International Journal of Science and Research (IJSR)
ISSN (Online): 2319-7064
Index Copernicus Value (2013): 6.14 | Impact Factor (2014): 5.611

Factors Affecting Credit Extension to the Tourism Sector Investment Facilities in Kenya by the Commercial Banks

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Abstract: ***The hospitality industry is one of the major and significant sectors contributing immensely to the country's Gross Domestic Product (GDP). Moreover; credit financing is one of the major factors influencing performance and time to break even in the small and medium hotel sector in major urban areas in Kenya. Small and medium hotels face poor performance, high bankruptcy rates and reduced growth potential due to their inability to attract credit financing from financial institutions. The main objective of the study was to establish the factors influencing credit financing to tourism investment facilities by financial institutions in Kenya. The specific objectives were to; establish the effect of collateral on credit financing to the tourism sector by Kenyan financial institutions; to determine the effect of loan pricing by financial institutions to the tourism sector to; determine the extent that risk profile of the hotel influences credit financing by financial institutions in Kenya, and; to examine the effect of performance of the business on credit financing by financial institutions to the tourism sector. The study applied a descriptive cross-sectional design. The study population was 43 commercial banks in Kenya but only 40 commercial banks were operational at the time of the study. The study was a census where three employees from each bank were the study respondents. Questionnaire was utilized as data collection instrument in the current study. The study results established that availability of collateral is a major factor that positively influences credit financing to small and medium hotels by commercial banks. Moreover, loan pricing and risk profile negatively affects access to credit by small and medium hotels from commercial banks. Study results also determined that performance of small and medium hotels is significant in determining credit financing to the sector by commercial banks***

Keywords: Credit extension, credit financing, collateral, loan pricing, risk profile, financial performance

1. Background of the Study

Tourism comprises the activities of persons travelling to and staying in places outside their usual environment. World tourism is growing fast and even exceeding the expectations. International tourist arrivals (overnight visitors) increased by 4.3% in 2014, reaching a total 1133 million after topping the 1 billion mark in 2012 (Otuki, 2014).

The Americas recorded the strongest growth with an 8% increase in international arrivals, followed by Asia and the Pacific and the Middle East (both +5%). In Europe arrivals grew by 3%, while in Africa they were up by 2%.International tourism receipts reached US$ 1245 billion worldwide in 2014, up from US$ 1197 billion in 2013, corresponding to an increase of 3.7% in realterms (UNWTO, 2014).

Tourism is one of the productive business activities directed for the production of the goods and services. It provides the goods and services for the customers (generally foreigners) while providing employment and income for the locals. With this not only the tourism business enterprises generate the earning from the operation of the business activities, but also the people related directly or indirectly with such business generate their earning. Further, tourism as an economic activity produces various direct, indirect and induced impacts in the economy.

It increases the foreign exchange earnings, generates the employment opportunity and increases the income. Again, the resultant income flows and circulates in the economy and boosts other economic activities ultimately inducing many rounds of income. Therefore, the role of tourism becomes distinct and significant in the economic growth and development of the country (UNWTO, 2015).

Since independence, Kenya has relied on its tourism industry to generate foreign exchange earnings. Kenya provides a good example of an African country which has embraced tourism as an important tool for socio-economic development. In the short term, Third World Countries in general, and Kenya in particular, viewed the development of tourism as a quick and reliable source of much sought after foreign exchange receipts, jobcreation and economic growth. However, a critical valuation of the evolution and development of tourism in Kenya indicates that the country's tourism industry faces socio-economic problems and structural deficiencies which reduce the industry's efficacy as a tool for local, regional and national sustainable development (Akama, 1999).

Scholars argue that tourism has larger multiplier effects than any other sector since every unit of tourist spending would generally go through several rounds of income creation and expenditure before its effect is exhausted (Gopalakrishnan & Parkash, 2015). This would beexpenditure on hotel accommodation, food and beverages, shopping, entertainment and transport, provides an income to hotel staff, taxi operators, shopkeepers and suppliers of goods and services. They in turn spend part of this income on their daily requirements of goods and services. Hence money accruing from tourism circulates through numerous segments of the economy through the multiplier process.

A more meaningful measure of foreign exchange receipts discounts the leakages from the gross receipts and arrives at a figure of net receipts from tourism. Many tourism enterprises in the Third World are owned and managed by foreign companies, usually multinational corporations. The parent company therefore is in a controlling position allowing it to repatriate most of the foreign exchange. Relatively large amounts of foreign exchange are lost to the developed world because of the structural dependency created through widespread foreign ownership, control and management of tourism enterprises in the Third World (Lea, 2003).

Kenya's hotel infrastructure is dispersed over the entire country although the concentration varies widely. Many of Kenya's main tourist hotels are found in the major cities and resort areas including Nairobi, Mombasa, Malindi, Nakuru and Kisumu. Other tourist hotels are located on the south coast region, which includes Diani and Tiwi beaches, around the Mt Kenya region, and in the central part of the Great Rift Valley. Lodges and tented camps are found mainly in the South West (covering the Amboseli region), the Maasai Mara, and in the Western region (Kakamega) and the northern parts of Kenya at Isiolo and Maralal (Akama, 1999).

The tourism and hospitality industry contributes greatly to government revenue through license fees, customs and exercise duty, value added tax (VAT) on tourism services, landing fees, passenger service charge and entry fees to game parks as well as income tax levied on other employees in the tourism industry. The generated revenues play a pivotal role in the overall development of the economy. The tourism and hospitality industry in Kenya faces a stagnated growth (Mutindi, Namusonge & Obwogi, 2013).

2. Specific Objectives

1) To assess the effect of collateral on credit financing to the tourism sector.
2) To investigate the effect of loan pricing to the tourism sector.
3) To establish the extent that risk profile of the hotel influences credit financing.
4) To assess the effect of financial performance on credit financing to the tourism sector

2.1 Theoretical Review

The current study was based on four theories. These are power theory of credit, loan pricing theory, information asymmetry theory and credit rationing theory. These theories were used in the study to provide a basis for the explanation on how the independent variables in the study (collateral, loan pricing, and risk profile of the hotel and performance of the business) influenced the dependent variable (credit financing by financial institutions to the tourism sector).

2.1.1 Power Theory of Credit

The power theory of credit was introduced by Djankov, Mcleish and Shleifer (2005). The theory states that financial institutions would be more willing to extend credit if, in case of default, they could easily enforce contracts by forcing repayment or seizing collateral. The amount of credit in a country would then depend to some extent on the existence of legislation that protects the creditors' rights on the quality procedures that leads to repayment. However, the presence of rules and regulations that are not cumbersome relating to seizing of collateral would mean that banks will be more willing to offer credit to businesses that provide collateral.

Further, the theory indicates that firms with more tangible assets as collateral will hence be able to enter into lending contracts with banks and put in place binding agreements on how the collateral will be disposed off in case of default. In the current study, the study was applied to assess whether small and medium hotels with more assets to pledge as collateral get more access to bank credit.

2.1.2 Loan Pricing Theory

According to Olokoyo (2011), this theory explains the attendant risks of banks having to set high interest rates in order to optimize returns from lending. When banks set very high interest rates, they induce the problem of adverse selection and moral hazard. This attracts borrowers with very risky projects into the banks portfolio. In return, the already high interest rates incentivize the borrowers into adding more risk to their investment portfolio due to high affinity for high returns. In view of this banks should consider the problems of adverse selection and moral hazard since it is difficult to forecast the borrower type at the start of banking relationship (Stiglitz and Weiss, 1981).

2.1.3 Information Asymmetry Theory

The information asymmetry theory was first introduced by Akerlof (1970). The basic tenets of this theory are that in many markets the seller uses some market statistics to measure the value of the goods being sold. In this scenario of the credit market the buyer (borrower) sees the average prices of the loans (credit) in the market they are intending to buy while the seller (bank) has more intimate knowledge of each specific loan product. According to Akerlof (1970) this puts the seller at a more advantage thus able to sell goods of less than average market quality. In such circumstances the limitation of the information available to the buyer may lead to the seller offering less than average quality of goods in the markets which eventually leads to reduction in size of the market. However, this information asymmetry can also be reversed where the borrower may have more knowledge about prospects of repayment than the lender.

2.1.4 Credit Rationing Theory

This theory was introduced by Stiglitz and Weiss (1981) who defined credit rationing as a situation in which there is an excess demand for commercial loans at the prevailing commercial loan rate. The theory indicates that financial institutions use certain performance standards to rule out some borrowers and hence reach equilibrium where demand equals supply. According to Keiding (2013) the financial institutions are mostly private entities which are guided by profit maximization objective. Contrary to this objective not all businesses who apply for financing are granted. Thus, the market for credits is not balanced through the price mechanism. Individuals may be denied credits even if they are willing to pay arbitrarily high interest rates. De Meza and Webb (1987) states that the credit market is not like the normal market where demand is equivalent to supply as the borrowers who are willing to pay higher interest rates may find it difficult when it comes to repayments.

Furthermore, credit rationing is sometimes done deliberately to cushion the financial institutions on foreseeable risks (Keiding, 2013). In instances that the institutions cannot be able to mitigate risks that may arise due to the free market principles being followed, the institutions may decide to ration credit however much the borrowers who demand funds are willing to pay in higher interest rates. In the current study, this theory will be applied to establish which performance factors that may influence credit financing to business in the hotel sector. Further, the theory will assist in establishing how factors such as performance, future projections and innovativeness of the business may influence the decision by the financial institutions to extend credit to that business

3. Research Gaps

First, the review of empirical studies establishes that there are few studies in sub-Saharan Africa and particularly Kenya that have been conducted in the hotel sector. Furthermore, the hotel sector financing has attracted very few studies globally. However, there are studies in Zimbabwe (Mabhungu et al., 2011), Tanzania (Sharma, 2010), Ghana (Ackah & Vuvor, 2011), Vietnam (Ngoc, 2013) and US (Uchida et al., 2008). However, there was a dearth in studies in the local context. The current study therefore sought to investigate those factors that affect credit financing to hotels in the local context.

Secondly, some of the studies reviewed have contrasting findings. For instance, Le (2012) observed that MSEs that had no audited statements had a lower chance of getting credit while Uchida (2008) found that audited financial statements are insignificant in determining the relationship closeness and scope of firm-main bank relationship. Further Uchida (2008) noted that audit have a positive effect on credit financing in US while it did not have any effect in Japan. This contrast in the findings indicates that some factors are linked to the context of the study indicating that factors established in one country cannot be generalized to other countries with differing circumstances. This therefore necessitated a study in Kenya to establish what determines credit financing to hotels. The current study applied regression analysis to establish whether the independent variables have any significant effect on the dependent variable.

4. Data Analysis

In this study, data analysis started by inspecting the collected questionnaires to ensure that they were correctly and comprehensively filled. Only the questionnaires that were correctly and comprehensively filled were included in data analysis. After inspecting the questionnaires, coding of the questionnaires and entering the responses into software which assisted in analysis followed. Statistical Product and Service Solutions (SPSS) was used for this purpose.

Analysis was through both descriptive and inferential statistics. Descriptive statistics that were utilized included percentages mean scores and frequency distributions. These were utilized to enable a description of the various data that was collected. Inferential statistics that were utilized included correlation and regression analysis. These assisted in establishing the relationship of the variables under study and the effect of the four factors onCredit financing of hotels by commercial banks.

The regression model was of the form;
$Y= \beta_o+ \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 +\varepsilon$
Where, Y= Credit financing to hotels
β_0 = Constant
β_i= Regression Coefficients
X_1 = Collateral
X_2 = Loan pricing
X_3 = Risk Profile
X_4 = Performance of the hotel
ε = Error term

The regression coefficients that were computed indicated the significance of effect of the independent variables on the dependent variable. Presentation of results for both the descriptive and inferential statistics was through tables, pie-charts and graphs.

5. Research Findings and Discussion

5.1 Summary of Major Findings

The study had four specific objectives. These were to establish the effect of collateral, loan pricing, risk profile and performance on credit financing to small and medium hotels by commercial banks in Kenya. The summary of the study is provided in this section based on the study objectives.

5.1.1 Effect of collateral on credit financing to the tourism sector

The results indicate that collateral by small and medium hotels significantly and positively affected access to credit financing from commercial banks ($\beta = 0.282$; $t = 2.289$; $p < 0.05$). This indicates that access to assets that can be pledged for loans by small and medium hotels makes the hotels to be eligible for credit. However, hotels that may lack such assets may not be in a position to access credit from commercial banks. The study results further revealed that personal assets of the hotel's representatives are considered when extending credit to the hotel (MS= 4.30; SD = 1.240) and that most banks require personal guarantees of hotel managers or directors before extending credit facilities to the hotels (MS = 4.15; SD = 1.018). Further results indicated that most banks always ask for collateral when lending to small and medium hotels (MS = 3.67; SD = 1.282). However, many small and medium hotels have tangible assets for pledging (MS = 2.00; SD = 1.267).

5.1.2 Effect of loan pricing to the tourism sector

Further, loan pricing negatively affected access to credit by small and medium hotels from commercial banks ($\beta = -0.304$; $t = -3.209$; $p < 0.05$). This indicates that loan pricing by commercial banks had locked most small and medium hotels from accessing loans from commercial banks. This indicates that higher interest rates reduce credit financing to hotel sector while lower interest rates are expected to enhance credit financing to the small and medium hotel sector. The study further revealed that the loans by the bank are highly priced which turns away hotels(MS = 3.67; SD = 1.521). Further, results indicated that there is a very high risk premium when it comes to hotel loans which makes loans to that sector very expensive(MS = 3.60; SD = 1.307).

5.1.3 Extent that risk profile of the hotel influences credit financing

Risk profile of hotels had significant negative effect on credit financing by commercial banks to the sector ($\beta = -0.348$; $t = -3.350$; $p < 0.05$). This result indicates that an improvement in risk profile of the hotels would result in improved credit financing to small and medium hotels. Moreover, as small and medium hotels increase their risk profile, credit financing to the sector dwindles. The study further established that the hotels past loan repayment record largely determines whether it will be provided with credit facilities (MS = 4.43; SD = 1.226). Furthermore, the hotel's frequency or quality of disclosure is an important factor applied in making the decision on credit financing of the hotel (MS = 4.22; SD = 1.195). Other factors which are taken into consideration include evaluation of the hotel by a third party (e.g. credit reference bureau) (MS = 3.98; SD = 1.389), management of the hotel (MS = 3.89; SD = 0.868) and record keeping and reporting (MS = 3.83; SD = 0.865).

5.1.4 Effect of financial performance on credit financing to the tourism sector

Performance of small and medium hotels were significant in determining credit financing to the sector by commercial banks ($\beta = 0.365$; $t = 6.714$; $p < 0.05$). This indicates that having good performance would enable a small and medium hotel to have access to credit from commercial banks. Poor performance on the other hand is suggested to make it harder for small and medium hotels to access credit from commercial banks. Study results revealed that liquidity of the hotel is considered critically before a loan is advanced (MS = 4.70; SD = 0.460). Moreover, commercial banks considers profitability of a hotel to a very great extent before making the decision to extend credit to the hotel (MS = 4.60; SD = 0.493). Similarly, quality of management of the hotel (MS = 4.59; SD = 0.691) and the revenues that the hotel has determines whether the bank will extend credit to it or not (MS = 4.57; SD = 0.640).

5.2 Conclusion

From the study findings, the following conclusions are made. First, availability of collateral is a major factor influencing credit financing to small and medium hotels by commercial banks. Those small and medium hotels who do not have access to assets that can be pledged as collateral may have limited access to credit from commercial banks. This conclusion supports the power theory of credit (Djankov et al., 2005) which postulates that financial institutions are more willing to extend credit where the debt is supported by collateral that can be disposed off when the borrower is unable to settle the debt. Moreover, the study conclusion also support the findings by Haron et al. (2013) and Sharma (2010) which had established that inability to meet collateral requirements makes borrowers unable to get financing form financial institutions. However, the study findings are in contrast to findings by Jang et al. (2008) which were conducted in the US and established that collateral was not a major factor in credit financing form financial institutions.

Secondly, loan pricing negatively affects access to credit by small and medium hotels from commercial banks. Loans to the small and medium hotels is highly priced due to the perceived riskiness of the sector by commercial banks thus putting high risk premiums on loans to small and medium hotels. This conclusion support the loan pricing theory by Olokoyo (2011) which indicates that banks as profit maximizing entities have a tendency to set high interest rates in order to optimize returns from lending and cover themselves from default risk. The outcome of this high loan pricing is that individuals and small businesses are unable to get credit from the banks due to the high interest charges. Moreover, the study conclusion on loan pricing is in agreement with results by Smith (2013) which indicated that high cost of loans to the informal sector influence access of credit by SMEs thus suppressing their sustainability and growth.

The study concludes that risk profile of small and medium hotels have significant negative effects on credit financing by commercial banks to the sector. Commercial banks seek information on the riskiness of the sector through credit referencing, past repayment records and the competence of management of these small and medium hotels. This conclusion agrees with the information asymmetry theory (Akerlof, 1970) as it indicates that lack of good record keeping and reporting was one factor established to limit access of credit by due to lack of information by the lender on the credit worthiness of the borrower. The conclusion also agree with findings by Sharma (2010) who observed that commercial banks have a general unwillingness to give loans to hotel and restaurant projects due to their perceived high riskiness. Other findings that support the conclusion of the study include Le (2012) and Ackah and Vuvor (2011) which established that SMEs are perceived as high risk due to their poor management, poor financial reporting and their informal record keeping nature.

Lastly, the study concludes that performance of small and medium hotels is significant in determining credit financing to the sector by commercial banks. Those hotels that have good liquidity, competent management, are profitable and have regular revenue streams have better access to credit in contrast to those hotels that may be struggling to perform. This conclusion supports the credit rationing theory by Stiglitz and Weiss (1981) which indicates that financial institutions use certain performance standards that are used to limit demand of credit from individuals and businesses. These standards (including performance of the business) are used to rule out some borrowers and hence reach equilibrium where demand equals supply. The study conclusions are also supported by findings by Keiding (2013) that financial performance is a critical factor that a business needs to meet to qualify for credit. Other studies that support the current study conclusions include Mabhungu et al. (2011) and Atieno (2010) which established that profitability of a business is a critical consideration by financial institutions when extending credit to businesses.

5.3 Recommendations

From the study findings, the following recommendations are made. First, in seeking loans from commercial banks, management needs to use not only the assets of the facility but also their personal assets so as to provide guarantees for loans. Moreover, small and medium hotels need to create partnerships with banks which may make them have easy access to credit financing when they need it.

Secondly, monetary policy making organs in Kenya need to ensure that they design effective policy measures that are aimed at reducing interest rates to the small and medium business enterprises in Kenya. This will spur their growth by making them to have access to funds for their operations, sustainability and growth.

Third, small and medium hotels should ensure that their loan repayment history, credit rating and reputation are above average. They should ensure that their credit score is not tainted by bad credit such that when they seek financing, they are denied or provide financing at high costs. Lastly, small and medium hotels should ensure that they observe prudent financial reporting and disclosure such that information asymmetry between them and commercial banks which raise costs of credit are reduced. Moreover, small and medium hotels should engage competent management who not only create good relationships with commercial banks but also steer the hotels to profitability.

5.4 Areas for Further Research

The study focused on factors that influence credit financing to the tourism sector in Kenya by commercial banks. The study focused on collateral, loan pricing, risk profiles of the hotels and performance of the hotels. The study established that all these factors are significant in determining credit financing to small and medium hotels. The study recommends that a similar study be conducted to establish the factors determining credit financing to other tourism sectors of the economy such as travel agencies, tour agents and transport companies. Such studies would provide a deeper insight into what may influence funding to these sectors and inform policy and practice.

Moreover, a study on other factors that may influence credit financing that may emanate from commercial banks themselves is suggested. Such factors could include bank policies and availability of loanable funds to the banks. This is because the current study was more concerned on the factors that may affect funding to small and medium hotels which emanate mostly from the small and medium hotels themselves.

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