Factors Influencing Credit Rationing by Commercial Banks in Kenya

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Abstract

The objective of this study was to examine the factors influence credit rationing by commercial banks in Kenya. Descriptive research design was used in the study. The target population from which the sample was drawn is Commercial banks within Nairobi region. A representative sample was drawn using the Proportionate Stratified random sampling. Both primary and secondary data was used in the study. Data collected was validated, edited and coded then analyzed using descriptive statistics with the aid of Statistical Package for Social Sciences (SPSS).Data presentation methods used were tables, charts and diagrams. The study established that the key factors that influenced credit rationing by commercial banks in Kenya are loan characteristics, firm characteristics and observable characteristics. Some of the recommendations that the study made were that that it is beneficial for banks to ration credit but it should be done with professionalism and with no biasness, the factors that influence rationing of credit should be evaluated thoroughly by the person in charge and given priority before issuing credit. And the Banks should find out more about credit rationing and how it can contribute to their business growth.

Key words: Information Asymmetry, Financial Institution, Credit rationing

1:0 Background of the Study

Gatonye (1995) identifies three broad roles of banking industry in Kenya's economy as: financial intermediation between savers and borrowers that entails mobilization of resources from entities with surplus funds and channeling them to the deficit areas. Implementation of government policies by way of money supply management using instruments of monetary policies namely: cash ratio requirement, open market operation and Treasury bill action. They also play another role of facilitating the flow and interaction of various economic acts. In Kenya before the liberation of financial system in the early 1990's the government played a significant role in bank's allocation of credit among borrowers (Long et al, 1995). By early 1990 liberalization was taking place and extensive deregulation measures were implemented. Country eliminated credit and interest rate controls and softened restrictions on market entry and diversification. Removal of controls on credit allocation meant that commercial banks were free to lend largely in accordance with their own internal credit policies, which would govern the factors to be considered by banks when making credit-rationing decisions. Greuning and Bratanovic, (2006) assert that credit risk is the major single cause of bank failures and therefore it's management is key to survival of vast majority of banks to minimize credit risk and earn high profits, banks must lend successful loans which should be paid back in full. Though there is uncertainty in assessing which borrowers will be able to repay the loans (Saunders, 2006: Agenor, 2000).

Bank credit refers to loans and overdrafts extended to enterprises by formal banking institutions. Bank credit is among the most useful sources of finance for business in Kenya, the provision of credit has increasingly been regarded as an important tool for raising the incomes, mainly by mobilizing resources to more productive uses. As development takes place, one question that arises is the extent to which credit can be offered by commercial banks.

Although Commercial banks have a primary role of providing credit ,there is historical evidence of credit rationing even to creditworthy borrowers by commercial banks all over the world Only 1.5 percent of MSEs receive loans from commercial banks in Kenya (International Centre for Economic Growth 1999). It is unclear, how the rest, who form the majority, meet their working and investment needs (Kimuyu and Omiti 2000). Commercial banks are the most dominant of financial institutions and function as financial intermediaries to fulfill a number of important roles. One of the functions is the brokerage role whereby through this role they tend to reduce cost to all the parties involved. They also undertake funds transformation role by attracting funds from government, businesses and repackaging them as financial products such as loans to suit the needs of different borrowers. They also lend to large numbers of other intermediaries and clients, banks are thus made able to create sophisticated port of diversified, which reduce risks to the banks and their clients. Banks are principal means of making payments (Mcmenamin, 1999).

1:1 Statement of the problem

Access to formal credit markets is important for the growth and development of the firms (Lapar and Graham, 1998). Kenya's credit market consists of formal and informal credit markets. The formal credit markets in Kenya include commercial banks, historically; the formal credit market in Kenya has been dominated by commercial banks, which are the major suppliers of credit to households and private businesses. To enhance the efficiency of accessibility to funds and to improve access to a wider variety of services in the formal credit markets, Kenyan government implemented a number of financial sector reforms which included licensing of additional commercial banks and other financial institutions, review of the Banking Act to widen the definition of banking beyond the commercial banks and removal of restrictive licensing policies and reducing the role of government in the financial sector

Kenya's financial sector was expected to result in efficient financial intermediation and make access to loanable funds easier for potential borrowers, thereby bringing about increased investments, higher productivity among all economic units in the economy, and creation of employment opportunities. Kenyan government has also utilized part of the diamond wealth to create a variety of development credit programmes. Government's most recent development in finance institution, provides subsidized credit, along with monitoring, mentoring, business advisory services and training, to selected entrepreneurs. A number of donors over the years also tried promoting credit schemes targeted at small and micro-enterprises (SMEs), including a USAID-sponsored credit guarantee scheme. Some external funding agencies also provide credit to local entities, often via Government. These government credit programmes can be classified as part of the formal financial sector which provides enterprise finance. By implication, there is increased supply of formal sector credit which should relax the credit constraints to firms and enhance their growth. Despite all these developments, there is evidence of constrained access to bank credit by SMEs despite the major role that they play in the fight against poverty in Kenya through creation of employment opportunities. This implies that banks do not lend to everybody who can afford the price of credit, but apply some degree of credit rationing using non-price mechanisms (Okurut and Botlhole, 2005).

Given the fact that the financial sector in Kenya is liberalized, the existence of imperfect information in the credit market may explain the credit rationing behaviour of banks to maximize their profits. Credit rationing occurs when loan demand exceeds supply, and some borrowers receive no loans or less than the amount applied for at the prevailing market interest rates (Hoff and Stiglitz, 1990). The constrained access to bank credit has the negative implication of stifling growth in SME sector, with serious implications for poverty and unemployment (Morewagae et al, 1995**)**. Informal sector credit is generally characterized by small loan amounts, short maturity periods and high interest rates which is not conducive for long-term enterprise development (Okurut et al, 2006). This suggests that MSE's are an example of firms that experience severe rationing of credit by commercial banks. The existing literature has not addressed the factors that commercial banks consider when making decisions on credit rationing this is the gap that this study intends to fill. Therefore the purpose of the study will be to find out the factors influencing credit rationing by commercial banks in Kenya.

1:2 Objectives of the study

The general objective of this study is to determine the factors explaining credit rationing by commercial banks in Kenya. The specific objectives of the research are:

i. To determine how firm characteristics influences credit rationing by commercial banks in Kenya.
ii. To investigate how loan characteristics influences credit rationing by commercial banks in Kenya.
iii. To find out how observable characteristics influences credit rationing by commercial banks in Kenya.

2.0 Literature Review

2.1Theoretical Review

The theoretical model of equilibrium with credit rationing follows from the pioneering work of Stiglitz and Weiss (1981). The model is based on imperfect credit markets characterized by information asymmetry, which makes it too costly for banks to obtain accurate information on the borrowers and to monitor the actions of the borrowers. The model assumes the existence of many banks that seek to maximize their profits through their choice of interest and collateral (thereby reducing the probability of default on their loans) and many potential borrowers who seek to maximize their profits through the choice of projects. The probability of success of the projects is unknown to the bank but known to the firms due to information asymmetry. In addition the borrowers may choose to shift from safe projects that yield normal returns to high risk projects that promise high returns but with a low probability of success, and the bank has no control over such actions of the borrowers. All projects yield the same value if they fail. Banks therefore compete by choosing interest rate and also use interest rates as a screening device for distinguishing bad risks from good risks. The borrowers are assumed to demand loans of fixed sizes to finance projects that have the same expected returns. Under this scenario, high risk borrowers are willing to pay a higher interest rate for a loan. But an increase in interest charged by the bank may actually lead to a decline in the expected profit of the bank due the adverse selection effect (which results from a deterioration in the quality of the pool of loan applicants) and the incentive effect (which results from a change in the behaviour of borrowers to shift from safe to high risk projects). Equilibrium with credit rationing therefore occurs at the interest rate at which the bank maximizes the expected profit (Banerjee, 2008). Under conditions of imperfect credit markets characterized by information asymmetry, interest rates fail to play the market clearing role of equating demand and supply. But rather the banks adopt the strategy of credit rationing using the non-price mechanisms so as to maximize their expected profits.

The bank's credit rationing behaviour may theoretically be influenced by a number of factors which include the borrower's observable characteristics (age, gender, wealth, experience, credit history), firm characteristics (business experience, risk profile, earnings), and loan characteristics (amount demanded, loan maturity, collateral offered, interest rate). Lapar and Graham (1988) argued that the bank's credit rationing behaviour against the firm's loan demand can be categorized into three stages: the screening stage, the evaluation stage, and the quantity rationing stage. At the screening stage, the bank manager interviews the potential borrower to determine their eligibility for credit (in terms of their creditworthiness, loan requirements and the terms desired). The manager then decides whether the applicant is sufficiently qualified to apply for a loan or not. At the evaluation stage, the loan officer undertakes a detailed analysis of the viability of proposed investment project10 (including detailed investigations of the credit history, the type and value of proposed collateral, management of the firm, probability of repayment). Based on this information, the loan officer (and/or the loan committee) makes a decision as to whether it will be profitable for the bank to grant a loan or not. The borrowers deemed to be not creditworthy will be denied loans completely (credit rationed). At the quantity-rationing stage, the bank determines the optimal loan size for a borrower at a given interest rate.

The optimal loan size will be determined by the bank taking into account the bank's evaluation of the probability of repayment, the marginal cost of granting the loan, and the value of collateral offered. Quantity rationing here refers to a scenario where some borrowers are granted loan amounts that are less than what they had applied for. It is at quantity- rationing stage that the bank fine tunes the loan contract to reflect the bank's subjective evaluation of the riskiness of the loan and of the borrower and the impact of these risks on expected profit (Lapar and Graham ,1988). The degree of risk of a firm also has an influence on the willingness of banks to offer bank loans (Hoff and Stiglitz, 1990). Firms for which the repayment of the loan is more uncertain are more risky for the bank, and hence are more likely to be credit rationed. The risk for the bank implies the default risk, being the risk that the firm can't fulfill its obligations to the bank. The degree of risk of the firm may be inferred from the credit history of the borrower, the expected returns of the project, business experience of the firm. Guido (2008) also argued that credit rationing may also originate from a lender's inability to classify loan applicants in proper risk categories, which effect is particularly strong when novel technologies are involved.

The value of the collateral offered by a firm also influences the credit rationing behaviour of the bank (Ghosh et al, 1999). Collateral serves as the last resort for recovery of the loan in case of default, where the bank can sell the collateral obtained to recover the balance (or part) of the loan. Collateral reduces the information asymmetry between the SME and the financial institution (Chan and Kanatas, 1985).

When a borrower has a project with a high probability of a high return, the collateral offered can signal the real value of a project. This signaling role is certainly important when the financial institution has limited information on the firm and the value of the project is estimated lower (Rothschild and Stiglitz, 1971). Thus collateral could have a signaling value for the bank when considering the creditworthiness of the firm (Bester 1985, 1987). Also ex post, after obtaining the loan and offering the collateral, credit applicants wish to fulfil their obligations and repay on a timely basis in order to avoid losing the collateral. Thus, giving collateral can also solve the „moral hazard" problem by reducing the motives to switch to a higher risk project or do less effort to realize the proposed project (Boot et al., 1991). This implies that firms with a lot of intangible assets, which are difficult to monitor, might incur difficulties in obtaining bank finance (Longhofer and Santos, 2000). Stiglitz and Weiss (1981) also considered if a higher value of collateral could reduce the risk and increase the return for the bank. In their model, they came to the conclusion that there is a positive, moral hazard effect, causing collateral to increase the return for the bank. On the other hand, there is also a negative adverse selection effect working when an increasing demand for high value collateral by banks makes the average and marginal borrower to become more risky. Stiglitz and Weiss show that the negative adverse selection effect more than compensates the positive moral hazard effect. So contrary to the signaling theory, Stiglitz and Weiss (1981) conclude that increasing the demand for collateral will decrease the expected return for the bank, so that offering more collateral will not increase the supply of bank debt to firms.

Theoretically, there is no consensus on the influence of collateral on credit rationing. Empirical studies (Atanasova and Wilson, 2004; Ogawa and Suzuki, 2000; Alphonse et al., 2004) mainly confirm the signaling theory. The magnitude of the firm's internal financing sources also affects the banks credit rationing behaviour. According to the pecking order theory, firms follow a certain order when choosing their financing resources (Myers, 1984). Firms prefer internal financial sources but if these sources appear to be insufficient, they will appeal to external finance, e.g. bank finance. However as a firm grows, the financial needs and options may change (Berger and Udell, 1998). Growing firms need more financial resources to fund the growth (Cressy and Olofsson, 1997) and will, according to the pecking order theory have to descend in the financing hierarchy and appeal to bank finance.

On the other hand, the possession of sufficient internal finance (due to a high profitability), could also increase the demand for external bank debt. The firm knows that the probability of acquiring additional debt is increased at that moment and will demand for more bank debt to insure itself against the need for more bank debt when the firm experiences a period of lower profitability. This reasoning is in accordance with the static trade off theory, based on the idea that every firm has an optimal debt ratio determined by a trade-off of the costs and benefits of debt finance (Modigliani and Miller, 1963; Jensen and Meckling, 1976; Harris and Raviv, 1990). Firms with more internal financial sources (proxied by business earnings) can therefore be expected to be less likely to be credit rationed as the banks will rate them as prime clients. The length of the loan maturity period required by the borrower may also influence the bank's credit rationing behaviour (Lapar and Graham, 1988). The longer the loan maturity period, the greater the risk of loan recovery due to the riskier nature of long term investments, hence the higher will be the likelihood that the borrower will be credit rationed. The observable socio-economic characteristics of the borrower (education level, wealth, household income, asset values) are argued in the theoretical literature to reduce the borrower's probability of being credit rationed (Nuryartono et al, 2005; Okurut et al, 2005). The rationale is that these factors tend to raise the borrower's credit rating, hence reducing the probability of loan default to the lender.

2.2 Empirical literature

According to a study done by Atieno (2001), Commercial banks and other formal institutions fail to cater for the credit needs of smallholders, however, mainly due to their lending terms and conditions. It is generally the rules and regulations of the formal financial institutions that have created the myth that the poor are not bankable, and since they can't afford the required collateral, they are considered uncreditworthy. The results showed that the limited use of credit reflects lack of supply, from the rationing behavior of both formal and informal lending institutions. The study concluded that given the established network of formal credit institutions, improving lending terms and conditions in favour of small-scale enterprises would provide an important avenue for facilitating their access to credit. According to a study done by Kimuyu P.et al (2002), took up the question of how finance is related to other aspects of small business. Specifically, they studied the determinants of probably the most important financial decision of MSEs, that of how to raise capital for the business, distinguishing between the initial capital and any follow-up capital acquired for expansion or restructuring.

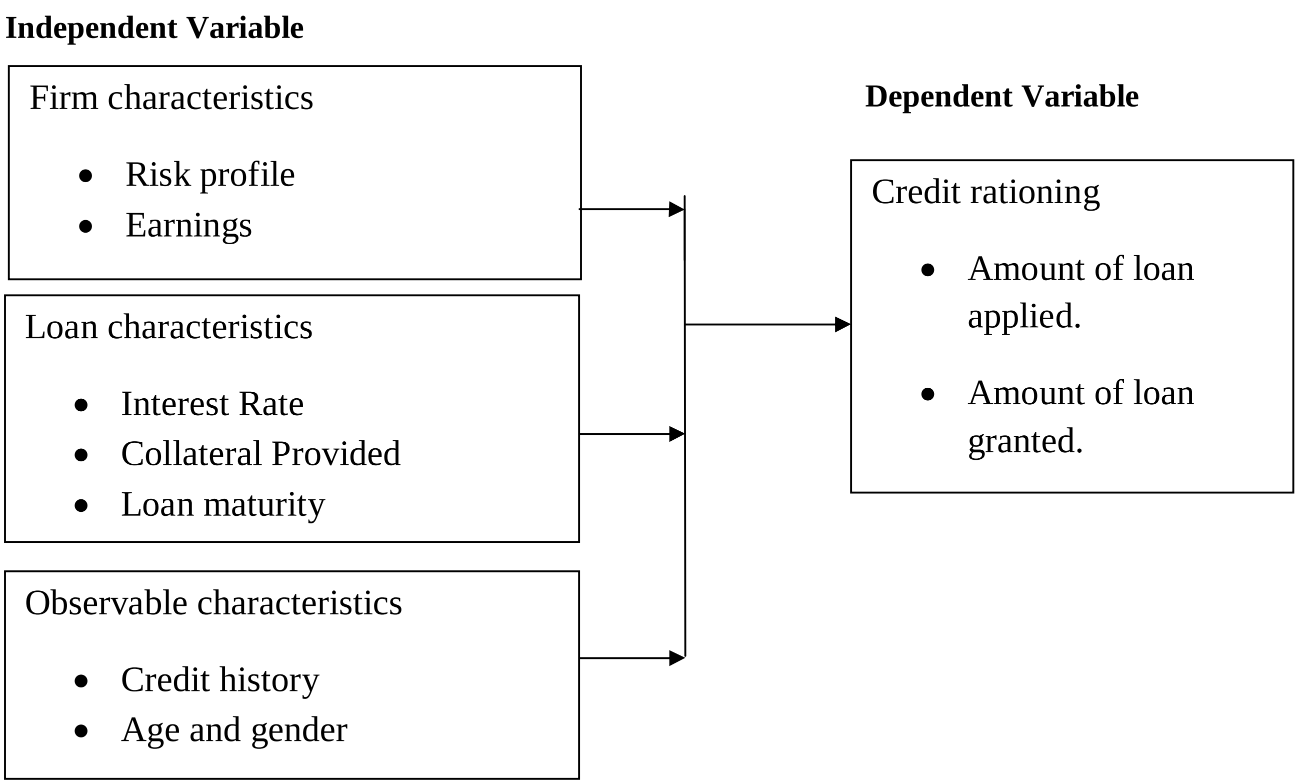
They examined this decision in the context of a large sample of MSEs in Kenya. Kenya's small enterprise sector forms an important part of the economy and available data suggests that, in the recent past, it has grown faster than the larger organized sector .Moreover, small enterprises tend to be more labour-intensive than large enterprises (Snodgrass and Biggs, 1995). Thus, a lot is expected of Kenya's MSEs in the fight against poverty and there is considerable interest in research that can enlarge the pool of information to help inform policy towards MSEs. More precisely, in their research, they identified first, the factors which lead Kenyan MSEs to borrow, whether from formal or informal sources, as against using equity; second, the determinants of the gearing rate which they actually employ.

According to a study done by Wagema G.M,(2006), which sought to identify critical factors that influence access to bank credit by MSEs is indicated that entrepreneurial orientation is a direct determinant of access to credit by MSEs. Further, knowledge-based resources gained from maturation (age), training, previous start-up experience and vicariously through entrepreneurial parents were found to be associated with greater levels of entrepreneurial orientation. Overall, these findings support the literature that underscores the primacy of entrepreneurial factors, over operating environment in facilitating small enterprises' access to bank credit.

2.3 Conceptual Framework

The main objective of this research was to find the factors that influence commercial banks to ration credit. Credit rationing was measured by the amount of loan a client applied and the amount of loan granted. If the loan granted is less than the amount applied for then that showed that there is credit rationing. The firm characteristic was measured by looking at the risk profile of either the business or the individuals who borrowed loan. The loan characteristics was measured by the interest rate and collateral provided by the client. The observable characteristics were measured by the age of the individual or the business and the credit history of the loan applicants.

Fig 1: Conceptual framework



3.0 Research Methodology

3:1Research design

The research design which was used is descriptive research design. Descriptive research determines and reports the way things are and also helps a researcher to describe a phenomenon in terms of attitude, values and characteristics (Mugenda and Mugenda, 2003).

According to Orodho (2003), descriptive design allows researchers to gather, present and interpret information for purposes of clarification. This design was chosen because the researcher seeks to find out the current state as far as credit rationing by commercial banks is concerned.

3:2 Target population

The population of interest for this study comprised of the 44 commercial banks licensed to carry out banking business in Kenya under the banking act (cap 488) section (4) and (5) that are in operation as at 2009 according to Central Bank of Kenya (2009): Annual Bank Supervision Report.

3:3 Sampling Design and Sample Size

The sampling design which was used is the proportionate stratified random sampling which according to Kombo, and Tromp, (2006) stratified random sampling involves dividing the population into homogenous subgroups and then taking a simple random sample in each subgroup. The banks will be stratified according to the asset base that is Large (assets above ksh 15 billion), medium (assets above ksh 5 billion but below 15 billion) and small (assets below 5 billion). The researcher will take 70% of the total banks in each stratum. The study focused on the credit analysts at the credit department based at the head office of the selected banks this is because the final decision of loan approval is made at the head office

3:4 Data Collection tools and instruments

This study made use of both the primary data and secondary data. Primary data was collected using semi-structured questionnaires that were administered personally by the researcher. The questionnaires were administered to credit analysts of the banks under study. Three questionnaires will be issued to each sample this is because in each commercial bank there are many credit analysts who approves the credit sought by borrowers. This made the sample size to be 93. The questionnaire was divided into two parts: in part one seek to obtain will background information on the banks and related credit environment, while part two will addresses credit rationing issues. Secondary data will be collected from the statistics available at the Central bank of Kenya.

3:5 Data Analysis

Data collected was validated, edited and coded and then analyzed using descriptive statistics such as percentage and means. Data presentation methods used were tables, charts and diagrams. Factor analysis will be used to rank the factors in order of importance. The statistical package for social sciences (SPSS) will be used to generate the descriptive statistics.

4:0 Findings and Discussion

The banks were found to offer their credit facilities to a variety of borrowers indicating the diversity of clients that provide with credit facilities. Findings indicated that banks issuing of credit to individual borrowers comprised of 91%, to groups of people had 38.5%, government is 8% and business firm or organizations had the largest portion of 98.23%. From the responses provided it's clear that most banks give credit to more than one category of clients; however the data showed that majority of the banks have specialized on one category of borrowers that is the business firms and organizations.

The major sectors of the economy in Kenya include the agricultural, manufacturing, trade, building and construction and tourism. The major payers in this sector require loans to finance working capital requirements and bank credit is one crucial source of funds. This study sought to find out the extent to which the banks provide credit to different sectors of country's economy. The study found that banks offered credit to a combination of sectors, the agricultural sector had 68.7% of credit provided, manufacturing borrowers received 72.3%, trade and industry had 83.1% with building and construction getting 73.8% and tourism 38 %. Other small sectors received 19.4% of credit. Trade and industry had the largest proportion of credit with 86.3%.This clearly indicates that banks offer credit to combination of sectors with others having an advantage of more credit than others.

The study found that 12% did not ration credit as long as the borrowers met the minimum credit score while 88% of banks rationed credit even among borrowers who had met the basic credit scores. This suggests that most banks rationed credit even to credit worthy borrowers. Since most banks indicated that they rationed credit, the study went on to investigate the main forms of credit rationing practiced by the banks going by the definition of credit rationing. The data for utilization of forms of credit rationing showed that 85.25% of the banks clients got full credit but others did not get credit at all, 58.30% indicated that they extended credit but less than the borrower would like while 8.23% indicated borrowers paying high interest rates were likely to get credit.

It's clear that the largest proportion of forms of credit rationing utilized was some get full credit but others do not get credit at all. The study evaluated the importance of the factors identified by using factor analysis in explaining why some Kenyan banks rationed credit and to rank the relative importance of each factor to the banks. The respondents were therefore asked to indicate the relative importance of each factor listed on a point likert scale. The results are based on mean ranks provided by the respondents. The likert scale had the following form very important, Important, Somewhat important, not important at all.

On objective one, the findings indicated that 60% of the respondents reported that it is a very important factor to ration credit in order to reduce the credit risk. While 24% of the respondents indicated that it was important for them to ration credit in order to avoid risk of adverse selection and the moral hazard. Therefore it is a very important factor to ration credit in order to reduce risks as it is depicted by an average mean of 3.32. The researcher also found out that it was important for majority of the banks to ration credit due to the limited management capacity to monitor higher credit activity this factor had a mean of 2.24. The study also established that another factor which is important and had a mean of 2.44 is to avoid risk of adverse selection and moral hazard. The findings indicated that the cost of borrowing is an important factor that influences credit rationing by commercial banks in Kenya.

On objective two, the findings showed that the amount of collateral affects the decision whether to give credit to borrowers or not. The findings as shown in table 4.7 indicated that it is a very important factor. Majority of the respondents which accounted for 72% agreed with the fact that the amount of collateral is a very important factor which influences credit rationing by commercial banks. While 4% of the respondents reported that amount of collateral was not an important factor at all which influences credit rationing. From the findings it shows an average mean of 3.56 which implies that it is a very important factor. The amount of collateral determines the amount of credit granted this is because in case of default the collateral given is used by the bank to recover their money.

On objective three, the findings showed that 52% of the respondents reported that high cost of obtaining information on borrowers and investments and reduction of cost of obtaining information are not important factors at all to be considered when giving credit to borrowers.24% of the respondents indicated that it is a very important factor to ration credit because of lack of reliable information on credit worthiness of the borrower. Lack of reliable information on credit worthiness of the borrowers and unfamiliarity with the local economy and business environment are important factors which influences commercial banks to ration credit the two factors identified had an average mean of 2.6 and 2.12 respectively. High cost of obtaining information on borrowers and investments and reduction of cost in obtaining information were ranked with a mean of 1.72 each which implies that they are somewhat important factors influencing credit rationing by commercial banks

The study established that most banks offer a combination of services so that to satisfy their customers but a higher percentage of banks offered credit to their customers. The study also clearly indicated that banks offered credit to different categories of clients that is to individual borrowers, government and business firms. Most banks offer credit to individual borrowers and they offered short term credit with a repayment of up to 12 months. The findings also indicated that there is evidence of credit rationing by commercial banks and the form of credit rationing utilized was that some of the barrowers get full credit but some do not get any credit at all. The study established that most of the banks ration credit based on the observable characteristics it was clearly indicated that the banks lacked reliable information on the credit worthiness of the borrower and that they incurred a high cost of obtaining information on borrowers and investments and therefore they rationed credit to reduce the cost of obtaining information. The banks found it expensive to explore the credit worthiness of borrowers before extending credit and afterwards monitoring the borrower. Some of the banks also rationed credit because of their unfamiliarity with the local economy and the business environment.

The study established that most of the banks rationed credit in order to reduce risk and to avoid the risk of adverse selection and moral hazard. At high interest rates the risk of adverse selection rises because borrowers with high repayment probabilities drop out and are replaced by those with high default risk. The findings indicated that increasing rates increases the riskiness of the bank loans portfolio by increasing the probability of adverse selection and moral hazard hence decreasing the bank profits. The study established that for most banks it was somewhat important to ration credit because of the high cost of preparing and enforcing loan contracts and there was lack of legislation to promote information disclosure. Research findings indicated that this factor influenced credit rationing.

The study also established that 68% of the banks considered the level of debt in the borrower's capital structure before giving credit. This is a clear indication that this was an important factor influencing credit rationing by commercial banks.

5:0 Conclusion

The purpose of this study was to establish the factors that influence credit rationing in Kenya. The study sought to achieve the following objectives: The first objective was to establish how firm characteristics influences credit rationing. The findings indicated that most banks considered the level of debt in the borrower's capital structure if the borrower's level of debt is high then the bank rations credit to such borrowers. This indicates that it is an important factor the bank considers. The second objective was to investigate how characteristics influences credit rationing loan. The findings indicated that most banks rationed credit in order to reduce risk and to avoid risk of adverse selection and moral hazard and limited technical capacity to monitor higher credit activity. This indicates that the cost of borrowing has an important effect on the decisions of rationing by the commercial banks.

The third objective was to find out how loan characteristics influences credit rationing. The findings revealed that majority of the banks rationed credit because of information asymmetry majority of the respondents indicated that lack of reliable information on credit worthiness of the borrower, unfamiliarity with local economy and business environment and high cost of obtaining information made the banks to ration credit.

Recommendations

On the basis of the findings of the study, the following recommendations can be made,

- That it is beneficial for banks to ration credit but it should be done with professionalism and with no biasness.
- Factors that influence rationing of credit should be evaluated thoroughly by the person in charge and given priority before issuing credit.
- Banks should find out more about credit rationing and how it can contribute to their business growth.
- The banks should not ration credit to credit worthy borrowers instead they should find reliable information on the credit worthiness of the borrowers.
- It is important for the banks to ration credit because it will minimize the risk of default.

Suggestions for further research

Research should be carried out on the following areas:

- Research on the effect of credit reference Bureau reports on credit rationing in the banking industry.
- Research on the weaknesses in the legal, regulatory and infrastructure framework of financial system that should be addressed in order to enhance efficiency of credit allocation to credit rationed borrowers.
- Research on the impact of credit rationing on the financing and investment decisions on firms in Kenya.

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