted in their institution to a great extent. More specifically, while majority of the respondents (72.7%) said that their Bank had a uniform loan repayment plans for all its customers, only 25.5% said were of the opinion that the bank had competent staff to evaluate the needs of the borrowers before giving out credit facilities to a great extent. Aiyar et al. (2014) did a study on capital requirements in the banking sector focusing on UK context. It was shown that the lending policy of the bank is simply viewed as guidelines which staff needs to adhere to before being granted with loan facilities. They are these procedures that determine the type of customers at the corporate level which should be approved when demanding for loan facilities

Credit Collection Policy

Table 3: Credit Collection Policy

Statement	no extent	little extent	moderate extent	great extent	very great extent
Our Bank has well established procedures for collecting debts	0.0%	12.6%	13.8%	44.8%	28.7%
Our Bank use highly skilled employees in collecting debts	3.4%	8.0%	12.6%	71.3%	4.6%
Our bank is keen on payment period when collecting debts	0.0%	23.0%	8.0%	54.0%	14.9%
Our credit collection team monitors the level of receivables after each collection process	14.9%	6.9%	24.1%	48.3%	5.7%
Our credit collection team reports the whole process after the collection of debts	0.0%	21.8%	13.8%	46.0%	18.4%
Our Bank has clear criterion on use of law suits in collection of credit	0.0%	19.5%	23.0%	48.3%	9.2%
Our Bank has clear policies on writing off debts that stand no chance of collection	1.1%	14.9%	13.8%	50.6%	19.5%
Our Bank has clear timelines on generation of regular loan status reports	2.3%	9.2%	12.6%	56.3%	19.5%
Overall Score	**2.7**	**14.5**	**15.2**	**52.5**	**15.1**

As per the results in Table 3, it can be seen that 52.5% of the respondents said that credit collection policy had been implemented in their organizations to a great extent. It was noted that while most of the respondents, 71.3% shared that their Bank used highly skilled employees in collecting debts to a great extent, 44.8% said that the bank had well established procedures for collecting debts to a great extent too. Obeng (2017) said that the essence of credit collection policy is to promote efficient loan management of disbursed funds.

Financial Performance of Islamic Banks

The study required collection of secondary data covering the period of 2016-2019. The findings of descriptive statistics are as indicated in Table 4.

Table 4: Financial Performance of Islamic Banks Measured by Return on Assets

Bank	Min	Max	Mean	Std. Dev
First Community Bank (FCB)	1	1.25	0.44	.01586
Gulf African Bank (GAB)	.06	1.49	0.95	.02909
Dubai Islamic Bank (DIB	-32.15	-5.22	-15.69	.03344

Table 4 gives the mean of ROA for First Community Bank as .0.44; Gulf African Bank as 0.95 and Dubai Islamic Bank DIB as -15.69. This implies that on overall, Gulf African Bank was doing well in terms of financial performance as compared with First Community Bank and Dubai Islamic Bank.

Regression Results

Regression analysis was conducted to test the formulated hypotheses. The findings of the model are as summarized in the next sections.

Regression Model

The findings of the regression model were established and summarized as indicated in Table 5.

Table 5: Regression Model

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.817[a]	.668	.652	.70426

Table 5 gives the value of R square as 0.668, this means that 66.8% change in financial performance of the Islamic banks in Kenya is jointly explained by credit standards, loan processing procedures and credit collection policy as part of the credit lending policies. From this analysis, a further 33.2% is attributed to other factors outside the scope of this study.

Analysis of Variance

Table 6 gives the findings of ANOVA.

Table 6: Analysis of Variance

	Sum of Squares	df	Mean Square	F	Sig.
Regression	87.665	3	29.222	41.509	.000[b]
Residual	43.647	62	.704		
Total	**131.312**	**65**			

The findings in Table 6 indicate the value of F calculated as 49.509 with p-value of 0.000 which is lower than 0.05. This means that the overall model of the study was significant.

Regression Beta Coefficients

The findings of the regression beta coefficients and significance are as indicated in Table 7.

Table 7: Regression Beta Coefficients and Significance

	Unstandardized Coefficients		Standardized Coefficients		
	B	Std. Error	Beta	t	Sig.
(Constant)	7.196	1.199		6.003	.000
Credit Standards	.104	.045	.056	2.311	.017
Loan Processing Procedures	.119	.048	.156	2.463	.016
Credit Collection Policy	.464	.038	.765	12.084	.000

From Table 7, the following model is predicted:

$$Y=7.196+.104X_1+ .119X_2+ .464X_3+ \varepsilon$$

Where:
X_1 = Credit Standards
X_2 = Loan Processing Procedure
X_3 = Credit Collection Policy

The first objective of the study was to establish the effect of credit standards on financial performance of Islamic banks in Kenya. From the results, the study noted that when all other variables are to be held constant, a unit change in credit standards by one unit would result into 0.104 unit improvement in financial performance of the Islamic banks. The second objective of the study was to assess the effect of loan processing procedures on financial performance of Islamic banks in Kenya. The findings of the study showed that when all other factors are held constant, unit change in loan processing procedures would lead to 0.1219 unit changes in financial performance of the Islamic banks. The last objective of the study sough was to determine the effect of credit collection policy on financial performance of Islamic banks in Kenya. The results were that when other variables are held constant, a unit change in credit collection policy would result into 0.464 unit changes in financial performance of the Islamic banks in Kenya.

CONCLUSION AND RECOMMENDATIONS

Conclusion

Based on descriptive statistics, the study concludes that most of the Islamic banks in Kenya have implemented credit standards to a great extent. The study further concludes that credit standards have significantly contributed towards financial performance of the Islamic banks in Kenya.

In line with the descriptive statistics, the study concludes that loan processing procedures have been adopted by the Islamic banks in Kenya to a great extent. The study further concludes that the loan processing procedures in place have significantly affected financial performance of the Islamic banks in Kenya.

On the basis of the descriptive statistics, the study concludes that credit collection policy was ion place among the Islamic banks in Kenya. The study also concludes that the credit collection policy has significantly enhanced financial performance of the Islamic banks in Kenya.

Recommendations For Managememnt ,Policy And Practice

The regression beta coefficients indicated that credit collection policy had the largest beta coefficient that was significant. Debt collection managers and officers of the Islamic financial institutions in Kenya should simply the terms of the credit collection policy so as to significantly enhance financial performance of their institutions.

From regression results, loan processing procedures had the second largest regression beta coefficient that was positive and significant. Thus, the study recommends that the credit administration managers and officers of the Islamic banks in Kenya should simplify the loan processing procedures so as to improve on financial performance.

The results showed that credit standards had the least but positive and significant beta coefficient. Thus, this study recommends that the credit administration managers of the Islamic banks in Kenya should work to improve on the credit standards that are in place so as to enhance financial performance.

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