ASSESSING INSTITUTIONAL FACTORS CONTRIBUTING TO LOAN DEFAULTING IN MICROFINANCE INSTITUTIONS IN KENYA

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DECLARATION AND APPROVAL

DECLARATION

This Research Project is my own original work and has not been presented for a Masters Degree Qualification in any other University or Institution of learning.

SIGNED ………………………………………… DATE **…………………….**

GATIMU, ERIC MAINA

CM16/0005/11

APPROVAL

This Research Project Proposal has been submitted for Examination with my approval as the University Supervisor.

SIGNED: ………………………………………… DATE: …………………….

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DEDICATION

This paper is dedicated to my wife Mrs Irene Njeri Maina who has been instrumental and inspiration to my study and to the almighty God who has seen me through the whole process.

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ABSTRACT

The success of individual MFIs in credit risk management is largely reflected in the proportion of delinquency's loans to gross lending. Factors such as credit policies, loan recovery procedures, and loan appraisal process are viewed as critical drivers of institutional factors leading to loan default; each of these factors significantly affects loan default performance in MFIs in Kenya. The study used primary data. The study target population compromise 48 MFIs registered by Association of Microfinance Institutions of Kenya (AMFIK). A descriptive survey design was used to carry out a census of 48 microfinance institution in Kenya, this is because of the small size population .The data was collected through a structured questionnaire and administered to MFIs loan officers for response. Multiple regression analysis was used to establish relationship between loan delinquency and credit policies, loan recovery procedures, and initial loan appraisal in MFIs in Kenya. A total of 48 questionnaires were administered of which 45 were adequately respondent to and considered for analysis, this formed 94% response rate. The findings indicated that all the three factors tested had a significant impact on the loan default rate, thus the micro-finance institutions have a cause to worry if they have to reduce the loan default rates by considering the three factors under the study It is recommended that the management of micro-finance institutions should take keen interest in the three institutional factors if they have to reduce their loan default portfolio in microfinance institutions. It is suggested that a similar study be undertaken targeting the banking sector to establish the factors that contribute to loan default in the banking sector in Kenya.

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LIST OFABBREVIATIONS

CPAK	Certified Public Accountants Kenya
KWFT	Kenya Women Finance Trust
MFIs	Microfinance Institutions
CBK	Central Bank of KENYA
MSE	Micro and Small Enterprise
IMF	International Monetary Fund
UN	United Nations
NCCK	National Council of Churches of Kenya
NGO	Non-Governmental Organization
SASRA	Societies Regulatory Authority
AMFI	Association of Microfinance Institutions
KUSCCO	Kenya Union of Savings and Credit
Corperatives	
ANOVA	Analysis of Variance

CHAPTER ONE

INTRODUCTION

1.1 Background to the Study

The major goal of microfinance is the provision of micro loans to the low-income and the poor households. The chance that a microfinance institution (MFI) may not receive its money back from borrowers (plus interest) is the most common and often the most serious vulnerability in a microfinance institution. Since most microloans are unsecured, delinquency can quickly spread from a handful of loans to a significant portion of the portfolio. This contagious effect is exacerbated by the fact that microfinance portfolios often have a high concentration in certain business sectors. International organizations are coming to the realization that MFIs are veritable and effective channels to ensure programme implementation effectiveness, particularly in poverty alleviation projects and firsthand knowledge of the needs and interest of the poor CGAP, (1999).

Lending to the poor or lower income group raises many debates among practitioners and academicians. The poor are usually excluded from credit facilities because of many reasons. These include insufficient collateral to support their loans, high transaction costs, unstable income, lower literacy and high monitoring costs. Usually they survive through involvement in micro business activities or informal activities that comprises food processing and sales, small scale agriculture, services, crafts and petty trading. However, these activities actually contribute a number of total employment and gross domestic product (GDP) to the country. Micro and small enterprises (MEs) have been recognized as a major source of employment and income in many countries of the Third World Modurch, (1999).

In 1990s micro loans given to customers did not perform which called for an intervention. Most suggestions were for the evaluation of customer's ability to repay the loan, but this didn't work as loan defaults continued The concept of credit management became widely appreciated by Microfinance Institutions (MFI's) in the late 90s, but again this did not stop loan defaults to this date Modurch, (1999).A key requirement for effective credit management is the ability to intelligently and efficiently manage customer credit lines. In order to minimize exposure to bad debt, over-reserving and bankruptcies, companies must have greater insight into customer financial strength, credit score history and changing payment patterns. The ability to penetrate new markets and customers hinges on the ability to quickly and easily make well-informed credit decisions and set appropriate lines of credit. Credit management starts with the sale and does not stop until the full and final payment has been received. It is as important as part of the deal as closing the sale. In fact, a sale is technically not a sale until the money has been collected. It may be difficult to establish an optimal credit policy as the best combination of the variables of credit policy is quite difficult to obtain. A firm will change one or two variables at a time and observe the effect. It should be noted that the firm's credit policy is greatly influenced by economic conditions (Pandey, 2008). As economic conditions change, the credit policy of the firm may also change.

Microfinance Institutions and other finance institutions must develop a credit policy to govern their credit management operations Pandey, (2008) and since microfinance institutions generate their revenue from credit extended to low income individuals in the form of interest charged on the funds granted (Central Bank Annual Report, 2010) the loan repayments may be uncertain. The success of lending out credit depends on the methodology applied to evaluate and to award the credit Ditcher, (2003) and therefore the credit decision should be based on a thorough evaluation of the risk conditions of the lending and the characteristics of the borrower. Numerous approaches have been developed in client appraisal process by financial institutions. They range from relatively simple methods, such as the use of subjective or informal approaches, to fairly complex ones, such as the use of computerized simulation models Horne, (2007). Many lending decisions by Microfinance institutions are frequently based on their subjective feelings about the risk in relation to expected repayment by the borrower. Microfinance institutions commonly use this approach because it is both simple and inexpensive. While each company would have its own method of determining risk and quality of its clients, depending on the target group, the following client evaluation concepts are useful for most occasions. These concepts are referred to as the 5C's of credit appraisal Joana, (2000). These elements are Character, Capacity, Collateral, Capital and Condition .

According to Schreiner, (2003), the World Bank Sustainable Banking with the Poor project (SBP) in mid-1996 estimated that there were more than 1,000 microfinance institutions in over 100 countries, each having a minimum of 1,000 members and with 3 years of experience. In a survey of 2006 of such institutions, 73 per cent were NGOs, 13.6 per cent credit unions, 7.8 per cent banks and the rest savings unions. An overwhelming majority of the world's poor live in the third world countries. Various approaches have been employed in alleviating poverty of which provision of credit that targets the poor is one. Many are now of the opinion that allowing the poor to have command over resources through credit can contribute towards poverty alleviation. Bystrom, (2007) argues that the best way to do something about poverty is to let the people do their own thing. Nobody will have more motivation to change his situation than the sufferer himself/herself.

Micro-financial institution that offers savings and credit services is facing realities of market competition due to the liberalization of the economy, excess liquidity in big commercial banks, inadequate financial resources resulting to low liquidity in lending institutions among other factors Dinos *et al*, (2010). The microfinance institutions have now become a household-name as millions of Kenyans rely on them, almost entirely for their basic needs of food, shelter and clothing and even school fees and medical expenses. They exist as viable and credible alternatives to formal banking institutions which to a large extent are beyond the reach of ordinary Kenyans. They provide the financial support and advantage which lies in the strong structure and shared values of trust mutual and development. They have mobilized funds over kshs.150 billion making them one of the major contributors to national economy. The Micro financial Act 2008 required that loans policy and procedures manual specifying the criteria and procedures applicable in the evaluation, processing, approval, documentation and release of loan or credit facilities are put in writing by every licensed society. Loans must be disbursed according to the established credit policy and procedures as given by Schreiner, (2003).

A written loan policy statement is beneficial as it communicated to employees in the loan department what procedures they must follow and what their responsibilities were. Therefore it helped the organization to move towards a loan portfolio, controlling its risk exposure and satisfying regulatory requirements Joana, (2000). Any exceptions to the policy should be fully documented and reasons for it listed. While any written policy must be flexible due to continuing changes in economic conditions and regulations, violation of loan policy should be infrequent events. Loans department should consider all such changes and periodically review all loans until they reach maturity. Loan review is crucial as it helped management to identify problematic loans more quickly and acted as a continuing check on whether loans policy was adhered to by loan officers. The commercial banks reviewed loans more efficiently such that they were able to top up loans-faster using modern technology unlike institutions Craig, (2006). According to Beatriz (2007), it was revealed that the study underscored the need to formulate a prudent credit policy for individual manufacturing firms as well as the need for a conducive macro and micro environment in order to synchronize benefits of using credit facilities to facilitate financial mobilization of firms which can be likened to institutions also. Therefore formulation of a prudent credit policy for institution is important to avoid loss of its market to its rivals and improve performance in terms of development.

According to Fofack ,(2005), the types of loan offered by institutions are mainly short-term and long-term loans. The short-term loans are those repayable within a year and are usually meant for school fees and other emergency expenses. The amounts are generally small is guaranteed by government and did not help farmers to increase their overall earning capacity. Long-term or development loans arc for larger amounts and had a longer term effects. They helped farmers to increase their earning capacity through success of projects financed by these loans. Repayment period was usually for more than one year, No collaterals are given by members in form of property pledged except the secured guarantors and thus management should consider securing them in that manner. There was evidence that repayment of institutions loans was not being taken seriously by members due to low interest rate charged, lack of suitable guarantors and poor management systems for loan collection. As a result most of them were caught up in serious cash flow problem. The situation was complicated further by overdrafts whereby institutions negotiated with commercial banks at higher interest rates are loaned to members at lower interest rates Pamoja, (2010).

The borrower’s credit worthiness is the ability of a customer to pay out the credit as and when due with a comfortable margin of error. This usually involves a detailed study of five aspects of loan application: character, capacity, cash, collaterals and conditions. Character refers to customer’s responsibility, truthfulness, serious purpose and intention to repay loan. If the customer is insincerely promising to use borrowed funds as planned and in repaying as agreed, the loan should not be made to avoid a credit problem. The loan officer must be convinced that a customer has a well defined purpose for requesting a credit and has a serious intention to repay. Capacity to borrow money refers to the authority to request a loan and the legal standing to sign a binding loan agreement by a customer. Thus the borrower must not be a minor and supportive documents must be provided for example a copy of resolution of borrowing company or pay-slip of an employee. According to Srinivasan, R. (2007) capacity refers to the income available to make repayment. Having a substantial income, holding the same job for several years and having few other debt payments suggest a strong financial capacity to repay.

Credit risk management should include strict delinquency monitoring, loan-loss provision and collection procedures. Credit risk is measured most accurately when loans are approved and processed on the basis of "five Cs"-character. Loans must be disbursed according to established credit policies and procedures. Loan analysis should therefore be guided by the formula: purpose, repayment schedule, amount applied for, collaterals, and terms of loan agreement, interest rate chargeable, applicant's character and experience that a member or loanee has to fulfill the purpose of loan. Craig, (2006) describes non-performing loan as that loan that is in default or close to default. Many loans become non-performing after being in default for three months, but depend on the contract terms. A loan is non-performing when payments of interest are past due by 90 days or more or at least 90 days of interest payments have been refinanced or delayed by agreement or payments are less than 90 days overdue but there are other good reasons to doubt that payments was not be made in full.

Credit is major form of external finance used by households, firms and governments in economy (Peeters, 2003). Credit finance encompasses any financing which requires unconditional payment or settlement in the future. In Kenya, credit continues to play an important role in the country's economy. The Central Bank of Kenya has estimated that the total domestic credit as at 30th June 2009 was reckoned Kshs. 408billion (CBK, 2007). When borrower approaches a financial institution for a loan facility the intention is to use it to finance a planned project and eventually repay the loan. Customers borrow funds for various reasons. The most common objectives for borrowing are for acquisition of assets like house, land or cars. As for business people, the need for funds would be to increase stock -in- trade, capital level or meet some current expenditure .In addition to the above primary needs the borrowers do sometimes approach financial institutions for bridging finance to take care of short-term needs.

1.2 Statement of the Problem

Competition among MFIs has not only brought benefits such as better access and lower interest-rates, but has also introduced problems Saloner,(2007). These adverse effects fall back not only on the MFIs, which are struggling to maintain their performance level, but also on the clients. Borrowers are facing serious problems from paying back their loans. According to Peeters, (2003), 25% of borrowers in microfinance institutions take loans from six or more different financial institutions which eventually lead to repayment crisis in the microfinance industry. Repayment crisis subsequently lead to liquidity problems which negatively influence the operational performance of microfinance institutions. Despite its importance due to the increasing competition in the microfinance industry in Kenya, there is no record available to this study on the factors contributing to loan defaulting in MFI's in Kenya.

1.3 Research Objectives

The main objective of the study is to assessing the institutional factors contributing to loan defaulting in micro-finances in Kenya.

1.3.1 Specific objectives.

(i) To assess whether credit policies contribute to loan defaulting in microfinance institutions in Kenya.

(ii) To establish whether initial loan appraisal process contribute to loan defaulting in microfinance institutions in Kenya.

(iii) . To determine whether loan recovery procedures contribute to loan defaulting in microfinance institutions in Kenya.

(iv) To determine the overall institutional factors that contribute to loan defaulting in microfinance institutions in Kenya

1.4 Research hypotheses

$Ho_{1:}$ There is no statistically significant relationship between loan defaulting due to credit policies

Ho_2: There is no statistically significant relationship between loan defaulting due to initial loan appraisal process

Ho_3: There is no statistically significant relationship between loan defaulting due to loan recovery procedures

Ho_4: There are no statistically significant relationships between factors that influence loan defaulting in microfinance institutions in Kenya

1.5 Significance of the Study

The study results provided a useful reference document to loan policy developer. It will be used by micro-finances in developing appraisals systems and loan collecting procedures. This document will also be used by other financial institutions to ensure they maintain a performing portfolio. The managers and credit officers will find the document relevant in delinquency management. The study findings will help the prospective loan seekers to make an optimal decision whereby they are able to choose a source of finance with minimum cost and optimum benefits both in the short run and long run period. Thus their choice of either institution loan or commercial bank loan will be a knowledgeable decision unlike the scenario whereby many people are ignorant about the cost element of loan capital specifically. The study will provide background information to other researchers or scholars who would like to investigate more on factors contributing to loans defaulting. The finding will further provide secondary material for student in micro-finance and will encourage and motivate on diverse issues on loan defaulting and micro-finance.

1.6 Scope of the Study

The study comprised of all microfinance's registered by Association of microfinance institute Kenya as at 31st December 2012. There were 48 microfinance institutions in Kenya as at that date.

1.7 Limitation of the Study

The researcher was affected by the following limitations:-

The unwillingness of the respondents to supply the right response was a limiting factor. The respondents felt there was no benefit in giving the right answers to the questions and for fear that other institutions use the same to achieve their goals. This implies that the respondents failed to give detailed responses to questions raised and this has a negative scholarly impact on the subject matter content of the study. The researcher obtained consent from different microfinance to be visited. This was be done by an official letter from the university and an introductory letter from the researcher.

1.8 Definitions of key Terms

Past due – This is loan installment that has not been paid at the period stipulated in the loan contract.

Arrears – Refers to a late payment, partial payment or a skipped payment.

Default – Default refers to a situation where a loanee fails to repay a loan. It occurs when a borrower cannot or will not repay the loan and the MFI no longer expects to receive payment.

Delinquency – In micro-finance this term refers to a situation where a loan is past “due”. It is an occurrence in a loan portfolio where payments are in arrears. A loan account is termed as delinquent when payment is due and a loanee has failed to honor a payment obligation at the stipulated time.

Micro-finance – The provision of financial services to low – income clients including the self – employed.

Loss – A situation whereby the borrower is unable to pay loan because he is financially incapable and security value of property visa-visa the outstanding loan is low.

Non – Performing loan – A loan that is not paid or serviced as per agreement

Policy – Broad guidelines spelling out the expectation of the organization on long term basis.

Credit terms – These are the conditions that have to be met before the loan is approved.

Security – Saving clients want to be sure that their savings are safe and that the institution that collects them is stable.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter reviews the relevant literature in area under study. It includes, theoretical framework, related to factors contributing to loan defaulting and the conceptual framework the chapter also covers the empirical studies related to this study.

2.1.1 Historical Background of Microfinance Institutions

Microcredit and microfinance are relatively new terms in the field of development, first coming to prominence in the 1970s, according to Robinson (2001). Prior to then, from the 1950s through to the 1970s, the provision of financial services by donors or governments was mainly in the form of subsidised rural credit programmes. These often resulted in high loan default, high loses and an inability to reach poor rural households

Robinson states that the 1980s represented a turning point in the history of microfinance in that MFIs such as Grameen Bank began to show that they could provide small loans and savings services profitably on a large scale. They received no continuing subsidies, were commercially funded and fully sustainable, and could attain wide outreach to clients (Robinson, 2001). It was also at this time that the term “microcredit” came to prominence in development. The difference between microcredit and the subsidized rural credit programmes of the 1950s and 1960s was that microcredit insisted on repayment, on charging interest rates that covered the cost of credit delivery and by focusing on clients who were dependent on the informal sector for credit Craig, (2006). It was now clear for the first time that microcredit could provide large-scale outreach profitably.

The 1990s “saw accelerated growth in the number of microfinance institutions created and an increased emphasis on reaching scale” Robinson, (2001). Microfinance had now turned into an industry according to Robinson (2001). Along with the growth in microcredit institutions, attention changed from just the provision of credit to the poor microcredit, to the provision of other financial services such as savings and pensions microfinance when it became clear that the poor had a demand for these other services Joanna, (2006). The importance of microfinance in the field of development was reinforced with the launch of the Microcredit Summit in 1997. The Summit aims to reach 175 million of the world's poorest families, especially the women of those families, with credit for the self-employed and other financial and business services, by the end of 2015 Beatriz, (2007). More recently, the UN, as previously stated, declared 2005 as the International Year of Microcredit.

Sustainability is a cornerstone of sound microfinance. This term refers to the ability of a microfinance institution (MFI) to cover all of its costs through interest and other income paid by its clients. Financially sustainable MFIs can become a permanent part of the financial system: they can continue to operate even after grants or soft loans are no longer available. Donors have nowhere near enough funds to meet the global demand for microfinance. But when an MFI becomes sustainable, it is no longer limited to donor funding. It can draw on commercial funding sources to finance massive expansion of its outreach to poor people. Experience proves that microfinance can be done sustainably, even with very poor clients. From bankers‟ perspective, a microfinance institution is said to have reached sustainability when the operating income from the loan is sufficient to cover all the operating costs Sharma and Nepal, (1997). This definition adopts the bankers‟ perspective and sticks to "accounting approach" of sustainability as the "accounting approach" to sustainability that takes into account the financial aspect of the institution is too narrow. The concept of sustainability includes, amongst other criteria obtaining funds at market rate and mobilization of local resources. Therefore, the performance assessment criteria for the financial viability of any microfinance related financial institution are: repayment rate, operating cost ratio, market interest rates, portfolio quality, and "demand driven‟ rural systems in which farmers themselves demand the loans for their project. From banker‟s perspective, sustainability of microfinance institution includes both financial viability and institutional sustainability (self sufficiency) of the lending institution Sharma and Nepal, (1997) .The terms of reference in bankers definitions are therefore, more financial, administrative and institution focused.

2.1.2 Micro Finance Institutions

Micro-finance is the provision of the financial services to low income clients including the self employed (CGAP, 1999). The reserve bank of India has defined microfinance as provision of thrift, credit and other financial services and products of very small amount to the poor in rural, semi-urban and urban areas for enabling them to raise their income levels and improve the living standards. Financial services include savings and credit. Therefore the definition of Micro-finance was to include both financial and social intermediation. According to CGAP, (2010) micro-finance is a means of providing variety of financial services to the poor based on market driven and commercial approaches.

The history of micro-finance back dates to about three decades when Mohammed Yunus founded Micro-finance in 1976. The micro-finance started offering in Bangladesh to poor women. He established the Grameen Bank. Grameen is a Bengah name which means village. Karimi, *et al*. (2003). Its evolution however dates back 30 years from the late 1960s with the efforts made toward reduction of poverty through the promotion o income earning activities among the poor. It is an up growth small enterprise development initiative. In providing services to its clients the micro-finances apply three approaches. The methodologies are individual lending, solidarity group lending and group of groups. The micro-finance in Kenya has greatly contributed to the uplifting of the status of the low income earners to a point that the banks are competing for the customers that they ignored. Kenya micro-finance is one of the oldest and most established in Africa. Its roots can be traced back to mid 1950s when the jot loan board scheme was established to provide credit to indigenous Kenyan with small trading businesses.

The main organization providing credit was Christian organizations for example the NCCK (National Council of Churches of Kenya) and small church based NGOs (Non-Governmental Organizations). Not until 1980 when two major micro-finances emerged, K-Rep which started as a subsidiary of United States based NGO and the Kenya Women Finance Trust. K-rep Bank was founded in 1984 with goals to generate employment and increase incomes by expanding financial services to poor people. Its core business is to serve low income people especially those operating very small and micro enterprises as a means of facilitating their participation in the economic development of this country. The organization provides and introduced alternative credit delivery mechanism for the poor that consisted of small amounts without the requirement of tangible collaterals. The development of micro-finance industry in Kenya went up a notch or more when K-rep obtained banking license in 1999 and became the first micro-finance to be converted into a bank (Samanath, 2009).

2.2 Development of Micro Finance in Kenya

The Kenyan Microfinance industry is one of the oldest and most established in Africa Field & Pande, (2008). Interest in informal sector in Kenya date back as early as 1970s after the seminal International Labor Organization (ILO) report on employment was issued to Kenya in 1972. The report identified the informal sector as a potentially important contributor to employment and economic growth in Kenya and other developing countries. In the 1970's the main organization providing credit to the informal sector were church based organizations such as National Council of churches of Kenya (NCCK) and other smaller church based NGOs. These programmes were heavily subsidized and were ad hoc additions to other social outreach programmes offered to the poor. Outreach was extremely limited. In the 1980's other specialized organizations which included KREP, a subsidiary of a U. S. based NGO and Kenya Women Trust (KWFT) began operations. These programmes were heavily subsided and credit and training approach to assist microenterprises. In the 1990's, interest and knowledge about the microfinance industry had grown substantially and the approach to the industry became more focused and sustainability oriented Peeters, (2003).

Kenyan microfinance has shown resiliency despite local droughts and high inflation rates that afflicted the nation in 2008 and 2009. With the Kenyan government and the Central Bank of Kenya emphasizing financial access as a key to modernizing the economy, the sector has been strengthened by progressive policies and innovative approaches to delivering financial services. A large deposit base, along with the existence of well-developed MFIs, have allowed financial and operational expenses to remain relatively low and have led to some of the highest profitability measures in the region Peeters, (2003).

In the 2000's, the microfinance sector witnessed emergence of large number of MFIs with some transforming to commercial banks and deposit taking institutions (DTM). The focus of these institutions gradually shifted from emphases on the very poor to the enterprise poor as demands on these institutions to be become financially sustainable increased. The Microfinance Act 2006 became operational in May 2008. The Act empowered the Central Bank of Kenya (CBK) to license and supervises deposit taking microfinance institutions. By December 2010, the CBK had licensed Faulu Kenya, Kenya Women Finance Trust (KWFT), SMEP, UWEZO and REMU as Deposit Taking Microfinance (DTMs) CBK, (2007) to conduct nationwide deposit taking microfinance business. As of May 2013, non-deposit-taking microfinance institutions did not fall under the jurisdiction of the Central Bank's microfinance regulations, and as such they fall under either the SACCO category supervised by the SACCO Societies Regulatory Authority (SASRA), or the informal microfinance category, which is unregulated except for the licensing required of all NGOs in Kenya CBK, (2007). The Central Bank is currently consulting with a variety of industry stakeholders to determine the best practices for incorporating non-deposit-taking MFIs into their regulatory framework. Four of Kenya's major commercial banks have roots in microfinance: two as building societies (Family Bank and Equity Bank) one as an NGO (KREP) and another as a cooperative society (Cooperative Bank). These commercial banks, along with a wide variety of registered microfinance institutions, savings and credit cooperatives, and NGOs, make up Kenya's microfinance industry. Srinivasan, (2007).

While Micro-finance approaches generally include some specific product design issues, a primary means of differentiating one approach from another is the choice of products and services provided and the manner in which the provision is made. Any approach must be based on the target markets and its demand for financial intermediation, as well as other products, contextual factors in the country, the objectives and institutional structure of the MFI. There are four well documented methods used in accessing credit to micro-entrepreneurs, namely individual lending, Grameen model solidarity and group lending village banking Srinivasan, (2007).

Individual lending is defined as the provision of credit to individuals who are not members of a group that is jointly responsible for loan repayment. It requires frequent and close contacts with the individual client. It is most successful for larger, urban based, production oriented businesses and for those who have some form of collateral or are willing consigner or with small scale farmers in rural areas, normally clients are those who require working capital and/or fixed assets (Frankel *et al*, 2000) Loan amounts and terms are bases on careful analysis by the credit offer. Detailed financial analysis and projections are often included with the loan application. The amount and terms are negotiated with the clients. Visit is often made to the clients place of business as specified in the loan contract. Savings may not only be provided depending on the institutional structure of the MFI. Training and technical assistance may be provided by the credit officers sometimes training in provided on a per-fee-basis or is mandatory Frankel *et al*, (2000).

2.3 Theoretical Frame Work

The theories to discussed here below are, liquidity preference theory, Austrian theory of business cycle, the Grameen Solidarity Group theory and microcredit theory.

2.3.1 Liquidity Preference theory

The theory explains the traditional upward sloping yield curve as puts forward by Keynes John (Carter *et al*, 2004).The logic is that investors prefer short term securities which give them greater liquidity because due both interest risk and default risk the longer a security must be held till maturity. Holders of long-term securities bear the risk that interest rates rising during the period making their fixed rate investments less valuable. Similarly unfavorable changes in the financial conditions of the company are also a function of time and today are more certain than tomorrow, next month is more certain than next year and thus the possibility of default increases over a longer period. Investors are therefore willing to accept the lowest rate of return only on the shortest term and most liquid securities.

They will require higher interest rate to compensate for the higher risks that go with longer terms. This theory underlies the significance role played by time value of money. It demonstrates that a shilling today is worth more than a future shilling because a shilling at hand is a sure shilling-it is has no uncertainties surrounding it. Such shilling can also be invested to fetch more returns on investments .This theory however fails clearly to demonstrate the wisdom behind investing a sure shilling at hand today in future investments whose certainty the same theory fails to clearly bring out. Hence, it's imperative that a study be undertaken to determine the factors influencing the non-performance of loans portfolio as part of future investments with uncertainty (Carter *et al*, 2004).

2.3.2 Austrian Theory of the Business Cycle

The Austrian theory of the business cycle emerges straight forwardly from a simple comparison of a savings induced boom Boldizzoni, (2008) .An increase in savings by households and credit expansion orchestrated by the central bank sets into motion market processes whose initial allocation effects on the economy's capital structure are similar but whose ultimate consequences are sharply different. The general argument of the theory though not the full argument can be stated in terms of the conventional macro-economic aggregates of savings and investments. The levels of investment are determined by the supply of and demand for loanable funds. Supply reflects the willingness of households to save at various rates of interest; demand reflects the willingness of business to borrow in order to finance investment projects.

Each represents a state of equilibrium in the loan market. An increase in the supply of loanable funds has obvious initial effects on the rate of interest and on the level of investment borrowing. But the ultimate consequences differ importantly depending upon whether the increase supply of loanable funds derives from increased saving by households or from increase credit creation by the central bank. Even in this simple loanable funds framework many aspects of the Austrian theory of the business cycle are evident. The natural rate of interest is the rate that equates saving and investment. The bank rate diverges from the natural rate as a result of credit expansion. When new money is injected into credit markets, the injection effects which the Austrian theorist emphasizes over price level effects take the form of too much investment. Boldizzoni, (2008).
Other significant aspects of the Austrian theory of the business cycle can be identified only after the simple concept of investment is replaced by the Austrian vision of a multi-stage time-consuming production process. The rate of interest governs not only the level of investment but also the allocation of resources within the investment sector. The economy's inter temporal structure of production consist of investment sub-aggregates which are defined in terms of their temporal relationship to the consumer goods they help to produce. Some stages of production such as research and development and resources extraction are temporally distant from the output of consumer goods. As implied by standard calculations of discounted factor values interest rate sensitivity increases with the temporal distance of the investment sub aggregate or stage of production from final consumption Boldizzoni,(2008).

An increase in the rate of saving implies a change in the preferred consumption pattern such that planned consumption is shifted from the near future to the remote future. A savings induced decrease in the rate of interest favors investment over current consumption. Significance in Austrian theorizing it favors investment in more durable over less durable capital and in capital suited for temporally more remote rather than less remote stages of production. These are the kinds of changes within the capital structure that are necessary to shift output from the near future to the more remote future in conformity with changing inter temporal consumption preferences. Boldizzoni, (2008).

This theory puts more emphasis on long-term investments running into the remote future with emphasis that such remoteness is likely to fetch higher interest rate for the firm. While this sounds prudent in theory, in practice such financial management principle may end up starving the organization of the short-term interest to run its day to day operations in anticipation of future booming interests. In any event even the time value of money is also not catered for in this theory. By extension the theory also does not provide a caveat on exactly what happens in the event that the interests payable and even the capital accrued from long -term loans is not forthcoming. This is a research gap that must be filled so as to determine the factors influencing non-performance of loans especially in public financial corporations. Robinson (2001).

2.3.3 The Grameen Solidarity Group Theory

This model is based on group peer pressure whereby loans are made to individuals in groups of four to seven Tedeschi, G. A. (2008). Group members collectively guarantee loan repayment, and access to subsequent loans is dependent on successful repayment by all group members. Payments are usually made weekly According to Tedeschi, G. A. (2008). solidarity groups have proved effective in deterring defaults as evidenced by loan repayment rates attained by organizations such as the Grameen Bank, who use this type of microfinance model. They also highlight the fact that this model has contributed to broader social benefits because of the mutual trust arrangement at the heart of the group guarantee system. The group itself often becomes the building block to a broader social network.

The concept is the brainchild of Dr Muhammad Yunus of Chittagong University who felt concern at the pittance earned by landless women after a long arduous day's work laboring for other people. He reasoned that if these women could work for themselves instead of working for others they could retain much of the surplus generated by their labor, currently enjoyed by others. Established in 1976, the Grameen Bank (GB) has over 1000 branches (a branch covers 25-30 villages, around 240 groups and 1200 borrowers) in every province of Bangladesh, borrowing groups in 28,000 villages with over 90% being women. It has an annual growth rate of 20% in terms of its borrowers. The most important feature is the recovery rate of loans, which is as high as 98%. A still more interesting feature is the ingenious manner of advancing credit without any "collateral security".

The Grameen Bank lending system is simple but effective. To obtain loans, potential borrowers must form a group of five, gather once a week for loan repayment meetings, and to start with, learn the bond rules and "16 Decisions" which they chant at the start of their weekly session Schoombee, A. (2000).. These decisions incorporate a code of conduct that members are encouraged to follow in their daily life e.g. production of fruits and vegetables in kitchen gardens, investment for improvement of housing and education for children, use of latrines and safe drinking water for better health, rejection of dowry in marriages etc. Physical training and parades are held at weekly meetings for both men and women and the "16 Decisions" are chanted as slogans. Though according to the Grameen Bank management, observance of these decisions is not mandatory, in actual practice it has become a requirement for receiving a loan Schoombee, A. (2000). Numbers of groups in the same village are federated into a Centre. The organization of members in groups and centers serves a number of purposes. It gives individuals a measure of personal security and confidence to take risks and launch new initiatives.

The formation of the groups - the key unit in the credit programmes - is the first necessary step to receive credit. Loans are initially made to two individuals in the group, who are then under pressure from the rest of the members to repay in good time. If the borrowers default, the other members of the group may forfeit their chance of a loan. The loan repayment is in weekly installments spread over a year and simple interest of 20% is charged once at the yearend Reinke,. (1998).

The groups perform as an institution to ensure mutual accountability. The individual borrowing member is kept in line by considerable pressure from other group members. Credibility of the entire group and future benefits in terms of new loans are in jeopardy if any one of the group members defaults on repayment Roodman, D. (2006).. There have been occasions when the group has decided to fine or expel a member who has failed to attend weekly meetings or willfully defaulted on repayment of a loan. The members are free to leave the group before the loan is fully repaid; however, the responsibility to pay the balance falls on the remaining group members. In the event of default by the entire group, the responsibility for repayment falls on the centre. The

Grameen Bank has provided an inbuilt incentive for prompt and timely repayment by the borrower i.e. gradual increase in the borrowing eligibility of subsequent loans.

According to the study by Petersen *et, al* (1994.) the lending procedure used by micro financial institutions have been bound by banks as an entry point through developing a very simple and unsecured procedures that include the submission of loanees identification card, letter of introduction from employer. Kenya Revenue Authority P.I.N. number, a loan form duly filled and current pay slips for at last three months. Terms and conditions of micro financial institutions are many and rigid unlike banks because a member is required to provide guarantors, boost his share savings and cannot be advanced a loan which will attract a deduction of more than two thirds of his or her basic pay despite the amount of shares held, which allows him to get a loan of about three times his/her shares. This eventually leaves the amount of loan disposable to the poor less than that advanced by banks thus becomes preferred by many rural members (Petersen *et, al* 1994.)

2.3.4 Micro credit theory

The psychological component of the micro credit theory - known as social consciousness-Driven capitalism - has been advanced by the most ardent promoter of micro finance, Muhammad Yunus (1998). His theory argues that a species of profit-making private venture that cares about the welfare of its customers can be conceived. In other words, it is possible to develop capitalist enterprises that maximize private profits subject to the fair interests of their customers The rationale of the theory is straightforward. Although altruism is not totally absent, Capitalism is founded mainly on the premise that human beings are selfish by nature. Accordingly, individuals interested in businesses are naturally motivated by the principle of profit-maximization, with little consideration for the interests of their clients. This premise is too limited to be a general model for capitalism, however, because it excludes individuals who are concerned about the welfare of their fellow human beings. A more generalized principle would assume that an entrepreneur maximizes a bundle consisting of financial return or profit and social return. This assumption creates three groups of entrepreneurs (Frankel *et al*, 2000).. The first group consists of traditional capitalists who mainly maximize financial returns or profits. The second group consists of philanthropic organizations (like traditional micro credit NGOs) and public credit agencies that mainly maximize social returns. The third group consists of entrepreneurs who combine both rates in making their investment decisions under the additional constraint that financial return cannot be negative. This group includes the microfinance enterprisers who are to be treated as socially concerned people, and microfinance, which is to be treated as a social consciousness-driven capitalistic enterprise. Microfinance theoreticians have advanced two theories regarding their aims-an economic and a psychological. Tambunan, (2007).

2.4 Factors Leading to Loan Defaulting in Microfinance

Every loan issued comes with definite terms and conditions and for as long as it is outstanding. Scheduled and periodical payments are tracked using a variety of methods and procedures ranging from cheque issue, clearance, loan money collection and deposit, reflection on periodical reports that are issued on weekly, monthly, quarterly or other basis depending on the micro-finance organization. The loan portfolio is the outstanding loan balance and the income earner and is the primary investment of the program. Pandey, (2008)

2.4.1 Loan Appraisal

A loan appraisal is a request/application for loan/funds on credit evaluated on its merits by a microfinance institution. Among others aspects, the purpose of loan, genuineness of its need, its quantum, borrower's repayment capacity, security etc are assessed on some parameters before loan is actually granted. Loan appraisal process plays a big role in assuring the lender of minimal circumstances on losing his/her money hence if the officers designated to loan appraisal are competent then high chances of leading money to non deserving customers would be high. . Boldizzoni, (2008). The key elements of loan appraisal are careful assessments of the loan applicant's include repayment capacity character or personal creditworthiness and capital and collateral situation.

2.4.2 Credit Policy

Credit policy can be defined as a Clear, written guidelines that set the terms and conditions for customer qualification criteria, procedure for making collections, and steps to be taken in case of customer delinquency. Lack of clear Credit policies can lead to default of repayment of microfinance loans, if microfinance does not have stringent credit policies then they stand to lose their money hence creating liquidity issues.

Credit policy is important in the management of accounts receivables. A firm has time flexibility of shaping credit policy within the confines of its practices. It is therefore a means of reducing high default risk implying that the firm should be discretionary in granting loans (Frankel *et al*, 2000).. Policies save time by ensuring that the same issue is not discussed over and over again each time a decision is to be made. This ensures that decisions are consistent and fair and that people in the same circumstance get treated in the same manner.

According to Pandey, (2008) credit policy provides a frame work for the entire management practices. Written credit policies are the cornerstone of sound credit management, they set objectives, standards and parameters to guide micro finance officers who grant loans and manage loan portfolio. The main reach for policy is to ensure operation’s consistency and adherence to uniform sound practices. Policies should be the same for all and is the general rule designed to guide each decision, simplifying and listening to each decision making process. A good credit involves effective initiation analysis, credit monitoring and evaluation.

Carter, (2000) carried and assessed the performance and sustainability of MFIs in Indonesia. Using a case study on village credit institutions, he found out that growing economy and supporting government policy at all levels through provision of a legal basis for the MFI and the Central Bank regulation (formal institutions) had contributed to the success of the MFIs. Thus, base on the necessary conditions of sustainable microfinance institution proposed by some scholars Peeters, H. (2003). He concluded that the Gianyar district village credit institutions have been sustainable, and by that implication they had positive net social benefits for their clients.

2.4.3 Loan Recovery Procedures

A recovery procedure is a detailed statement of steps to be taken regarding when and how the past-due amounts of a debt are to be collected. Each company has its own collection procedure, with information such as due dates, grace periods, penalties, date of repossession, date of turnover of delinquent account to collection agency, among others. The recovery procedure for any loan arrangement should be spelled out as part of the loan terms. It is important for borrowers to be aware of his details of the collection procedure so as to avoid penalties, and in the case of collateral or secured loans, repossession of the collateral. While recovery procedures may vary for each company they should all be complaint with existing laws. Third party collection agencies must also adhere to set Acts, not just in the collection procedure details but also the manner in which the collection takes place Latifee, (2006).

The Act specifies not only recovery procedures to be followed by government financial institutions, but also specifies that a person or organization indebted to the United States, against whom a judgment lien has been filed, is ineligible to receive a government grant. What this means is that it is of utmost importance to comply with the debt collection act, especially since non-compliance carries with penalties that can range from steep fines to imprisonment. If microfinance institutions do not come up with well administered collection procedures then this could be a recipe for one defaulting to repay the loan Boldizzoni, (2008).

2.5 Empirical studies

According to Fidrmuc *et al*,(2007) who sought to find out whether a lender extends credit to customers it recognizes the possibility that customers will be unable to pay or unwilling to pay as his objective. This study adopted a survey research design targeting all types of lenders. He found out that lenders must establish policies for determining who will receive credit for how long and how much. He also found out that lender should built their credit policy around five of credit that character, capacity, capital, collateral and conditions for them to be successful. He concluded that borrowers may sometimes fail to pay back loans due to lack of financial ability and other related factors other than not being willing to pay for credit given.

Njeru, B. W. (2011). who sought to find out about public debt his objective being the structure and servicing of Kenya`s public debt. She utilized a descriptive survey targeting Kenya as a country as his research methodology in studying the structure and servicing of Kenya`s public debt. Her study findings were: the Government was not happy with the level of stock of domestic debt and the government was not supporting the private sector has it should. She concludes that for government needs to put in place measures to reduce its public debt. As part of the measures of addressing the problem, she concludes that that the Government should support the private sector to make it more productive and in the process raise Gross domestic product.

On the other hand Rose, (2002) in her study on credit analysis had her objective of finding out whether credit analysis is important in ensuring that institutions maintain good loaning policy. She adapted a case study design targeting one organization and analyzed the findings quantitatively. She found out that credit analysis is important in ensuring that institutions maintain good loaning policy. The credit department must answer three questions regarding each loan application that is: the borrower credit worthy, can the loan agreement be properly structured and documented for adequate protection of stakeholders and ensure that customer's probability of loan repayment is high without excessive strain? And can the institution perfect its claim against the assets or earnings of the customer so that, in the event of default the funds can be recovered rapidly at low cost and with low risk? She concluded that organizations had a duty to analysis their credit mechanisms if they intend to achieve a good loaning policy.

Mwaura`s (2003), sought to find out the responsiveness of manufacturing firms on credit policies, his objective was find out how whether individual manufacturing firms has credit policy was prudent. He used descriptive survey design targeting the entire manufacturing firms in Kenya. He found out that manufacturing firms did not formulate prudent credit policies and that their performance was affected by a lack of these policies. He concluded that there was need to formulate a prudent credit policy for individual manufacturing firms. The formulation of a prudent credit policy for institution of this nature is important to avoid loss of its market to its rivals and helps them to improve performance in terms of development.

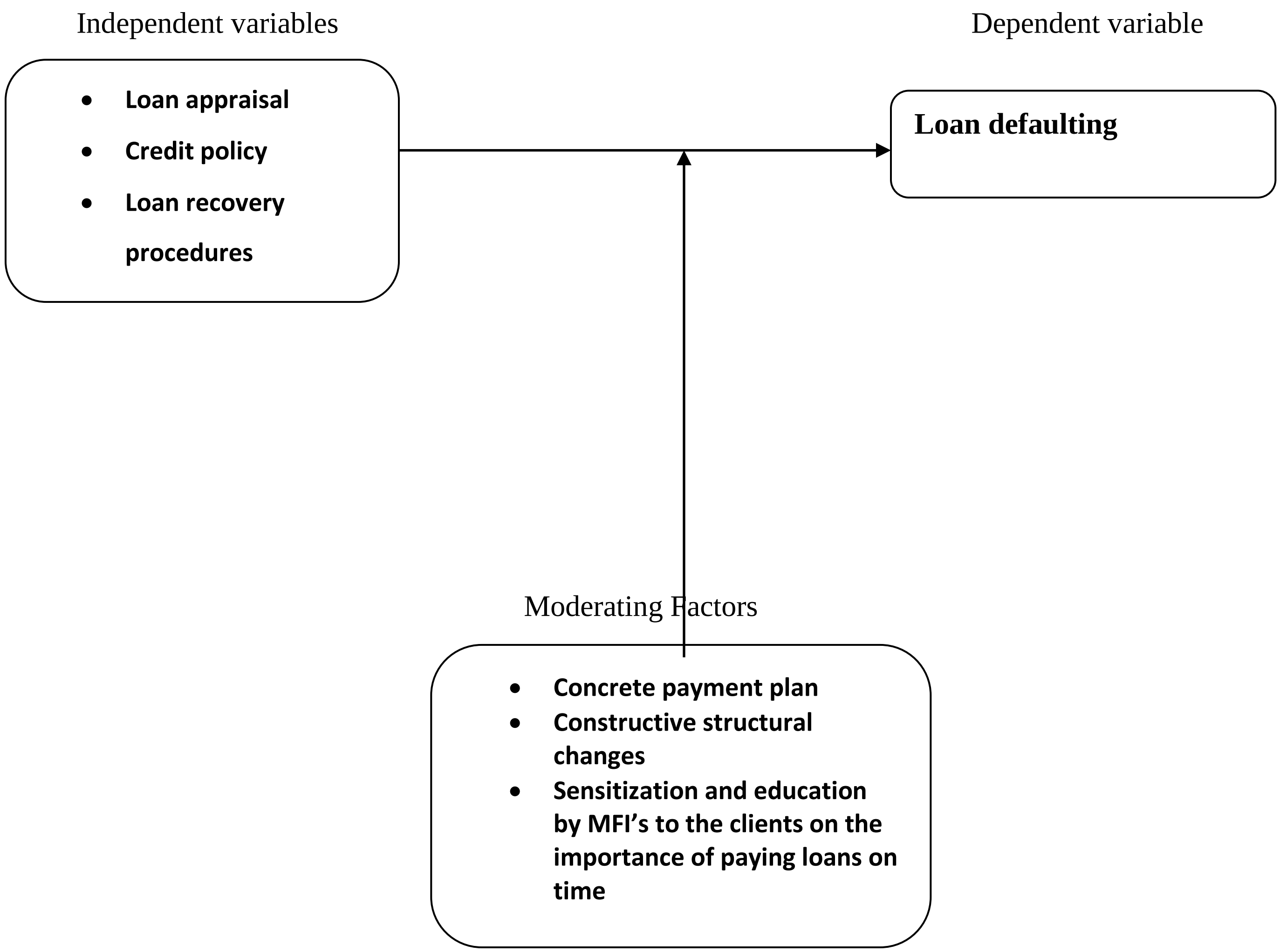
Roodman, (2006). used a regression analysis to identify the variables that had a significant bearing on credit repayment performance by farmers associations in Kiambu. Variable such as size of loan, income, education level and number of years of farming experience were found to be statistically significant while distance and size of the households were not significant. Tambunan,(2007). hypothesized that credit repayment performance from external source depends on duration of loan servicing, size or amount of credit obtained and income generated from the capital, while credit repayment performance from internal sources (member capital) depends on duration of membership, size of the household, amount of credit available, income generated from sales, gender of the household, income transfers received, the type of information and the extent of business diversification. Using standard probability model, the results revealed that gender, amount of loan, member experience and household size were not statistically significant in various specifications while crop sales, the size of enterprise, the degree of diversification, income transfers and quality of information were statistically significant

Delany, G. (2005), studied crop loan repayment behaviour in cotton growers with the aim of analysing behaviours and characteristics of borrowers along with the causes of non-repayment in crop loans. Relational analysis revealed that the social personal characteristics such as education, annual income, land holding and irrigation influenced positively the borrowing pattern and repayment behaviour of the borrowers. Murdoch, (1999). studied factors influencing attitudes of the farmers towards farm credit with the aim of understanding the attitudes of the borrowers and non-borrowers towards farm credit. It was found that there was negative and significant relationship between age and attitudes of both borrowers and non-borrowers. it was further noted that education exposure to mass media and extension contact were found to be positively related with attitude of borrowers and non-borrowers.

2.6 Conceptual Framework

The diagrammatic representation of conceptual framework shows how the variables are related. Loan appraisal credit policy, loan recovery and loan appraisal are independent variables, loan default of loan repayment is dependent variable which depends on the occurrences of the said independent variables.

Figure 2.1 Conceptual framework



Source: Research Data 2013

The dependent variable of this study is loan default which is influenced by various independent variables. The independent variables considered in the study are loan appraisal, credit policies and loan recovery procedures.

2.6.1 Credit Policies

Credit policies to a great extent influence loan default. Poor loan policies while increase loan default rates while well formulated policies will reduce loan default rates. In addition, are various policies that an organization should put in place to ensure that credit management is done effectively, one of these policies is a collection policy which is needed because all customers do not pay the firms bills in time. Some customers are slow payers while some are non-payers. The collection effort should, therefore aim at accelerating collections from slow payers and reducing bad debt losses Tedeschi,(2008). At the same time the nature of credit policies including loaning terms and conditions as well as loaning procedures had the long term effect on loan default. The basic requirements a member will be required to meet to qualify for a loan in the institution determined whether or not that member would honour the loan repayment in future. Liberal, stringent and lenient credit policies had long-term consequences on the loan default. For instance, it is highly likely that lenient and liberal policies would almost automatically create a huge portfolio of loan default. Robinson (2001).

2.6.2 Initial Loan Appraisals

Initial loan appraisals would determine the level of loan default. This will involve the use of false information or means to acquire loans from lending institutions. These might also include giving or accepting collaterals whose values have been overstated and impaired. Some borrowers who might have falsified their business past performance of records in order to acquire loans would not be able to repay comfortably later. The initial loan appraisal therefore, includes the core five ingredients of loan appraisal. This will comprise of tests on accuracy, honesty, collaterals, capacity and cash flow to determine loanee’s credit worthiness and there likelihood chances of loans default (Sterns, (1995).

2.6.3 Loan Recovery Procedures

The loan recovery procedures employed by microfinance will contribute to loans default to a greatest extent. Poor loan recovery procedures for example will create a huge portfolio of debt uncollected thus led to loans default and vice versa. Robinson M.S report on microfinance revolution Volume I (1994) defines a loan as an extension of credit to another person (client) which maybe long term (more than a year) a short term (less than a year). Breth (1999) stated that before a deal in signed a loan application is to be completed. This provides risk protections by enabling the lending institutions to follow up when the borrowers fail to honor the agreement.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter represents the research design, sampling design, sampling procedures, data collection, data analysis and reporting, limitations and expected outcomes.

3.2 Research Design

This study adopted a descriptive survey design of the institutional factors contributing to loan defaulting. The main reason for the use of a descriptive survey design is the aim to provide as much information on the entire population under study in relation to institutional factors contributing to loan defaulting in MFI's. This provided some data and perceptions of the population and they may support inferences of cause and effect on the topic under study. Survey designs are of particular value to researchers seeking help on investigating and analysis interrelationships of a number of factors involved, and in which it is difficult to understand the individual factors without considering their relationships with each other Mugenda & Mugenda, (1999).

3.3 Target Population.

The population of interest in this study consisted of all the 48 Mfi's registered by Association of microfinance institution-Kenya as at 31st December 2012 (both deposit and non deposit taking institutions). This includes the 9 deposit taking Mfi's registered by the central bank of Kenya. As per the MFI bill 2002, the Central Bank of Kenya was mandated to register all the MFIs in Kenya, however as at the time of study, they had only registered deposit taking MFI's which numbered 9 and they were yet to register non-deposit taking MFI's, this leaves AMFI as the only formal body that registers MFIs in Kenya.

The researcher undertook a census of the 48 MFI's registered with the AMFI; one credit manager from the 48 MFIs was targeted for response. The census was chosen because of the small number of the population and secondly it was reduced the margin of error that come with sampling.

3.4 Data Collection Methods and Instruments

Methods of data collection used involved primary data. Primary data was derived from questionnaires distributed to senior credit officer in credit department of the targeted MFIs. The questionnaires had both open and closed-ended questions and covered factors contributing to loan defaulting in MFIs. The researcher personally administered the questionnaires. Questionnaire allowed for confidentiality of the respondents to be kept. The questionnaires contained information on credit policies, loan collection procedures loan appraisal system in relation to their contribution to defaulting.

3.5 Data Analysis and Presentation

Data was analyzed on the basis of descriptive statistics. Descriptive statistics describe data on variables with single numbers while analysis of variance (ANOVA) tests for any significance difference between mean values of variables. Arithmetic mean, median, maximum, minimum and the standard deviation are some of the main descriptive statistics applied in data analysis.

Pearson correlation was then be performed to establish the significance differences between the independent variables of loan defaultance attributes (credit policy, initial loan appraisals and loan recovery procedures) and the dependent variable of loan default, where quality attributes was regressed against the client satisfaction. t – test will be used to test for the significance of each predictor variables in the model. The null hypothesis (i.e. the model lacking explanatory power) was rejected when the significance value t – statistic is less than 0.05 (significance level).

A multiple regression model was used to test the hypotheses of the combined effect of the four independent variables (loan appraisal, loan recovery procedures and credit policies) on the dependent variable (loan defaultance). The study adopted by the following regression model:

$$LD=\beta 0 + \beta\ 1\ (X1) + \beta\ 2\ (X2) + \beta\ 3\ (X3) + \beta.4\ (X4) + \varepsilon$$

Whereby;

LD=Loan Delinquency

X1 = Loan appraisal

X2 = Loan recovery Procedures

X3 = Credit policies

B0 is the Y intercept,

$\beta 1 \ldots$to $\beta 3$ are the coefficients of the variables

ε = error term

3.5.1 Reliability Analysis

Reliability analysis was done to assess the reliability, internal consistency and validity of the survey instruments used. Reliability analysis was explained by Cronbach’s reliability coefficient. The study made use of Likert scale hence suitability for reliability analysis. Likert scale enables easier analysis as it removes doubt on the type of response given. Cronbach’s alpha coefficient was pegged on Mugenda, and Mugenda rule of thumb (0.6). Cronbach's alpha is a measure of reliability.

Alpha is a lower bound for the true reliability of the survey. Mathematically, reliability is defined as the proportion of the variability in the responses to the survey that is the result of differences in the respondents. That is, it answers to a reliable survey was different because respondents have different opinions, not because the survey is confusing or has multiple interpretations. The computation of Cronbach's alpha is based on the number of items on the survey (k) and the ratio of the average inter-item covariance to the average item variance. Under the assumption that the item variances are all equal, this ratio simplifies to the average inter-item correlation, and the result is known as the Standardized item alpha (or Spearman-Brown stepped-up reliability coefficient).

CHAPTER FOUR

DATA ANALYSIS AND PRESENTATION

4.1 INTRODUCTION

This study set out to investigate institutional factors contributing to loan defaulting in micro-finances institutions in Kenya. The data was collected using questionnaires targeting credit managers/officers of the registered micro-finance institutions in Kenya. Out off 48 questionnaires issued 45 were returned back duly filled representing 94% response rate.

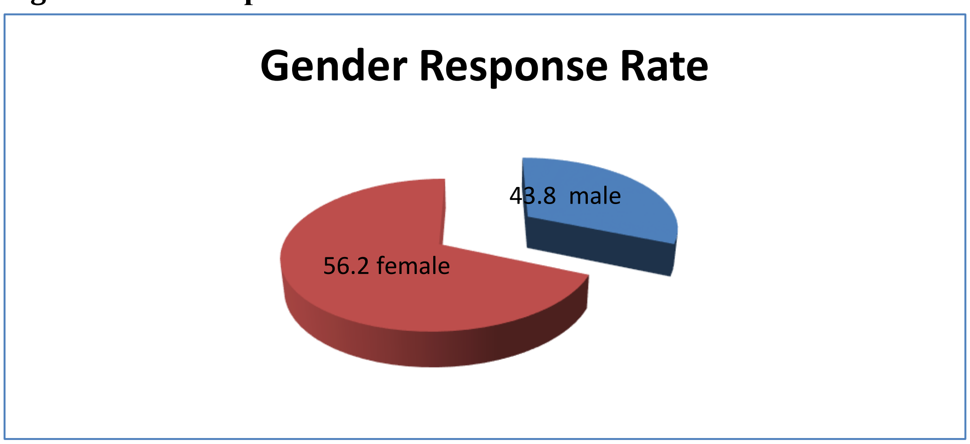
4.2 Background information of the respondents

The target population of the study comprised of all registered microfinance institutions in Nairobi County. The data for the study was collected through questionnaires to credit officers. .Majority of the respondents (credit officers) were female forming 56.2% while the male respondents were 43.8%

4.2.1 Respondents gender

Of all the questionnaires issued, the researcher managed to collect a good proportion as shown in the figure below

Figure 4.1: Respondent's Gender



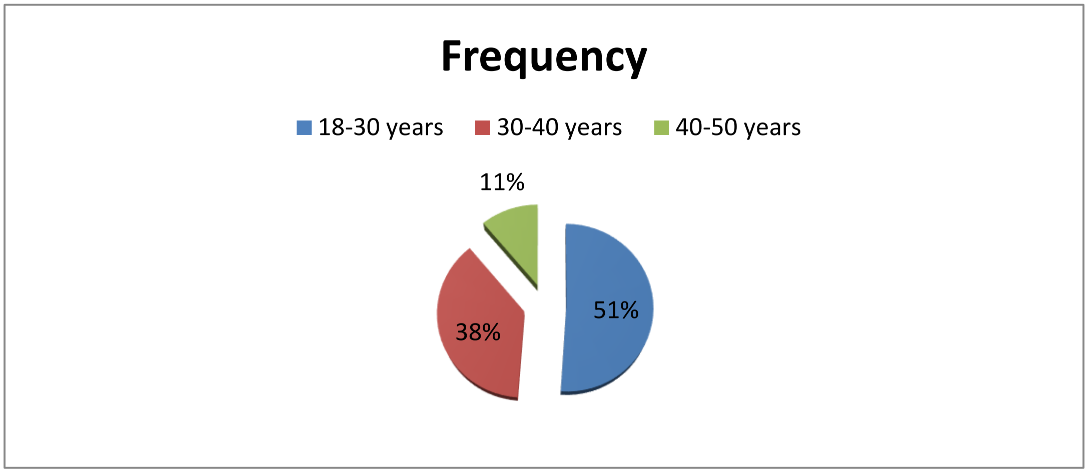
Source: Research Data 2013

From the data presented by the figure above, the questionnaires response was good with an aggregate of 100%. The head of credit officers who received questionnaires are represented by Female 56.2% while Male composes of 43.8%. This implies that more female officers in credit department unlike their counterparts

4.2.2 Respondents Age bracket

The study sought to establish the ages of MFIs Credit Officers in various microfinance's. Findings are given in figure below

Figure 4.2: Age bracket



Source: Research Data 2013

The findings revealed that the majority (50%) of the respondents are below 30 years, while (37.5%) of the respondents are aged between 30 – 40 years and 12.5 % of them are aged above 40 years. This implies that those aged between 18-30 years are the ones in control of credit departments in microfinance's

4.2.3 Respondents Level of Education

The Study sought to investigate distribution of credit officers by academic qualification. The results were as indicated in table below.

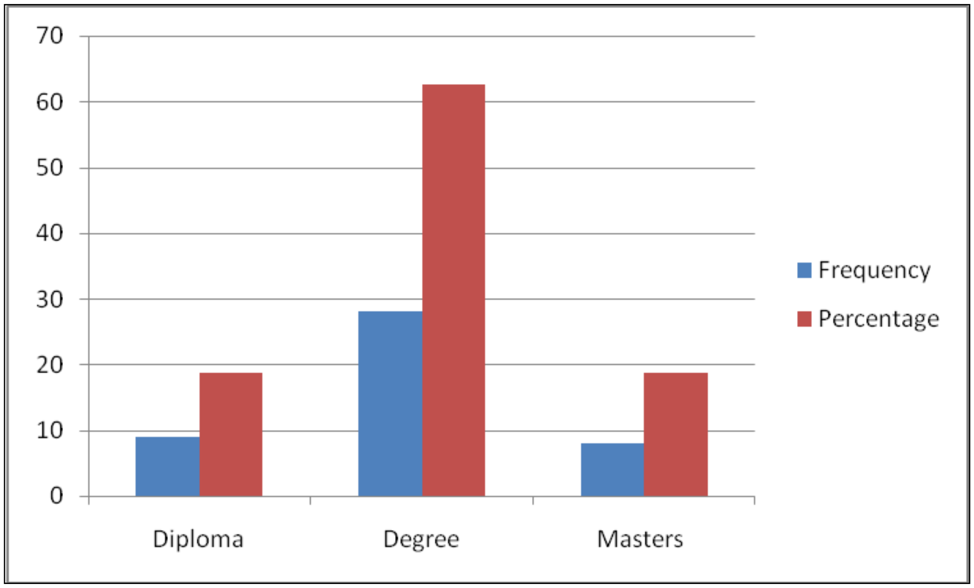
Table 4.1: Level of Education.

Response	Frequency	Percentage
Diploma	9	18.8
Degree	28	62.5
Masters	8	18.8
Total	**45**	**100.0**

Source: Research Data 2013

The information also represented in the figure bellow

Figure 4.3: Level of Education



Source: Research Data 2013

Majority of employees in credit departments in the micro-finance are Degree holders as the table above shows. The representation of 62.5% are degree holders, while 18.8% represents the diploma holders who are specialized in banking, micro-finance and business administration only a proportion of 18.8% are holders of Masters in Business Administration. This implies that majority of the credit officers have prerequisite skills and knowledge to carry out duties and functions as regards to advancing loans to prospective members.

4.2.4 Respondents Work Experience With the organization

The Study also sought to investigate the work experience in their current placement in their respective microfinance's. The results are tabulated in table below.

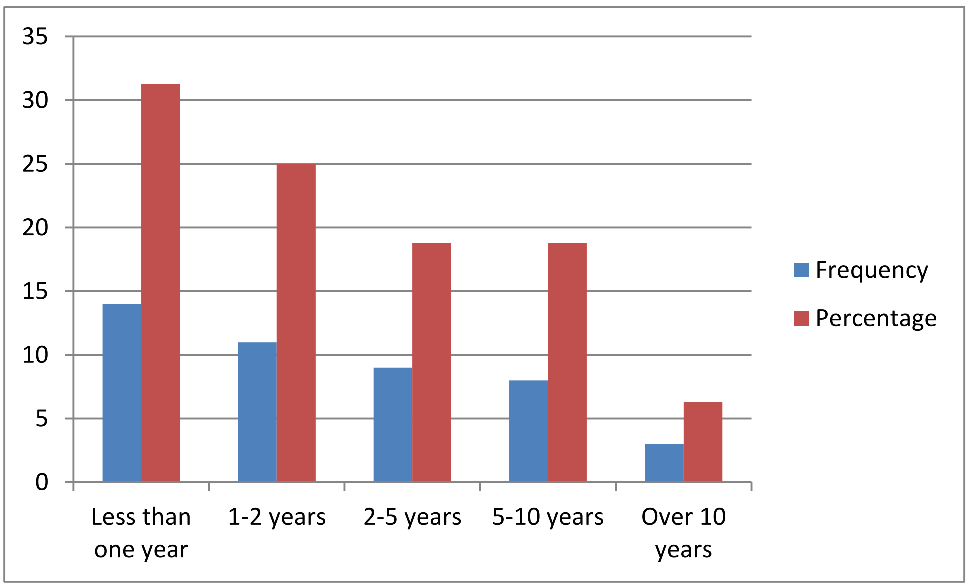
Table 4.3 Work Experience

Response	Frequency	Percentage
Less than one year	14	31.3
1-2 years	11	25.0
2-5 years	9	18.8
5-10 years	8	18.8
Over 10 years	3	6.3
Total	**45**	**100.0**

Source: Research Data 2013

The information also represented in the figure bellow

Figure 4.4: Work Experience



Source: Research Data 2013

The Study found out that 31.3% of the respondents had a working experience of less than one year. About 25.0% of the respondent had a working experience of 1-2 years whereas 18.8% each had a working experience of 2-5 year and 5-10 years, respectively and 6.3% had a working experience of over ten years. This implies that majority of respondents didn't have enough experience.

4.3 Institutional Factors Contributing To Loan Defaulting Results

The researcher sought to establish the factors contributing to loan defaulting. The results per each variable is discussed here below;

4.3.1 Credit policy

The five point likert scale with no contribution, least contribution great contribution greater contribution and greatest contribution. The results are tabulated in the table 4.

Table 4.4 Credit policy

Variables	**No contribution**	**Least contribution**	**Great contribution**	**Greater contribution**	**Greatest contribution**
Poor loan policies	19%	19%	6%	25%	31%
Strict repayment policies	7%	33%	20%	13%	27%
Well formulated policies	25%	31%	19%	0%	25%
Flexible loan policies	13%	38%	6%	6%	37%
Poor record keeping policies	19%	19%	12%	0%	50%
To what extent does credit policies affect loan defaulting	13%	6%	19%	19%	43%

Source: Research Data 2013

Objective one sought to find whether credit policies contribute to loan defaulting in microfinance institutions in Kenya. To achieve this objective, the respondents were asked to indicate the extent to which credit policies have contributed in loan defaulting in microfinance institutions. This include poor loan policy, strict repayment policy, well formulated policy, flexible policy poor record keeping policy and the overall effect of credit policy in relation to loan defaulting. The five point likert scale with no contribution, least contribution great contribution greater contribution and greatest contribution was used.

The researcher analyzed different factors under the credit policy impact on the loan defaulting, 19% of the respondents indicated that poor loan facilities have no contribution on loan defaulting and least contribution respectively, 6% indicated that it has great contribution, 25% said it has greater contribution while the majority 31% indicated that it has the greatest contribution. When asked about strict repayment policies, majority 33% indicated that it has leas contribution, 20% said it has great contribution, 13% said it has greater contribution while 27% said it has greatest contribution. For well formulated policies, 31% said it has least contribution and 25% said it has no contribution and greatest contribution respectively. For flexible loan policies 38% indicated that it has least contribution and greatest contribution. Majority of the respondents 50% said poor record keeping policies have greatest contribution on loan defaulting while 44% said the overall credit policies affect loan defaulting.

4.3.2 Loan appraisal process

The five point likert scale with no contribution, least contribution great contribution greater contribution and greatest contribution. The results are tabulated in the table 4.5.

Table 4. 5 Loan appraisal process

Variables	**No contribution**	**Least contribution**	**Great contribution**	**Greater contribution**	**Greatest contribution**
To what extent does loan appraisal affect loan defaulting	12%	13%	6%	19%	50%
Use of false information to acquire loan	0%	13%	6%	31%	50%
Accepting collaterals whose values are overstated or impaired	13%	13%	31%	6%	37%
Falsified past business performance records	0%	19%	12%	44%	25%
Poor tests of accuracy and honesty of applicants	6%	0%	12%	38%	44%

Source: Research Data 2013

The second objective of this study sought to establish whether loan appraisal process contribute to loan defaulting in microfinance institutions in Kenya. In this regard, the respondents were asked to indicate the level of loan appraisal in terms of false information, accepting collaterals whose values have been impaired, falsified past business and dishonest applicants. The five point likert scale with no contribution, least contribution great contribution greater contribution and greatest contribution was used.

When asked how the loan process affects the default rate, a half of the respondents said it bears the greatest contribution, 13% said it has no contribution and it has least contribution respectively while 19% said to the greater contribution. Fifty percent said use of false information to acquired loan have the greatest contribution, 31% said to greater contribution, 13% said to least contribution while 6% said to great contribution. When asked about how accepting collaterals whose values are overstated or impaired affect loan defaulting, 38% said to the greatest contribution. Fourty four percent said falsified past business performance records affects loan default, 25% said to the greatest contribution, 19% said to the least contribution while 13% said to great contribution.

For poor tests of accuracy and honesty of applicants, 44% said it contributes to the greatest extent, 38% said it has greater contribution, 13% said it has great contribution while 6% indicated that it has no contribution on loan default rate.

4.3.3 Loan recovery procedures

The five point likert scale with no contribution, least contribution great contribution greater contribution and greatest contribution. The results are tabulated in the table 6.

Table 4.6 Loan recovery procedures

Variables	**No contribution**	**Least contribution**	**Great contribution**	**Greater contributi on**	**Greatest contributi on**
Listening to defaulters excuses to extend period	13%	13%	19%	25%	30%
Uncommitted debt collectors	13%	19%	0%	38%	30%
Long repossessing period	0%	19%	19%	19%	43%
Corrupt staff/officers	25%	0%	13%	12%	50%

Source: Research Data 2013

The third objective of this study sought to establish whether loan recovery procedures contribute to loan defaulting in microfinance institutions in Kenya. In this regard, the respondents were asked to indicate the level of loan recovery procedures in terms of listening to defaulters excuses to extend payment period, uncommitted debt collectors, long repossessing period, and corrupt staff. The five point likert scale with no contribution, least contribution great contribution greater contribution and greatest contribution was used.

The researcher went further to inquire how the loan recovery procedures affect the loan default rate, 31% said listening to defaulters excuses to extend period said to greatest contribution, 25% said to greater contribution, 19% said to great contribution while 13% said to no contribution and least contribution respectively. When asked about uncommitted debt collectors 38% said to greater contribution, 31% said to greatest contribution, 19% said to least contribution while 13% said it had no contribution. 44% said long repossessing period contributes to greatest contribution while 19% said it contributes the least, great contribution and greater contribution respectively. 50% of the respondents said corrupt staff/officers have the greatest contribution, 25% said it have no contribution while 13% said to great contribution and greater contribution respectively. From the analysis it indicate that loan recovery does not have much impact to loan default however corruption must be either be stopped or reduced, this is because the more the credit officers become more corrupt the more the microfinance keeps losing its money rather investment.

4.3.4 Loan defaulting

In order to get the overall significance, the computed index for all the individual variables measures were computed and summarized as shown on the table 4.7 below.

Table 4.7 Loan defaulting

Variables	Highly	Moderate	Low
Loan appraisal process	44%	12%	44%
Credit policies	50%	38%	12%
Loan recovery procedure	50%	50%	0%
Level of interest rates	11%	47%	42%
Management decisions	29%	47%	24%
Conditions and procedures	32%	38%	30%

Source: Research Data 2013

The researcher went ahead to inquire about the overall impact of loan defaults by various variables. 44% said loan appraisal process has low impact and high impact respectively while 13% said it has moderate impact. Fifty percent said credit policies have high impact on loan default, 38% moderate impact and 13% said low impact. When asked about loan recovery procedure 50% said it has high and moderate impact respectively. Fourty two percent said level of interest rates has a low impact, 47% said it has moderate impact while 11% said it has high impact. When asked about management decisions, 47% said it has moderate impact, 29% said it has high impact while 24% said it has low impact and lastly the researcher inquire about the impact of conditions and procedures and 38% said it has moderate impact, 32% said it has high impact while 30% said it has low impact.

4.4. Factors contributing to loan defaulting

The analysis started with computation of the descriptive statistics, analysis under each variable discussed here below.

Table 4.8 Factors contributing to loan defaulting

N=45

	Median	Mean	Skewness	Kurtosis	Std. Deviation
Credit Policy	22	2.33333	0.536	0.432	2.30940
Loan Appraisal Process	25	3.66667	0.760	0.765	3.05505
Loan Recovery Procedures	22	3.33333	0.833	0.675	2.51661
Loan Defaulting	22	2.25331	0.901	0.567	2.16513

Source: Research Data 2013

Credit policy has an average mean score of 2.33333 and the median gap is 22. The standard deviation is 2.30940 indicating that it is not widely diverted away from the mean. The distribution is positively skewed with a skewness of 0.536 which indicates that the figures are deviated more to the right. The kurtosis value is 0.432 which means that there is clustering somewhere away from the mean.

The loan appraisal process had an average score 3.66667 indicating that actually most of the respondents actually did concur with the fact that loan appraisal process did contribute to loan default. The distribution was positively skewed indicating strong relationship between the independent variable to the dependent variable. The kurtosis value from the analysis indicated 0.765 indicating that it is more relative to from the mean

Averagely from the analysis it is evident that most of the respondents actually did indicate that the above variable largely contributed to loan default with of mean of 3.33. The standard deviation of the responsiveness dimension is 2.51661 which indicate that the gaps are not very widely deviated from the mean. The deviation is to the right with a positive skewness of 0.833. The gaps are also clustered at a point different from the mean of the distribution because the kurtosis value is 0.986.

Averagely from the analysis it is evident that most of the respondents actually did indicate that the above variable largely contributed to loan default with of mean of 2.2533. The standard deviation of the responsiveness dimension is 2.16513 which indicate that the gaps are not very widely deviated from the mean. The deviation is to the right with a positive skewness of 0.901. The gaps are also clustered at a point different from the mean of the distribution because the kurtosis value is 0.567.

4.5 Correlation Analysis

The table 9 below displays the value of the correlation coefficient and the significance value for each pair of variables used in the Paired Samples T Test procedure.

Table 4.9 Correlation Analysis

N=45 Sig. 0.05

	Credit Policy	**Loan Appraisal Process**	**Loan Recovery Procedures**	**Loan Defaulting**
Credit Policy	1.000 0.000			
Loan Appraisal Process	0.222 0.603	1.000 0.000		
Loan Recovery Procedures	0.252 0.568	0.882(*) 0.046	1.000 0.000	
Loan Defaulting	0.333 0.602	-0.816 0.221	0.000 0.000	1.000 0.000

*** Correlation is significant at the 0.05 level (2-tailed).**

Source: Research Data 2013

The two correlation variables should represent the same group at different times or two related groups, the correlation should be fairly high and the significance value low (typically less than 0.05).

The mean values for the two variables are displayed in the Paired Samples Statistics table. A low significance value for the t test (typically less than 0.05) indicates that there is a significant difference between the two variables. If the confidence interval for the mean difference does not contain zero, this also indicates that the difference is significant.

The researcher went further to establish the correlation between the dependent and independent variables, for credit policy and loan appraisal they were positively correlated at p. value of 0.222 but the correlation was not significant as the sig. value was 0.603, for credit policy and loan recovery procedures they were positively correlated at 0.252 but not significant as the sig. value was 0.568. Loan appraisal process was found to be significantly correlated to the loan recovery procedures at 0.882 and sig. value of 0.046. Credit policy and loan defaulting the correlation was positive at 0.333 but not significant at 0.602. The correlation between loan appraisal process and loan defaulting was found to be negatively correlated at -0.816 but not significant while loan recovery procedures and loan defaulting was positively correlated and significant at 0.000. sig. level.

4.6 Multiple Regression Results

A multiple regression analysis was conducted to find out the effect of credit policy, loan appraisal process and loan recovery procedures on loan default in MFIs institutions in Kenya, as a proxy for external factors. The results are presented in table 10

4.6.1 Factors contributing to loan defaulting in micro-finances in Kenya

The researcher sought to establish the factors contributing to loan defaulting in micro-finance institutions, to achieve it, the researcher performed regression analysis on the three objectives and the results are presented in table 4.10 below.

Table 4.10 Factors contributing to loan defaulting

Variable	Coefficient	Std. Error	t-Statistic	Prob.
Loan default (Y intercept)	13.03692	9.577753	-1.361167	0.1830
Credit Policy	9.937288	1.980772	-5.016877	0.0000
Loan Appraisal process	6.090383	1.966459	-3.097132	0.0040
Loan Recovery Procedure	2.549503	1.231732	-2.069851	0.0466

Source: Research Data 2013

The final regression model was expressed as

LD=□0 +□ 1 (X1) +□ 2 (X2) +□ 3 (X3) +β.4 (X4) + ε

Whereby;

LD=Loan Delinquency

X1 = Loan appraisal

X2 = Loan recovery Procedures

X3 = Credit policies

B0 is the Y intercept,

β1…to β3 are the coefficients of the variables

ε = error term

The final regression model was expressed as;
LD = 13.03692+ 9.937288*CP + 6.090383*LA +2.549503*LR

The estimated regression coefficient (β= 9.937288) for MFI variable implies that an improvement in microfinance institutions specific factors by one unit leads to a corresponding 9.937288 decline in loan delinquency in MFIs in Kenya. This suggests that, a unit increase in Loan appraisal factors (β= 6.090383) leads to a corresponding 6.090383 decline in loan delinquency in MFIs in Kenya. Conversely, the regression analysis results indicate that Loan recovery procedure is negative and significantly (t-values -2.069) related to loan delinquency performance. This depicts that, a unit increase in external factors (β= 2.549) leads to a corresponding 2.549 decline in loan delinquency in microfinance institutions in Kenya.

4.6.2 Effect of Credit Policy on Loan Default

$Ho_{1:}$ There is no statistically significant difference in loan defaulting due to credit policy the t value and significance level indicates that the independent variable of credit policy explained a highly significant proportion of the variation in the dependent variable. Therefore the first hypothesis has been rejected. From the analysis which shows actually loan appraisal process contributes to loan default, contrary to (Boldizzoni, 2008), it is evident from the respondents who are actually credit officers in these microfinance institution admit that they have been forced to bend rules in order to capture more large base clientele since the returns they make from these loans enable them expand and take care of their recurrent expenditure. Therefore this variable has an impact and directly contributing to loan default.

The first correlation was between the credit policies and independent variable against loan defaulting, this was in a bit to evaluate whether the credit policy has any effect on loan defaults. The findings revealed that for credit policy and loan default the t value was -5.016877, thus the hypothesis Ho1 was rejected. These results actually concurs with (Mwaura,2003) findings that manufacturing firms did not formulate prudent credit policies and that their performance was affected by a lack of these policies hence the same, the microfinances need to come up with credit policies which will deter loan default.

4.6.3 Effect of Loan appraisal process on loan defaulting

Ho_2: There is no statistically significant difference in loan defaulting due to initial loan appraisal process. The study established that there significant relationship between loan appraisal process and loan default; it shows that loan appraisal process a great attribute that needs much attention from micro finance in order to reduce loan default. This study is supported by Fidrmuc *et al*,(2007) their study they mainly focused on appraisal process of loans therefore concurring, with the same. The research regressed the loan default against the initial loan appraisal process, to establish the effect. The t-value was -3.097132 implying there was significance difference between the loan defaulting and loan appraisal process, thus $Ho_2$was rejected.

4.6.4 Effect of Loan recovery on loan defaulting

Ho_3: There is no statistically significant difference in loan defaulting due to loan recovery procedures

When loan recovery procedures was regressed with loan default to establish the effect of loan recovery procedures on loan default, the t-value was -2.06 thus Ho_3: was rejected. The findings concurs with (Waweru *et al*, 2009) who established that lending procedure used by micro financial institutions have been bound by banks as an entry point through developing a very simple and unsecured procedures that include the submission of loanees identification card, letter of introduction from employer.

4.7 Overall factors contributing to loan defaulting

Table 4.11 Overall factors contributing to loan defaulting

Model	**R**	**R Square**	**Adjusted R Square**	**Std. Error of the Estimate**	**Change Statistics**					**Durbin - Watson**
					R Square Change	F Change	df1	df2	Sig. F Change	
1	1.000(a)	1.000	1.000	.	1.000	.	2	0	.	.500

a Predictors: (Constant), Loan Appraisal Process, Credit Policy and loan recovery procedure.
b Dependent Variable: Loan Defaulting
Source: Research Data 2013

The R square in the table above indicates that model explains 100% of the variability in the dependent variable. The Durbin-Watson test is a widely used method of testing for autocorrelation. The Durbin-Watson Statistic is used to test for the presence of serial correlation among the residuals. The value of the Durbin-Watson statistic ranges from 0 to 4. As a general rule of thumb, the residuals are uncorrelated is the Durbin-Watson statistic is approximately 2. A value close to 0 indicates strong positive correlation, while a value of 4 indicates strong negative correlation (Durbin and Watson, 1971). Durbin-Watson should be between 1.5 and 2.5 indicating the values are independent (Statistica). For this study, the researcher established Durbin Watson value of 0.5 , this implies that there was a positive correlation among the values, implying a change in any of the values will cause a positive change to the other values and vice versa.

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.1 Summary of Findings Correlation

This study set out to investigate the institutional factors contributing to loan defaulting in micro-finances in Kenya. The data was collected using questionnaires targeting credit managers/officers of the registered micro-finance institutions in Kenya. Out off 48 questionnaires issued 45 were returned back duly filled representing 94% response rate. The researcher sought to establish the gender of the respondents from the micro-finance institutions. Majority of the respondents were female forming 56.3% while the male respondents were 43.8%. The researcher further sought to establish the issue of age bracket; the findings indicated half of the respondents 50% were below 30 years old, 37.5% were between 30-40 years while 12.5% were between 40-50 years old

Majority of the respondents had attained the degree level of education forming 62.5%, while 18.8% had attained diploma and masters levels respectively. When asked to indicate their work experience in their respective organizations, majority of the respondents 31% had worked for between 2-5 years, 25% had worked for between 1-2 years, 18.8% had worked for between 5-10 years and less than 1 year respectively while 6.3% had worked for over 10 years.

The analysis started with computation of the descriptive statistics, under the credit policy, the minimum was 12, maximum 36, mean 23.4 and standard deviation was 1.67332, for loan appraisal process, the minimum, maximum ,mean and standard deviations were 11, 37,23.2 and 2.38747 respectively, for loan recovery procedures the minimum, maximum ,mean and standard deviations were 12, 36, 23.2 and 1.788 respectively while for loan defaulting the minimum, maximum ,mean and standard deviations were 13, 38, 25.3 and 2.51 respectively.

The researcher went further to establish the correlation between the dependent and independent variables, for credit policy and loan appraisal the correlation was 0.222 and significance was 0.603, for credit policy and loan recovery procedures the correlation was 0.252 and significance was 0.568, credit policy and loan defaulting the correlation was 0.333 and significance was 0.602. The correlation between loan appraisal process and loan recovery procedures was 0.882 and significance was 0.046, loan appraisal process and loan defaulting the correlation was -0.816 and significance was 0.221. For loan defaulting and credit policy the correlation was 0.333 while significance was 0.602.

The mean values for the two variables are displayed in the Paired Samples Statistics table. A low significance value for the t test (typically less than 0.05) indicates that there is a significant difference between the two variables. If the confidence interval for the mean difference does not contain zero, this also indicates that the difference is significant.

The R square indicates that model explains 100% of the variability in the dependent variable. The Durbin-Watson test is a widely used method of testing for autocorrelation. The Durbin-Watson Statistic is used to test for the presence of serial correlation among the residuals. The value of the Durbin-Watson statistic ranges from 0 to 4. As a general rule of thumb, the residuals are uncorrelated is the Durbin-Watson statistic is approximately 2. A value close to 0 indicates strong positive correlation, while a value of 4 indicates strong negative correlation (Durbin and Watson, 1971). Durbin-Watson should be between 1.5 and 2.5 indicating the values are independent (Statistica). For this study, the researcher established Durbin Watson value of 0.5, this implies that there was a positive correlation among the values, implying a change in any of the values will cause a positive change to the other values and vice versa.

In general, the purpose of analysis of variance (ANOVA) is to test for significant differences between means. Elementary Concepts provides a brief introduction to the basics of statistical significance testing. If we are only comparing two means. At the heart of ANOVA is the fact that variances can be divided, that is, partitioned. From the findings the sum of squares under the regression was 12.667 and under residual was 0.0, the df under regression was 2, under residual was 0, the mead square was 6.333.

5.1.1 Credit Policy and Loan Defaulting

In order to test the research hypotheses, the researcher correlated each of the four independent variables against the dependent variable. The first correlation was between the credit policy as an independent variable against loan defaulting, this was in a bit to evaluate whether the credit policy has any effect on loan defaults. The findings revealed that for credit policy and loan defaulting the t value was -5.01687, thus the hypothesis Ho1 was rejected. This confirms the same for (Fidrmuc *et al*,2007) whose findings were more or less on introduction of credit policies which will deter loan defaulters.

5.1.2 Loan Appraisal Process and Loan Defaulting

The research regressed the loan default against the initial loan appraisal process, to establish the effect. The t-value was -2.079 implying there was significance difference between the loan defaulting and loan appraisal process, thus $Ho_2$was rejected. This study is supported by Fidrmuc *et al*,(2007) their study they mainly focused on appraisal process of loans therefore concurring, with the same.

5.1.3 Loan recovery and loan defaulting

Lastly the researcher sought to establish the effect of loan recovery on the overall loan default rate by the micro-finance institutions. Thus when loan recovery procedures was regressed with loan default to establish the effect of loan recovery procedures on loan default, the t-value was -3.097132 thus Ho_3: was rejected. The findings concurs with (Waweru *et al*, 2009) who established that lending procedure used by micro financial institutions have been bound by banks as an entry point through developing a very simple and unsecured procedures that include the submission of loanees identification card, letter of introduction from employer.

5.2 Conclusion

The general objective of the study was to assess institutional factors contributing to loan defaulting in micro-finances in Kenya. The researcher went ahead to test three factors of credit policy, loan appraisal process and loan recovery process against the loan default. In order to test the research hypotheses, the researcher correlated each of the four independent variables against the dependent variable of loan default. Based on the findings of this study, the following were the salient conclusions which were arrived at.

The first correlation was between the credit policy as against loan defaulting, this was in a bit to evaluate whether the credit policy has any effect on loan defaults. The findings revealed that credit policy had a significant impact on loan defaulting. The research regressed the loan default against the initial loan appraisal process, to establish the effect. The findings established a significance difference between the loan defaulting and loan appraisal process, thus there was a significant impact of loan appraisal process on loan default.

Lastly the researcher sought to establish the effect of loan recovery on the overall loan default rate by the micro-finance institutions. Thus when loan recovery procedures was regressed with loan default to establish the effect of loan recovery procedures on loan default, the findings indicated a significant impact of the loan recovery process on loan default rate.

The findings indicated that all the three factors tested had a significant impact on the loan default rate, thus the micro-finance institutions have a cause to worry if they have to reduce the loan default rates by considering the three factors under the study.

5.3 Recommendations

Having established the three factors significantly contribute to loan defaulting in micro-finances in Kenya. It is recommended that the management of micro-finance institutions should take keen interest in the three institutional factors if they have to reduce their loan default portfolio in microfinance institutions. The current study considered the registered micro-finance institutions in Kenya, it is recommended that a cross sectional study be undertaken for the micro-finance institutions in East Africa to establish if the factors are the same and forge the way forward. Since the current study only touched on the micro-finance institutions, it is suggested that a similar study be undertaken targeting the banking sector to establish the factors that contribute to loan default in the banking sector in Kenya.

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APPENDIX I: QUESTIONNAIRE COVER LETTER

INSTITUTIONAL FACTORS CONTRIBUTING TO LOAN DEFAULTING IN MICROFINANCE INSTITUTIONS IN KENYA QUESTIONNAIRE

Egerton University

Department of Accounting, finance and management science,

Faculty of Commerce

P.O BOX 536-20115

EGERTON

Dear Participant

I am a Masters student at Egerton University, Faculty of Commerce. In order to fulfill the degree requirements, I am undertaking a management research project on "Institutional Factors Contributing to Loan Defaulting in Microfinance Institutions in Kenya".

To this end, I kindly request you that you complete the following short questionnaire regarding your perception of loan defaulting in your institution (microfinance).

Your response is of the utmost importance to me and will be used exclusively for academic purposes.

Should you have any enquiries or comments regarding this project, you are welcome to contact me directly on 0727-374-650. E-mail: ericgatimo@yahoo.com

Yours Sincerely,

ERIC MAINA GATIMU

APPENDIX II: QUESTIONNAIRE

Dear respondent

You are here provided with a questionnaire for collecting the data to enable the student meet the requirement for the award of a Masters Degree of Egerton University. The information collected will be strictly used for the said purpose and will be held confidential, Kindly tick where appropriate.

SECTION A: PERSONAL DATA

Microfinance institution…………………………………………………..

Department /section………………………………………………………….

Demographic Data

No.	Questions	Answer categories	Tick
1.	Gender	1. Male 2. Female	
2.	Age bracket	1. 18-30 years 2. 30- 40 years 3. 40-50 years 4. Above 50 years	
3.	Level of education	1. Certificate 2. Diploma 3. Degree 4. Masters 5. Other specify	
4.	Work experience with the organization	1. Less than 1 year 2. 1-2 years 3. 2-5 years	

		4. 5-10 years 5. Over 10 years	

SECTION B: FACTORS CONTRIBUTING TO LOAN DEFAULTING

Using the scale 1-5 as shown below, please tick the extent of contribution of the following credit policies on loan defaulting.

1	2	3	4	5
No Contribution	**Least Contribution**	**Great Contribution**	**Greater Contribution**	**Greatest Contribution**

1 Credit policy	**1**	**2**	**3**	**4**	**5**
(i) Poor loan policies					
(ii) Strict repayment policies					
(iii) Well formulated policies					
(iv) Flexible loan polices					
(v) Poor record keeping policies					
(vi)To what extent does credit policies affect loan defaulting					

Using the scale 1-5 as shown below please tick the extent of contribution of the following loan appraisal processes on loan defaulting.

1	2	3	4	5
No Contribution	**Least Contribution**	**Great Contribution**	**Greater Contribution**	**Greatest Contribution**

1 Loan Appraisal Process	**1**	**2**	**3**	**4**	**5**
(i)To what extent does Loan Appraisal affect loan defaulting					
(ii)Use of false information to acquire loan					
(iii)Accepting collaterals whose values are over stated or impaired					
(iv)Falsified past business performance records					
(v)Poor tests of accuracy and honesty of applicants					

Using the scale 1-5 as shown below please tick the extent of contribution of the following loan recovery procedures on loan defaulting.

1	2	3	4	5
No Contribution	**Least Contribution**	**Great Contribution**	**Greater Contribution**	**Greatest Contribution**

3.Loan Recovery Procedures	**1**	**2**	**3**	**4**	**5**
(i)Listening to defaulters excuses to extend period					
(ii) Uncommitted debt collectors					
(iii)Long repossessing period					
(iv)Corrupt staff/officers					

Which factors do you think in your own opinion contribute to loan defaulting. Tick them whether highly moderate or low.

	Highly	**Moderate**	**Low**
Loan appraisal process			
Credit policies			
Loan recovery procedure			
Level interest rates			
Management decisions			
Conditions and procedures			

THANK YOU FOR YOUR TIME

APPENDIX III: REGISTERED MICROFINANCE IN KENYA AS AT 31ST DEC 2012

MEMBER NAME	ADDRESS
1. K-rep Bank Ltd	K-Rep Centre, Wood Avenue P.O BOX 25363-00603 NAIROBI
2. Equity Bank	Equity Centre, Upperhill P.O BOX 75104-00200 NAIROBI
3. Co-operative Bank	Co-operative Bank of Kenya Ltd Co-operative Hse Building- 4th Floor P.O BOX 48231-00100, NAIROBI
4. Kenya Post Office Savings Bank	Market Lane Off 17 Banda Street, Postbank House P.O BOX 30311-00100 NAIROBI.
5. Kenya Women Finance Trust-DTM	Upperhill, Kiambere Road P.O BOX 4179-00506 NAIROBI.
6. Rafiki Deposit taking Microfinance Ltd	Elroy Plaza, Tom Mboya Street, P.O. Box 66049 00800 Nairobi
7. Faulu Kenya DTM	Ngong Road, Ngong lane P.O BOX 60240-00200 NAIROBI
8. SMEP DTM	Kirichwa Road, Kilimani P.O BOX 64063 NAIROBI
9. Remu DTM Ltd	Finance House, 14th Floor, Loita street P.O. Box 20833-00100 Nairobi
10. Uwezo DTM Ltd	Park Plaza, Ground Floor, Moktah Daddah Street P.O. Box 1654-00100 GPO Nairobi
11. Century DTM Ltd	New Pumwani Road K K Plaza, Gikomba
12. Sumac Credit DTM Ltd	Consolidated Bank Building, Koinange Street, 2nd Floor P.O. Box 11687-00100 Nairobi
13. Blue Limited	Chester House-Koinange Street P.O BOX 27749-00100 NAIROBI

14. K-rep Development Agency	K-Rep Development Agency Ltd K-Rep Centre| 7th Flr. Wood Av. Kilimani P.O. Box Box 10528 – 00100, Nairobi.
15. Eclof Kenya	Chiromo, Royal Offices, Mogotio Road P.O BOX 34889 NAIROBI **Email:** info@eclof-kenya.org
16. KADET	Capital Hill, Cathedral Road Community P.O BOX 1676-00200 NAIROBI
17. BIMAS	Bimas Complex P.O BOX 2299 EMBU
18. SISDO	Ngong Road, Ngong lane P.O BOX 76622-00508 NAIROBI
19. Micro Africa Ltd	P.O BOX 52926 NAIROBI
20. Opportunity Kenya	Geomaps Centre-Matumbata rd Upper Hill P.O BOX 19497-00202 Nairobi
21. Yehu Microfinance Trust	Buxton, Tom Mboya Street P.O BOX 82120 NAIROBI
22. Fusion Capital Ltd	ACK Garden house, Wing A, Ground Floor, 1st Ngong Avenue, Community next to ardhi house.
23. Canyon Rural Credit Ltd	Studio Hse,3rd floor P.O. box 46532-00100 Nairobi.
24. One Africa Capital Ltd	Koinange Street-Ratansi Educational Trust Building, 2nd Floor P.O. Box 74093-00200 oneafrica.microfin@yahoo.co.uk

25. Jitegemea Credit Scheme	Jogoo Road, KCB building P.O BOX 46514, NAIROBI jitegemea@wananchi.com
26. AAR Credit Services	Methodist Ministries Centre, 1st Floor Oloitokitok Road
27. Agakhan Foundation Microcredit Programme	Mpaka plaza, Westlands 3rd floor P.O BOX 13149-00100, NAIROBI
28. ADOK TIMO	Sifa House, Ground Floor, Mission Rd. Off Kakamega Rd. Opposite Kibuye Market. KISUMU.
29. Pamoja Women Development Programme	Kikinga House, Kiambu Town P.O. Box 2472 – 00100 Nairobi. E-mail: info@pawdep.org
30. Juhudi Kilimo Co.Ltd	Mucai Road, Ngong Road P.O. Box 10528-00100 Nairobi E-mail : nat@juhudikilimo.com
31. Musoni Kenya Ltd	Cape Office Park Along Ring Road Kilimani, Opposite Yaya Centre P.O. Box 25351-00100 Nairobi.
32. Molyn Credit Ltd	Bruce House 9th Floor Standard Street P.O. Box 10144-00100 Nairobi Email : info@molyn.co.ke
33. Renewable Energy Technology Assistance Programme(RETAP)	Waumini Hse, Westlands 1st Floor P.O. Box 28201-00200 Nairobi E-mail : info@retap-africa.org
34. Rupia Ltd	View Park Towers, 10th Floor P.O. Box 2987-00200 Nairobi Tel : 2251389 Email : info@rupialtd.com
35. Taifa Options Microfinance	Finance House, Kenyatta Highway P.O. Box 727, Ruiru E-mail : taifaoption@yahoo.com
36. U&I Microfinance Ltd	1st Floor, Asili Complex River Road/Latema Road Junction Opposite Kampala Coach E-mail: info@uni-microfinance.co.ke
37. Select Management Services Ltd	Kenya Re towers, off Ragati Road P.O. Box 27639,00506 Nairobi.
38. Greenland Fedha Ltd	KTDA, KTDA farmers building P.O. Box 30213-00100 Nairobi.

39. Youth Initiatives – Kenya (YIKE)	Kariobangi North, Sanoda Hse, 2nd Flr P.O. Box 50622-00200, City Square, Nairobi
40. Biashara Factors	Finance House, 11th Floor, Loita Street P.O. Box 66065-00800 Nairobi
41. Platinum Credit Limited	2nd floor, union towers, moi avenue P.O. Box 73304-00200 Nairobi info@platinumcredit.co.ke
42. Ngao Credit Ltd	2nd Floor NHIF Bldg. Community P.O. Box 60776-00200 Nairobi Email: info@ngaocredit.com
43. Indo Africa Finance	Museum Hill Centre 3rd Floor, Museum Hill Road P.O. Box 39435-00623 Nairobi – Kenya Email: info@indoafricafinance.co.ke
44. Springboard Capital	Kensia House along Muranga road, Opposite Kobil Petrol Station 1st Floor, suite no.12 P.O. Box 23720-00100, Nairobi.
45. Mini Savings & Loans Ltd	Highway Building, Githunguri Town (Near Githunguri Post Office) P.O. Box 874-00216, Githunguri, Kiambu Email: minisaving@yahoo.com
46. KEEF-Kenya Entrepreneurship Empowerment Foundation	Mapa House 3rd Floor Kiambu Road P.O. Box 648 Kiambu
47. Women Enterprise Solutions	Development House, Moi Avenue P.O. Box 4083-00200 Nairobi. info@wesokenya.com
48. Focus Capital Limited	Donholm Mina Centre P.O. Box 2406-00202 Nairobi. Email:aligeproperty@rocketmail.com

APPENDIX IV: LETTER OF AUTHORITY TO COLLECT DATA

EGERTON UNIVERSITY
NAIROBI CITY CAMPUS

Tel: (020) 271028/2710530
Mobile: 0704309390/0736309390
Fax: (020) 2711350
E-mail: ntc@egerton.ac.ke

Stanbank House
Moi Avenue
P O Box 20075 - 00200
NAIROBI

13th September 2013

TO WHOM IT MAY CONCERN

RE: ERIC MAINA GATIMU – CM16/0005/11

The above named student is undertaking a Masters thesis Research project title "Assessing Institutional Factors contributing to loan defaulting in Microfinances Institutions in Kenya.

This is to kindly request you to assist him collect relevant data for his research using a questionnaire administered to Head of Credit Office in your institution.

Do not hesitate to contact us, if you have any enquiries or comments regarding both the student and his data.

Thank you,

Mr. F Kalui
Coordinator Commerce Programmes

Egerton University is ISO 9001: 2008 Certified

APPENDIX V: SCHEDULE OF RESEARCH ACTIVITY

	July	August	September	October	November	December
Coming up with a Researchable Topic						
Writing Chapter One						
Writing Chapter Two and Three						
Finalizing on the Research Proposal						
Research Proposal Compilation and Presentation						
Data Collection and analysis						
Presentation of final research project						

APPENDIX VI: CORRELATION RAW OUTPUT

Correlations

		Credit Policy	Loan Appraisal Process	Loan Recovery Procedures	Loan Defaulting
Credit Policy	Pearson Correlation	1	.603	.252	0.333
	Sig. (2-tailed)		.222	.568	0.602
	N	45	45	45	43
Loan Appraisal Process	Pearson Correlation	.603	1	**0.882(*)**	**-0.816**
	Sig. (2-tailed)	.222		**0.046**	**0.221**
	N	45	45	45	45
Loan Recovery Procedures	Pearson Correlation	.252	**0.882(*)**	1	.000
	Sig. (2-tailed)	.568	**0.046**		.000
	N	45	45	45	45
Loan Defaulting	Pearson Correlation	0.333	**-0.816**	.000	1
	Sig. (2-tailed)	0.602	**0.221**	.000	
	N	45	45	45	45

*** Correlation is significant at the 0.05 level (2-tailed).**

APPENDIXVII: RESEARCH BUDGET

No.	ITEM	COST (Ksh)
1.	Transport Expenses	20,000/=
2.	Typing Expenses	10,000/=
3.	Printing, Photocopy and Binding Charges	13,000/=
4.	Library and Internet Expenses	15,000/=
5.	Research Assistant	12,000/=
	Sub Total	54,000/=
6.	Contingencies (10 % of Sub-Total)	5,400/=
	TOTAL COST	**75, 400 /=**