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Original Article

Relationship Between the Credit Risk Assessment and The Financial Performance of Tier-Two and Tier-Three Commercial Banks in Kenya

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ABSTRACT

This study examined the relationship between credit risk assessment and the financial performance of tier-two and three commercial banks in Kenya. The research adopted a cross-sectional design targeting 312 top-level employees from 30 tier-two and tier-three banks, with a sample size of 175 respondents selected through simple random sampling. Data were collected using structured questionnaires and analysed using descriptive and inferential statistics. The results showed that while credit risk assessment practices were generally in place, the correlation with financial performance was positive but statistically insignificant ($r = 0.057$, $p > 0.05$). This indicates that although credit risk assessment is important, it alone may not significantly influence financial performance unless combined with other credit risk management strategies. The findings suggest that banks should not rely solely on assessment but enhance other practices for improved financial outcomes.

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INTRODUCTION

Globally, credit risk assessment remains a cornerstone of financial risk management within commercial banking institutions. It is a systematic process of evaluating the creditworthiness of a borrower to determine the probability of default and the potential loss to the lender (Ekinci & Poyraz, 2019; Nderitu, 2022). In the aftermath of the 2007–2008 global financial crisis, banks across developed economies such as the United States and those in the European Union intensified efforts to refine credit risk assessment systems, incorporating advanced credit scoring models, artificial intelligence (AI)-driven risk profiling, and data analytics to preemptively identify risky borrowers. As a result, these institutions have seen improved asset quality, reduced non-performing loan (NPL) ratios, and strengthened profitability (Ekinci & Poyraz, 2019; Al-Hadad et al., 2020).

In these settings, credit risk assessment extends beyond traditional collateral checks to include predictive analytics based on borrower behaviour, macroeconomic indicators, and industry-specific risk profiles. Basel III frameworks and International Financial Reporting Standards (IFRS 9) have further institutionalised credit risk assessment procedures globally, requiring financial institutions to adopt expected credit loss (ECL) models and maintain adequate capital buffers against default risk.

Regionally, across Sub-Saharan Africa, credit risk assessment remains underdeveloped in many banking sectors. While countries like South Africa and Nigeria have made strides toward adopting international best practices, many commercial banks in the region still face significant challenges related to data availability, weak enforcement of credit policies, and limited integration of credit reference bureaus into lending practices (Noori, 2021; Ndum, 2021; Agyei-Mensah, 2018). Studies in Nigeria and Ghana reveal that although banks acknowledge the importance of credit assessment, practical constraints such as political interference, insufficient borrower data, and informal lending systems often undermine the reliability of credit decisions (Nyebar, Obalade, & Muzindutsi, 2023).

For instance, Nyebar et al. (2019) found that effective credit risk assessment systems among agricultural banks in Ghana significantly increased loan repayment rates and improved overall bank performance. On the contrary, Ekinci and Poyraz (2019) observed a negative relationship between credit risk assessment and performance in Turkish banks, underscoring the fact that without institutional efficiency, even robust assessment frameworks may fail to translate into financial gains.

In the Kenyan context, tier-two and tier-three commercial banks face unique challenges in implementing credit risk assessment frameworks. These banks typically serve underserved market segments, including small and medium enterprises (SMEs), informal traders, and rural population borrowers who often lack formal financial histories or collateral (Karanja, Karuti, & Senaji, 2022). Consequently, traditional credit assessment tools may not be effective, increasing the exposure of these banks to credit defaults.

According to the Central Bank of Kenya (CBK), while credit risk remains the most significant threat to the stability of commercial banks, the industry has made notable progress through the introduction of the Credit Information Sharing (CIS) mechanism and risk-based lending models. However, the utilisation of these systems varies significantly between banks, with smaller institutions lagging due to cost constraints and limited technical expertise.

Locally, commercial banks in Kenya evaluate credit risk using borrower-specific factors such as income level, employment status, business performance, and existing debt obligations. Yet, as noted by Nderitu (2022), many of these assessments are still conducted manually, increasing the potential for errors, bias, and inefficiency. Moreover, as Ekinci

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and Poyraz (2019) argue, reliance on historical financial data without incorporating forward-looking risk models limits the predictive accuracy of credit assessments.

The current study focused on assessing the relationship between credit risk assessment and financial performance among tier-two and tier-three commercial banks in Kenya. Financial performance was measured using Net Interest Margin (NIM) and Return on Equity (ROE), two key indicators of a bank's operational efficiency and profitability. The rationale was that a robust credit risk assessment framework should result in high-quality loan portfolios, reduced provisioning costs, and improved earnings, thereby boosting both NIM and ROE.

Ownership structure was also considered as a moderating factor in this relationship. Ownership patterns, whether local, foreign, private, or state-owned, often influence governance practices, risk appetite, and the adoption of risk management systems. For instance, foreign-owned or institutionally backed banks may have access to better credit analytics tools and stricter risk compliance standards, enhancing the quality of credit risk assessments (Varde, 2023). Conversely, family-owned or closely held banks may rely more on relational lending, potentially undermining objective risk assessment procedures.

In sum, while credit risk assessment is globally recognised as a determinant of financial health, its application and effectiveness vary across regions. In Kenya, particularly among tier-two and tier-three commercial banks, contextual constraints such as limited data infrastructure, borrower informality, and inconsistent adherence to credit policies complicate the execution of sound credit risk assessment practices. This study contributes to the ongoing discourse by empirically examining how these practices relate to financial performance in a developing economy context, thereby offering insights for regulators, practitioners, and policymakers seeking to strengthen the resilience of the Kenyan banking sector.

Statement of the Problem

Commercial banks play a vital role in economic development through credit provision and financial intermediation. Globally, credit risk assessment has emerged as a critical determinant of financial performance, enabling banks to evaluate borrower creditworthiness, mitigate default risk, and maintain sound loan portfolios (Ekinci & Poyraz, 2019). However, in many developing economies, particularly in Africa, weak credit risk assessment frameworks continue to contribute to rising non-performing loans (Ndum, 2021).

In Kenya, tier-two and tier-three commercial banks are particularly vulnerable. Despite their role in promoting financial inclusion, their financial performance has declined significantly over the last decade, with several institutions placed under receivership due to high levels of NPLs, poor credit assessment practices, and weak internal controls (CBK, 2022). Although reforms such as enhanced credit information sharing and regulatory oversight have been introduced, inefficiencies in credit risk assessment persist (Nderitu, 2022).

Limited empirical studies have specifically examined how credit risk assessment influences financial performance among these banks, or whether this relationship is moderated by ownership structure. This gap in knowledge impedes efforts to design effective risk management strategies tailored to Kenya's mid-tier banking segment. Accordingly, this study sought to examine the relationship between credit risk assessment and the financial performance of tier-two and tier-three commercial banks in Kenya.

Research Hypothesis

***H_{01}*:** There is no statistically significant relationship between the credit risk assessment and the financial performance of tier two and three commercial banks in Kenya.

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Literature and theoretical review

Credit Risk Assessment and Financial Performance

Credit risk assessment entails assessing a customer's probability of defaulting on payment before advancing credit to them. Financial institutions examine their clients' creditworthiness by examining their income levels, credit scores, payment history of past loans and overdrafts, and assessing the value of the given collateral (Nderitu, 2022). According to Ekinci and Poyraz (2019), credit risk assessment is the estimation of the probability of a loss occurring due to the failure of the customer to repay the loan. Therefore, credit risk assessment can be described as assessing the borrower's ability to repay a debt per the bank's original terms and conditions. Assessing the credit risks, lenders consider the capacity to repay, associated collateral, capital, loan conditions, and credit history.

Ekinci and Poyraz (2019) sought to examine the impact of credit risk assessment on deposit banks' financial performance in Turkey. The study was quantitative and adopted a descriptive approach. The sample size consisted of 26 deposit banks in Turkey between 2005 and 2017. Financial statements, annual reports, and statistical reports provided secondary data. Panel data analysis was employed to analyse the data. Financial performance was measured using Return on Equity and Return on Assets. The data obtained revealed that credit score assessment had a negative relationship with Return on Equity and Return on Assets. The study mainly focused on commercial banks in general, while the current study focused on tier-two and tier-three commercial banks.

Muzindutsi, Nyebar, and Obalade (2023) sought to assess the effectiveness of credit risk management strategies on the financial performance of agricultural financing commercial banks in Ghana. The study adopted a mixed research technique, and a sample size of 19 respondents was used, where 10 respondents represented credit managers and 9 were farmers. The interview schedule and questionnaire were used to collect primary data, while secondary data was collected from websites and published financial statements. Results from Qualitative data analysis and content analysis indicated that collateral valuation had a positive and insignificant effect on financial performance. The study further revealed that commercial banks in Ghana lacked specific policies that guide their daily operations. Notably, the reviewed study focused on the financial performance of agricultural financing commercial banks in Ghana, while this study focused on tier two and tier three commercial banks in Kenya.

Mogga, Mwambia, and Kithinji (2018) assessed the impact of credit management practices on South Sudan's commercial banks' performance. The independent variables included risk analysis and assessment, risk monitoring process, credit approval, and risk identification. The study was anchored on information theory, arbitrage pricing theory, and portfolio theory. A descriptive research design was employed with a sample size of 40 respondents picked through a stratified sampling technique from a target population of 80. A structured questionnaire was used to obtain primary data. Descriptive and inferential statistics were considered for data analysis, where the output affirmed that loan approval and risk monitoring had a significant effect on the financial performance of commercial banks.

Wachira (2017) studied the effect of credit risk assessment on commercial banks' performance in Nyeri County. The study mainly focused on credit scoring evaluation, written credit policies, and customer payback history. A descriptive research design was adopted, and the study used a census with 86 participants, including credit officers, branch managers, and credit managers. A structured questionnaire was used to collect primary data, which was later analysed using descriptive statistics. The findings showed that written credit

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policies had a strong effect on commercial banks' performance. The credit scoring evaluation and customer payback history indicated a moderate and significant effect on the performance of commercial banks. The study concluded that commercial banks need to evaluate customer credit scores and payback history accurately. It can be noted that the reviewed study adopted a descriptive research design, while this study relied on a cross-sectional research design that made it possible to test research hypotheses.

Nderitu (2022) examined the effects of credit risk assessment on DT Sacco's financial performance in Mombasa County, Kenya. The variables of the study were anchored on operational risk theory, liquidity preference theory, and financial intermediation theory. A descriptive research design was used, and a sample size of 49 respondents was obtained from a target population of 55 employees drawn from 5 DT Saccos in Mombasa County. Both primary and secondary data were collected and analysed using descriptive and inferential statistics. The findings showed that credit score assessment and payment history positively and significantly affected the financial performance of DT Saccos. The study concluded that financial institutions need to assess the client's payment history, assess the credit score, and do collateral valuation before credit approval. This study was in DT Sacco, while the current research focused on tier-two and tier-three commercial banks.

Various methodologies were utilised in the reviewed studies. Ekinci and Poyraz (2019) examined 26 deposit banks and relied on secondary data. Nyebar, Obalade, and Muzindutsi (2023) conducted a small-scale study with a sample size of 19 respondents, which limits generalisation. Meanwhile, Nderitu (2022) conducted research in 5 DT Saccos located in Mombasa County. This study aimed to fill the gaps in context and concept by examining 36 tier-two and three commercial banks and using mixed research methods. For this study, credit risk assessment will be indicated by income, credit score, collateral valuation, and payment history.

Moderating Effect of Ownership Structure

Hussain and Rasheed (2022) sought to determine the effect of credit management, liquidity management, and capital adequacy on the economic performance of commercial banks with a moderating role of ownership structure. The study adopted qualitative and quantitative research designs. Annual financial statements between 2012 and 2021 were retrieved from 15 commercial banks in order to provide secondary data. Descriptive statistics and unit root tests were used to analyse the data; correlation and multicollinearity were used to test the hypotheses. The study indicated that ownership structure did not have any moderating role in credit risk management, liquidity management, and capital adequacy on the economic performance of commercial banks. In conclusion, the ownership structure is not a vital indicator of a bank's financial performance.

Boachie (2023) examined the moderating effect of ownership structure on the relationship between corporate governance and banks' financial performance in Ghana. The study adopted a cross-sectional research design where the sample consisted of 23 commercial banks. The sample size of 414 respondents was obtained from commercial banks. This involved top, middle, and lower management and employees. Multiple linear regression analysis was adopted, and the findings indicated that foreign ownership structure had a moderate effect between the independent and dependent variables. The study used corporate governance as an independent variable, while this study used credit management practices as the independent variable.

Chol, Nthambi, and Kamau (2020) conducted a study on moderating the effect of ownership structure on the relationship between bank stability and commercial banks' financial performance in South Sudan. The study was anchored on camel

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theory and adopted a descriptive design approach. Twenty-nine senior managers were purposively selected from 29 commercial banks. Qualitative and quantitative data were obtained, and annual financial statements between 2012 and 2017 were used to provide secondary data. A semi-structured questionnaire, on the other hand, was adopted to obtain primary data. Data were analysed using descriptive statistics and inferential statistics. ANOVA and regression models, t-test, and f-test were employed to conduct a statistical test. The study findings indicated that ownership structure statistically moderated commercial banks' financial performance.

Kiprop (2018) analysed the effects of ownership structure on the relationship between credit management strategies and financial institutions' performance in Kenya. An explanatory research design was adopted, and 239 respondents were selected to form a sample size through a stratified sampling technique. Primary data was obtained using a structured questionnaire, and data were analysed by employing descriptive statistics and inferential statistics. The findings indicated that ownership structure had a positive and significant impact on the financial performance of financial institutions. Further, the study found that ownership structure moderated the relationship between evaluation, risk analysis, and financial institutions' performance. However, ownership structure did not significantly moderate the relationship between monitoring, risk identification, and the financial performance of financial institutions in Kenya. The study concluded that policymakers need to use the identity of ownership to foster the relationship between credit management strategies and financial institutions' performance

Financial Performance of Commercial Banks

Mushafiq, Sindhu, and Sohail (2023) studied financial performance under the influence of credit risk in non-financial firms in Pakistan. The study adopted the Altman Z-score as a measure of credit risk, and return on equity and return on assets as measures of financial performance. In addition, the study used firm size, liquidity, and leverage as the control variables. Panel data was obtained from 69 non-financial firms in the Pakistan Stock Exchange between 2012 and 2017. This data was analysed using panel regression analysis. The study found that firm size, Altman z-score, and leverage had a significant influence on the return on equity and return on assets of the non-financial firms. The effect of liquidity was found to be insignificant. At the same time, Altman's z-score and firm size had a significant positive effect on financial performance, and leverage had a negative relationship with financial performance. It is noted that the reviewed study focused on 69 non-financial firms listed in the Pakistan stock exchange, while the current research focused on the financial performance of Tier Two and Tier Three commercial banks in Kenya.

Harb, El Khoury, Mansour, and Daou (2023) examined the relationship between credit risk management and bank performance in the Middle East and North Africa region. Bank performance in this study was measured in terms of accounting ratios using ROA and ROE, and market performance using Net Interest Margin. The study relied on panel data obtained from 51 listed commercial banks from 10 countries in the Middle East and North Africa region between 2010 and 2018. The study found that credit risk management has a non-linear relationship with market performance, while it does not have any relationship with accounting performance. Further, the study found an insignificant relationship between liquidity risk and both the measures of bank financial performance, but both credit risk management and liquidity, when combined, had a significant influence on bank performance. The reviewed study was carried out in 10 countries, where the findings could be influenced by several factors, such as economic, political, and technological factors; this research was carried out in Kenya.

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Temba, Kasoga, and Keregero (2024) examined the impact of the quality of credit risk management practices on the financial performance of commercial banks in Tanzania. The specific focus of the study was to assess the impact of credit risk monitoring and supervision, the adequacy of the credit recovery process, the quality of the credit process and controls, and the impact of credit risk assessment on the financial performance of banks. This study targeted fifteen commercial banks, and panel data of 225 observations were made between 2003 and 2019. The findings revealed that credit risk monitoring and supervision, adequacy of the credit recovery process, and the quality of credit process and controls positively impacted the financial performance of the banks through their asset quality, efficient use of equity, and capital adequacy. The study further established that the earning ability of the banks and liquidity were negatively affected by risk assessment practices, credit approval rates, and risk monitoring and supervision.

Kimani (2023) studied the determinants of the financial performance of general insurance companies in Kenya. The predictor variables for this study were liquidity, solvency, firm size, capital adequacy, and underwriting risk. Financial performance was measured by return on equity. The study adopted a descriptive research design and targeted 31 general insurance companies in Kenya. Secondary data was obtained from financial statements using a data extraction form from the year 201 in Kenya. Secondary data was obtained from financial statements using a data extraction form from 2014 to 2020. Data was analysed using regression, exploratory, and descriptive techniques. The study established that capital adequacy and liquidity had a negative and insignificant influence on financial performance, solvency had a positive and significant influence on financial performance, and underwriting risk had a negative and significant effect on the financial performance of general insurance companies. Notably, the study was conducted in general insurance companies with a different regulatory framework, while this research was carried out in commercial banks.

The Theory of Financial Distress

The theory was proposed in 1983 by Baldwin and Scott. It offers a non-biased perspective to all credit managers and originates from the credit risk and liquidity challenges faced by the bank. The theory proposes a neutral ground that can be adopted for undertaking an incisive customer analysis within commercial banks to avoid credit repayment defaults. Baldwin and Scot (1983) argued that financial distress in organisations is always a result of incapacity and inability to fulfil financial obligations. The effects of financial distress are experienced when there are previous defaults in credit payments.

According to Bhatt, Ahmed, Iqbal, and Ullah (2023), a financial institution's ability to lend to borrowers is associated with certain risks that can lead to liquidity challenges. Therefore, these institutions must adopt efficient credit management practices to enhance their liquidity. However, according to Irungu (2013), financial distress theory suffers from some limitations, one of them being the assumption of homogeneity among firms facing financial distress, which may not fully capture the diverse range of challenges and strategies employed by commercial banks in managing credit risk. Similarly, Lew and Lau (2022) criticised the theory for focusing solely on the firm-level perspective while neglecting the broader systemic and macroeconomic factors that can affect banks' credit quality and performance within the overall financial system. Despite the weaknesses of this theory, it lays emphasis on the framework that should be adopted to manage credit risk and minimise the possibility of the bank facing liquidity challenges despite having good profit records. Mushafiq *et al.* (2023) held that when a commercial bank experiences a positive growth rate that significantly surpasses the internal rate of return, it may encounter challenges in maintaining sufficient revenue flow to cover its expenses. This situation

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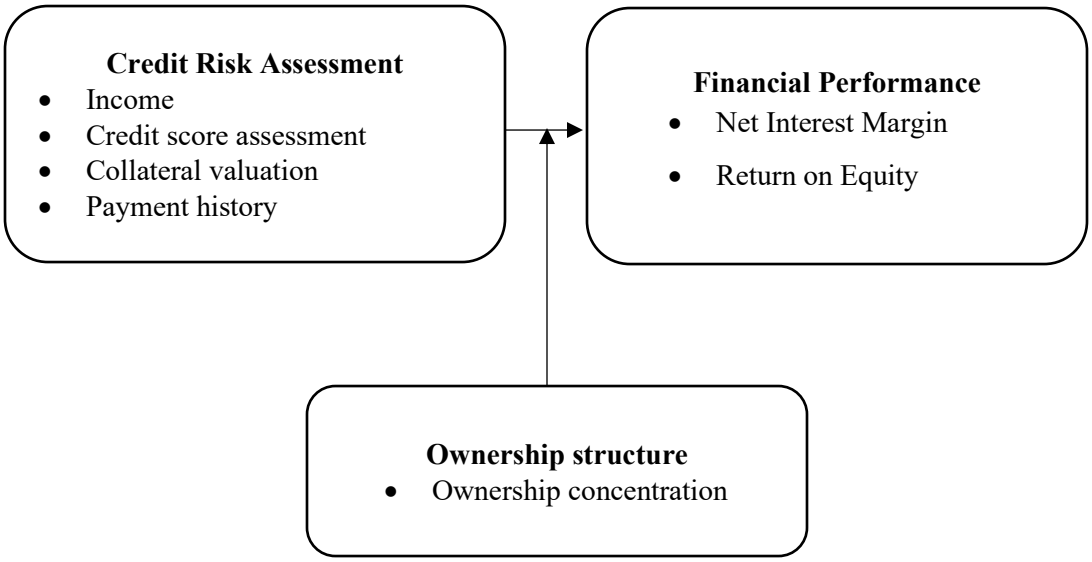
could hinder the bank's ability to meet its financial obligations. This theory is grounded on the financial performance of tier two and three commercial banks.

Conceptual Framework



Research Methodology

The study employed a positivist research philosophy and adopted a cross-sectional research design, focusing on Tier II and III commercial banks in Nairobi County, Kenya, due to the city's role as the nation's financial hub. The target population comprised 312 top management employees (bank managers, credit managers, credit officers, and credit analysts) from all 30 Tier II and III banks registered with the Central Bank of Kenya. A stratified random sampling technique was applied, followed by simple random sampling to select a representative sample size of 175 respondents, determined using Yamane's formula. A structured questionnaire served as the primary data collection instrument, divided into two sections: the first capturing institutional characteristics, and the second focusing on the study variables using a five-point Likert scale. This tool was chosen for its efficiency in collecting standardised data from a broad sample.

Results and discussion

Demographic Information

The study gathered demographic data on the number of branches, years of experience, and departments of respondents within the banks. Most banks (52%) had between 6 and 10 branches, indicating widespread operations beyond head offices. Regarding experience, 38.7% of respondents had worked between 6 and 10 years, while 37.6% had over 11 years of service, suggesting that the participants were knowledgeable and experienced in bank operations. Departmental representation showed that 38.2% were credit officers, 27.7% credit managers, 17.9% bank managers, and 16.2% credit analysts, confirming that the study captured a balanced and relevant cross-section of banking professionals involved in credit and risk management.

Descriptive Statistics

The study examined the relationship between credit risk assessment and financial performance in tier II and III commercial banks in Kenya.

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Credit Risk Assessment and Financial Performance

This section contains statements on the credit risk management practices adopted by tier two and tier three commercial banks. Indicate the extent to which you agree to these statements by putting a cross mark (X) on the Likert scale provided below. On the scale, number five stands for strongly agree, four stands for agree, three stands for not decided while two stands for disagree, and finally, one stands for strongly disagree.

Table 1: Credit Risk Assessment

Statement on Credit Risk Assessment	SA	A	ND	D	SD	M	SD
The bank uses the borrower's income in determining the risk level of lending	54(31.2)	69(39.9)	44(25.4)	6(3.5)	0(0)	3.99	084
The bank conducts a credit score assessment of the borrowers frequently before disbursing the loan	8(4.6)	87(50.3)	67(38.7)	10(5.8)	1(6)	3.53	0.70
There is an effective collateral valuation of the customers that reduces the risk of the bank	64(37)	79(45.7)	18(10.4)	5(2.9)	7(4)	4.09	0.98
The bank's credit department assesses customers' payment history to determine the level of risk	85(49.1)	68(39.3)	17(9.8)	3(1.7)	0(0)	4.36	0.73
The bank's credit risk assessment has led to an increase in financial performance	15(8.6)	91(52.6)	64(37)	3(1.7)	0(0)	3.68	0.65
Use of credit reference bureau services has enhanced the loan recovery rate	51(29.5)	71(41)	46(26.6)	5(2.9)	0(0)	3.97	0.82

The researcher sought to know if the bank uses the borrower's income in determining the risk level of lending. The majority, 69 (39.9%) of the respondents agreed, 54 (31.2%) strongly agreed, 44 (25.4%) were undecided, and only 6 (3.5%) of the respondents disagreed with this statement. When questioned whether the bank conducts credit score assessment of the borrowers frequently before dispatching the loan, most, 87 (50.3%) of the respondents agreed and 8 (4.6%) of the respondents strongly agreed with the statement. However, 67 (38.7%) of the respondents were neutral, while 10 (5.8% disagreed, and 1 (6%) of the respondents strongly disagreed with the statement.

The respondents were asked if there is effective collateral valuation of the customers that reduces the risk of the bank, and the majority, 79 (45.7%), agreed, and 64 (37%) of the respondents strongly agreed. On the other hand, 18 (10.4%) of the respondents were neutral, 5 (2.9%) of them disagreed, and 7 (4%) of the respondents disagreed with the statement. Nearly half, 85 (49.1%) of the respondents strongly agreed and 68 (39.3%) of the respondents agreed that the bank's credit department assesses customer's payment history to determine the level of risks, while 17 (9.8%) of them were neutral and only 3 (1.7%) of the respondents disagreed with this statement.

When questioned if the bank's credit risk assessment has led to an increase in financial performance, the majority, 91 (52.6%) of the respondents agreed and 15 (8.6%) of the respondents strongly agreed to this while 64 (37%) of the respondents were neutral and a few, 3 (1.7%) of the respondents disagreed on the statement. The researcher sought to find out if the use of credit reference bureau services has enhanced the loan recovery rate. A majority, 71 (41%) of the respondents agreed with this. Further, 51 (29.5%) of the respondents strongly agreed, 46 (26.6%) were neutral, and 5 (2.9%) of the respondents disagreed

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that the use of credit reference bureau services has enhanced the loan recovery rate.

Ownership Structure

This section presents the frequencies, means, and standard deviations of responses regarding the ownership structure of tier two and tier three commercial banks. The responses were measured by a five-point Likert scale, where number five presented strongly agree, four presented agree, three presented not decided, while two presented disagree, and finally, one presented strongly disagree. The findings are summarised in Table 2.

Table 2: Ownership Structure

Statement on Ownership Structure	SA	A	ND	D	SD	M	SD
There is involvement of government ownership in the bank	46(26.6)	87(50.3)	23(13.3)	12(6.9)	2(2.9)	3.91	0.97
There is involvement of foreign ownership in the bank	46(26.6)	82(47.4)	25(14.5)	12(6.9)	8(4.6)	3.84	1.04
There is involvement of institutional ownership in the bank	19(11)	74(42.8)	31(17.9)	38(22)	11(6.4)	3.30	1.12
There is involvement of individual ownership in the bank	47(27.2)	79(45.7)	31(17.9)	16(9.2)	0(0)	3.91	0.90
The ownership structure of the bank includes managerial ownership	47(27.2)	93(53.8)	25(14.5)	5(2.9)	3(1.7)	4.02	0.83
The ownership structure of the bank is dominated by family ownership	48(27.7)	76(43.9)	30(17.3)	16(9.2)	3(1.7)	3.87	0.98

The results in Table 2 show that most, 50.3% of the respondents agreed, 26.6% strongly agreed, and 13.3% were neutral when questioned if there was involvement of government ownership in the bank. On the other hand, 6.9% of the respondents disagreed and 2.9% strongly disagreed with this statement, revealing a mean of 3.91 and a standard deviation of 0.97. When asked whether there is involvement of foreign ownership in the bank, a majority, 47.4% of the respondents agreed, 26.6% strongly agreed, 14.5% were neutral, 6.9% disagreed, and 4.6% strongly disagreed. These findings projected a mean of 3.84 with a standard deviation of 1.04.

The respondents were questioned if there is involvement of institutional ownership in the bank, and this revealed a mean of 3.30 and a standard deviation of 1.12. This is because a majority,42.8% of the respondents agreed, while 11% strongly agreed, 17.9% were neutral, 22% disagreed, and 6.4% of the respondents strongly disagreed with the statement. The statement that there was an involvement of individual ownership in the bank had a mean of 3.91 and a standard deviation of 0.90. This is because 45.7% of the respondents agreed, 27.2% strongly agreed, 17.9% were neutral, and 9.2% disagreed that individual ownership in the bank has led to improvement in financial performance.

The researcher asked whether the ownership structure of the bank included managerial ownership. Most, 53.8% agreed, 27.2% strongly disagreed,14.5% were undecided, while 2.9% disagreed and 1.7% of the respondents strongly disagreed. This led to a mean of 4.02 and a standard deviation of 0.83. When asked if the ownership structure of the bank was dominated by family ownership, the majority, 43.9% of the respondents agreed, 27.7% strongly agreed and 17.3% were neutral, 9.2% disagreed, and 1.7% of the respondents strongly disagreed. These results

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showed a mean of 3.87 and a standard deviation of 0.98.

Financial Performance

This section presents the frequencies, means, and standard deviations of responses regarding the financial performance of tier two and tier three commercial banks. The responses were measured by a five-point Likert scale, where number five presented strongly agree, four presented agree, three presented not decided, while two presented disagree, and finally, one presented strongly disagree. The findings are summarised in Table 3.

Table 3: Financial Performance

Statement on financial performance	SA	A	ND	D	SD	M	SD
There has been an improvement in banks' net interest margin	67(38.7)	97(56.1)	6(3.5)	3(1.7)	0(0)	4.32	0.63
There has been an increase in the bank's return on equity	41(23.7)	84(48.6)	30(17.3)	12(6.9)	6(3.5)	3.82	0.99
There has been a reduction in non-performing loans, leading to an increase in the bank's profitability.	63(36.4)	90(52)	17(9.8)	3(1.7)	0(0)	4.23	0.69
There has been an improvement in the bank's return on assets.	10(5.8)	73(42.2)	55(31.8)	31(17.9)	4(2.3)	3.31	0.91
There has been a reduction in default rates, leading to a higher return on investment for the bank	23(13.3)	46(26.6)	35(2.2)	49(28.3)	20(11.6)	3.02	1.24
Loan portfolio quality has been strengthened, resulting in better overall financial performance	27(15.6)	68(39.3)	35(20.2)	20(11.6)	23(13.3)	3.32	1.25

Table 3 indicates the respondents' responses when questioned if there has been an improvement in banks' net interest margin. The majority of the respondents, 56.1% agreed, 38.7% strongly agreed, 3.5% were undecided, and only 1.7% disagreed with the statement, showing a mean of 4.32 and a standard deviation of 0.63. The findings also show that most of the respondents, 48.6% agreed, 23.7% strongly agreed, 17.3% were undecided, 6.9% disagreed, and 3.5% of the respondents strongly disagreed that there has been an increase in the bank's return on equity. This projected a mean of 3.82 and a standard deviation of 0.99.

When asked whether there has been a reduction in non-performing loans, leading to an increase in the bank's profitability, a majority, 52% agreed, 36.4% strongly agreed, 9.8% were undecided, and 1.7% disagreed, indicating a mean of 4.23 and a standard deviation of 0.69. The statement that there has been an improvement in the bank's return on assets indicated a mean of 3.31 with a standard deviation of 0.91. This is because a majority, 42.2% of the respondents agreed, 5.8% strongly agreed, 31.8% were undecided, 17.9% disagreed, and 2.3% of the respondents strongly disagreed that there has been an improvement in the bank's return on assets.

The majority, 28.3% of the respondents, disagreed that there has been a reduction in default rates, leading to a higher return on investment for the bank, revealing a mean of 3.02 and a standard deviation of 1.24. Further, 11.6% strongly disagreed, 20.2% were undecided, 26.6% agreed, and 13.3% strongly agreed with the statement. The respondents were questioned if the loan portfolio quality had been strengthened, resulting in better overall financial performance, and most of them, 39.3% agreed, 15.6% strongly agreed, 20.2% were undecided, 11.6% disagreed, and 13.3% strongly

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disagreed. This resulted in a mean of 3.32 with a standard deviation of 1.25.

Inferential Statistics

To assess the nature of the relationship between the variables, correlation and regression analysis were carried out.

Correlation Between Credit Risk Assessment and Financial Performance

The correlation analysis between credit risk assessment and financial performance revealed a weak positive relationship ($r = 0.057$, $p = 0.457$), suggesting that credit risk assessment, as a standalone factor, does not significantly influence the financial performance of tier II and III commercial banks in Kenya. This weak correlation may indicate that other factors, such as liquidity management, credit risk mitigation practices, or ownership structure, might play a more substantial role in shaping financial performance. The lack of a strong relationship highlights the complexity of financial performance, which likely depends on multiple interconnected variables rather than solely on credit risk assessment practices.

Table 4: Correlation between Credit Risk Assessment and Financial Performance

Variable	Credit Risk Assessment	Financial Performance
Credit Risk Assessment	**1.000**	**0.057**
Financial Performance	**0.057**	**1.000**
Sig. (2-tailed)		**0.457**
N	**173**	**173**

The weak and statistically insignificant correlation ($r = 0.057$, $p = 0.457$) between credit risk assessment and financial performance in this study aligns with findings from previous research that has explored the complex relationship between credit risk management and financial outcomes in banking. According to Fofana et al. (2019), while credit risk management practices, including credit risk assessment, are essential for managing potential defaults and ensuring financial stability, their direct impact on financial performance may not always be substantial. This suggests that financial performance in banks is influenced by a myriad of factors beyond just credit risk assessment, such as liquidity risk management, capital structure, and external economic conditions.

In line with the findings of Al-Tamimi (2010), who noted that credit risk assessment alone does not guarantee improved financial performance unless integrated with other risk management practices, the weak correlation observed here could indicate that banks may need to adopt a more holistic approach to credit risk management. For example, liquidity risk monitoring and credit risk mitigation strategies, as discussed by Saiti and Goh (2019), could play a more prominent role in ensuring banks' profitability and operational success.

Moreover, the literature suggests that the effectiveness of credit risk assessment is contingent on the bank's ownership structure and management practices. According to Iqbal et al. (2015), banks with a strong governance structure and diversified ownership are more likely to make informed credit risk decisions that positively affect their financial performance. The ownership structure, as indicated in the study's results, was more strongly correlated with financial performance ($r = 0.426$, $p < 0.01$), implying that governance factors may influence how effectively credit risk is managed, further supporting the need for a comprehensive approach to managing credit risk.

In conclusion, while credit risk assessment remains an essential part of credit risk management, its direct impact on financial performance is limited without the integration of other factors, as supported

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by the literature. The findings of this study suggest the need for a broader perspective on credit risk management, considering multiple variables such as liquidity management, credit risk mitigation, and ownership structure for better financial outcomes.

Testing of the Research Hypotheses

The hypothesis of the study was:

$H_0$1: There is no statistically significant relationship between credit risk assessment and the financial performance of tier two and three commercial banks in Kenya.

A simple regression analysis was conducted to examine the relationship between credit risk assessment and financial performance. The results from the analysis are presented in Tables 5–8.

Table 5: Model Summary for the Relationship between Credit Risk Assessment and Financial Performance.

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.400[a]	0.160	0.153	0.450
a. Predictors: (Constant), Credit Risk Assessment				

The results in Table 5 show that R-square is 0.160. This means that 16% variance in financial performance can be explained by credit risk assessment, and 84% variance in financial performance can be explained by other factors.

Table 6: ANOVA Results for Credit Risk Assessment and Financial Performance

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	12.500	1	12.500	45.455	0.000[b]
	Residual	47.067	171	.275		
	Total	59.567	172			
a. Dependent Variable: Financial Performance						

Table 6 explains that the model was statistically significant. The F-statistic of the regression (F (1,171) = 45.455) was statistically significant (p=0.000<0.05). This means that the model applied significantly predicted the change of the dependent variable (financial performance) as a result of the predictor variable (credit risk assessment). The model, therefore, fits the data.

Table 7: Coefficients for Credit Risk Assessment and Financial Performance

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		β	Std. Error	Beta		
1	(Constant)	3.372	.402		8.380	.000
	Credit Risk Assessment	.076	.102	.057	.745	.457
a. Dependent Variable: Credit Risk Assessment						

Table 7 shows that there exists a statistically insignificant positive relationship between liquidity risk monitoring and financial performance, with a coefficient of 0.076 (β=0.076; p = 0.457>0.05). This explains that when credit risk management increases by an additional unit, financial performance increases by 0.076. The following regression equation was obtained. $Y=3.372+0.072X_1$. Where; Y= Financial performance, X_1= Credit Risk Assessment

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Therefore, the null hypothesis, that there is no statistical significant relationship between the credit risk assignment and financial performance of tier II and III commercial banks in Kenya, was accepted and the hypothesis that there exists a statistical significant relationship between the credit risk assessment and financial performance of tier II and III commercial banks in Kenya was rejected. This implies that credit risk management does not affect the financial performance of tier II and III commercial banks in Kenya.

These findings can be corroborated with those of Nyebar, Obalade, and Muzindutsi (2023), who, in assessing the effectiveness of credit risk management strategies on the financial performance of agricultural financing commercial banks in Ghana, established that credit risk assessment had a positive and insignificant effect on financial performance. Similarly, Ekinci and Poyraz (2019) found that credit risk assessment had a negative relationship with Return on Equity and Return on Assets of commercial banks in Turkey.

Moderated Regression Analysis

The study examined the moderating effect of ownership structure on the relationship between credit risk assessment and the financial performance of tier two and three commercial banks.

Table 8: Model Summary for the Moderating Effect of Ownership Structure on the Relationship between Credit Risk Assessment and Financial Performance

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.161[a]	.026	.020	.51865
2	.427[b]	.183	.173	.47647

a. Predictors: (Constant), Credit Risk Assessment
b. Predictors: (Constant), Credit Risk Assessment, Ownership Structure

Table 8 shows the moderating effect of ownership structure on the relationship between credit risk assessment and financial performance. R-squared in the moderated model changed from 0.026 to 0.183. This suggests that ownership structure has a significant moderating effect on the relationship between credit risk assessment and financial performance.

Table 9: ANOVA Results for the Moderating Effect of Ownership Structure on the Relationship between Credit Risk Assessment and Financial Performance

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	1.221	1	1.221	4.539	.035[b]
	Residual	45.999	171	.269		
	Total	47.220	172			
2	Regression	8.626	2	4.313	18.997	.000[c]
	Residual	38.594	170	.227		
	Total	47.220	172			

a. Dependent Variable: Financial Performance
b. Predictors: (Constant), Credit Risk Assessment
c. Predictors: (Constant), Credit Risk Assessment, Ownership Structure

Table 9 shows that the two models were statistically significant since model 1 had (F (1,171) = 4.539), which was statistically significant (p=0.035<0.05), and model 2 had F (2,170) = 18.997, which was statistically significant (p=0.00<0.05). The mean square of the residuals reduced from 0.026 in model

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1 to 0.227 in model 2. Therefore, the ANOVA results in the moderated model indicate that the model was significant, suggesting that it significantly fits the data.

Table 10: Coefficients for the Moderating Effect of Ownership Structure on the Relationship between Credit Risk Assessment and Financial Performance

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	3.008	.313		9.602	0.000
	Credit Risk Assessment	.182	.086	.161	2.131	0.035
2	(Constant)	2.569	.298		8.624	0.000
	Credit Risk Assessment	0.366	0.124	0.322	2.947	0.004
	Credit Risk Assessment* Ownership Structure	.653	.114	.625	5.711	0.000

a. Dependent Variable: Financial Performance

Table 10 indicates that credit risk assessment had a coefficient of 0.366, which is statistically significant since $p<0.05$. This means that without considering the moderating effect of ownership structure, an increase in credit risk assessment reduces financial performance. After moderation, the beta coefficient for credit risk assessment was 0.653 with a p-value<0.05, indicating that ownership structure has a significant moderating effect on credit risk assessment and financial performance.

Conclusion

The inferential statistics in this study offer valuable insights into the relationship between credit risk assessment and the financial performance of tier II and III commercial banks in Kenya. The correlation analysis revealed a weak and statistically insignificant positive relationship between credit risk assessment and financial performance ($r = 0.057$, $p = 0.457$), indicating that credit risk assessment alone does not substantially influence financial performance. This finding was further supported by regression analysis, where the model explained only 16% of the variation in financial performance, and the coefficient for credit risk assessment was not statistically significant ($\beta = 0.076$, $p = 0.457$). Consequently, the null hypothesis stating there is no statistically significant relationship between credit risk assessment and financial performance was accepted.

However, the moderated regression analysis revealed that ownership structure significantly influences the relationship between credit risk assessment and financial performance. The introduction of ownership structure into the regression model increased the explanatory power (R^2 rose from 0.026 to 0.183), and both the interaction term and the moderated model were statistically significant ($p < 0.05$). Specifically, the interaction between credit risk assessment and ownership structure ($\beta = 0.653$, $p < 0.000$) demonstrated that ownership structure significantly strengthens the positive impact of credit risk assessment on financial performance.

These results suggest that while credit risk assessment in isolation may not directly improve financial performance, its effectiveness is significantly enhanced when moderated by a robust ownership structure. This highlights the importance of corporate governance practices in optimising risk management strategies and achieving improved financial outcomes. The findings underscore the need for a holistic approach to credit risk management, integrating internal structures such as governance and external risk mitigation practices to

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ensure better financial performance in the banking sector.

Recommendation

Based on the study's findings, it is recommended that tier II and III commercial banks in Kenya adopt a more integrated and holistic approach to risk management. The results indicated that credit risk assessment alone does not significantly influence financial performance. Therefore, banks should incorporate other complementary risk management practices such as liquidity risk monitoring, credit risk mitigation strategies, and market risk evaluation. By aligning credit risk assessment within a broader enterprise risk management framework, banks can enhance the reliability and effectiveness of their financial strategies.

In addition, the study highlighted the significant moderating role of ownership structure on the relationship between credit risk assessment and financial performance. As such, commercial banks should strengthen their corporate governance frameworks by fostering ownership structures that promote transparency, accountability, and diverse stakeholder involvement. A well-structured ownership model can improve the quality of credit decisions and risk oversight, thereby positively influencing financial outcomes.

Moreover, banks should invest in capacity building and data-driven decision-making tools. Equipping credit officers with analytical skills and modern risk assessment technologies can enhance the precision of credit evaluations. Continuous professional development and the adoption of predictive modelling tools can enable more informed and proactive credit risk management practices, especially when supported by a governance environment that encourages strategic risk-taking.

There is also a need for commercial banks to regularly review and tailor their credit risk assessment procedures. These practices should be aligned with the institution's size, customer base, strategic objectives, and regulatory environment. Customising credit risk tools to suit the specific context of each bank can improve their effectiveness in predicting default risk and enhancing profitability.

Finally, the study suggests that further research should be conducted to explore additional moderating or intervening variables that may influence the relationship between credit risk assessment and financial performance. Future studies could examine the roles of technological adoption, managerial competence, macroeconomic stability, and customer relationship management in shaping bank performance. This broader perspective would provide a deeper understanding of the dynamics at play and support the formulation of more effective financial policies and strategies.

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