# INFLUENCE OF LENDING TERMS ON LOAN PERFORMANCE OF MICROFINANCE INSTITUTIONS IN KISII COUNTY (CASE STUDY; KENYA WOMEN MICROFINANCE BANK)

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## ABSTRACT

The purpose of the study was to investigate the influence of lending terms on microfinance institutions' loan performance in selected Kenya women microfinance Bank. The specific objectives included the following; to determine the influence of loan standards on loan performance of Kenya women microfinance Bank in Kisii County, to establish the influence of credit period on loan performance of Kenya women microfinance Bank and to examine the influence of value of collateral on loan performance. The study adopted descriptive research design. The study adopted simple random sampling technique to select 167 customers and census to select all 14 employees working in Kenya women microfinance Bank in Kisii County. The study concluded that there is a positive relationship between loan standards and loan performance of Kenya women microfinance banks and was statistically significant. Kenya women microfinance banks offers training on the need to make partial payments and clear their loans on time. There was a positive relationship between Credit period and loan performance of microfinance banks and was statistically significant. Microfinance banks require a deposit of collateral before the client take a loan. Collateral value was positively correlated and statistically significant on loan performance of Kenya women microfinance bank. The study recommended that borrowers should be allowed to provide their suggestions on the type of loan standards can lead to loan performance. Therefore, a more comprehensive understanding of the best loan standards should be embrace on borrower's lending terms and conditions. On credit period, the study recommended that Kenya women microfinance bank should provide friendly payment modes and terms. There is need to consider the credit period with 5'cs model of client appraisal to determine a particular customer's credit period. The study further recommended that collaterals from defaulted borrowers should be used on sale for loan recovery. Microfinance banks should consider borrower's ability to pay based on the collateral submitted value, repayment history, and the need to make site visits. The research suggested for a similar studies to be done to assess the effect of lending activities on financial performance of other microfinance institutions.


**Key Words: lending terms, loan standards, credit period, value of collateral, financial performance**

## INTRODUCTION

### Background of the Study

According to Anderson (2015), microfinance is an effective instrument applied in fighting poverty by financial institutions. Most financial institutions use institutional credit in alleviating poverty by ensuring that non-performing loans are held minimum. Loans are described as the highest income, particularly in microfinance institutions (Bystrom, 2007). It is associated with the most considerable default risk as compared to the other microfinance

assets. Loans facilitate the collection of higher returns from investments in compensation for lower liquidity and increased risks (Thomas, 2006). It is perceived that demand for loans has increased due to the availability of fast lending rates, which are enhanced through credit management policies that ensure that customer information is properly assessed to reduce the number of defaulters (Chimkono, Muturi & Njeri, 2016).

Small and medium enterprises formed part of the economic growth catalyst as they are used to create employment opportunities for too many youth and women, thus the source of income leading to poverty reduction (Lavine, Beck, Kunt & Demirguc, 2003). SMEs contribute at least 49 percent of economic growth, leading to employment creation (Ghana Banking Survey, 2013). Ngugi (2017) stated that macro and medium enterprises have primarily contributed to developing and sustaining economies, both domestically and internationally.

Nigeria's central bank (2011) has reported that microfinance in Nigeria has faced enormous challenges since the microfinance policy system launch in December 2005. The effect of the global financial crisis of 2007/2008 was highly felt by the microfinance institutions than expected because access to credit was limited by intense competition, which increased credit risk, which made many clients unable to pay back their loans, thus leading to unstable economic conditions. Nnanna (2003) argued that the banking industry had experienced distress and, at times, failures. Financial institutions distress resulted due to improper financial risk management.

Dell Arriccia et al. (2010) and Valencia (2011) argued that the banking crisis contributed to a 20 to 25 percent loss of Gross Domestic Product. Twenty-seven percent of small enterprises in Nigeria were found to be distressed and had shut down their premises in the last six months (Moghalu, 2013). Credit risk leads to four commercial banks being put under receivership. Idama et al. (2014) noted that credit risk still forms a significant threat to the micro-financial institution's development and sustainability.

It is owed to credit institutions as an obligation to protect depositors' funds. Therefore, credit companies seek to avoid credit delinquency and default because the lender's money is lost if the debt is not paid, and the institution will no longer be viable. Idama, Asongo, and Ngutor (2014) argued that credit risk is the client's inability to satisfy the terms of a loan agreement. Realistic and sound credit risk is key to the stability of microfinance banks. Similarly, Agene (2011) characterized the credit risk portfolio as a reduction in the loan portfolio's quality, resulting in the loss of loans and high delinquency management costs. A loan that is defaulted or near to default is a non-performing loan.

A loan is non-performing if interest and principal payments are due for 90 days or longer, or interest payments have been capitalized, refinanced, or postponed by consent for at least 90 days, or charges are scheduled for less than 90 days. Still, other fairgrounds for doubting the payment would be made in total (IMF, 2009).

NPLs may be viewed as undesirable outputs or costs for banks to loan, which reduces the bank's performance. NPLs are defined as assets by Hennie and Sonja (2009), not revenue generation. This is when, for 90 days or more, the principal or interest is due and left unpaid. In any lending, loan defaults are unavoidable. To mitigate the probability of defaults, what banks do is (Mikiko, 2003). Increased debt levels on SME loans are a major area of concern for policymakers in developing countries due to the unforeseen negative impact on SMEs' financing (Kyalo, 2015). According to Ameyaw - Amankwah, the costs of loan delinquencies will be borne by both lenders and borrowers (2011). The lender incurs expenses in delinquency cases, such as missed revenue, the principal's relative value, litigation costs, and costs associated.

The default decision is a trade-off for the borrower between the fees associated with sorting out the current loan in lost goodwill from default and the relative value of preceding investments. According to estimates, non-performing loans are one of the main causes of economic stagnation. Various approaches to improve financial sustainability are necessary through reducing non-performing loans (Nishimura, Kazuhito & Yukiko, 2001).

Microfinance institutions consider credit risk management a decisive factor in raising markets, leading to accelerated growth in credit, which has significantly increased credit risk levels among individual microfinance institutions. Waweru & Kalani (2009) argued that non-performing loan levels are immensely growing due to insufficient protection. The accumulation of non-performing assets has often characterized microfinance banks. There is a need to establish ways to reduce non-performing loans.

Omino (2015) argued that microfinance institutions are becoming households of many Kenyans by facilitating affordable loans. This loan assists many financial institutions in reaching many ordinary citizens in Kenya. Micro-financial institutions support development. According to Ndung'u, he argued that micro-financial institutions had mobilized some funds totaling Kenya shillings of One hundred fifty billion, thus forming the contributing factor in developing the national economy. According to Thisika (2017), microfinance institutions have expanded their credit facilities. This is illustrated by substantial portions that concentrate on the lending organizations' operational properties. Appropriate loan portfolios are critical, especially for lending organizations based on lending capability, profitability, liquidity, and microfinance firms' earnings.

## Statement of the Problem

Munyiri (2018) argued that micro-finance institutions had increased levels of non-performing loans recently. Even though it has put in place measures to curb loan defaulting, part loan defaulting is inevitable among the lending firms (Samuel, 2011). Many authors have studies appropriate lending procedures, microfinance lending fundamentals, and practice, among other aspects, despite that risks at the portfolio have increased. Idama et al. (2014) argued that credit risk had become a threat to much microfinance, affecting their sustainability.

The number of delinquent loans has increased despite that micro-financial institutions have adopted various techniques, especially in screening borrowers. The delinquency levels have increased in the past few months, from an average of 2.2 percent to 4.7 percent (CGAP, 2018). The records obtained from the microfinance report of 2011 stated that loans borrowed by members' accounted for up to three-quarters of the total microfinance assets. Thus, the loan quality has been affected, thus challenging an average gross non-performing loan (NPL), 9.6 percent. Nonperforming Loans (NPLs) ' average performance to total gross loans was stated at 7.8%; this was towards the end of June 2018. Burundi and Tanzania formed the highest NPL ratio, 12.7 percent, and 8.2 percent, respectively. In Rwanda, the levels of Non-performing Loans from financial institutions were rated at 6.6 percent; this was June 2018. The Central Bank Annual Supervision Report (2018) showed increased credit risk levels, which lead to increased levels of non-performing loans from the microfinance institutions over the past ten years condition which has affected their returns.

The sustainability of MFIs is primarily determined by the ability of microfinance capacity to collect disbursed loans effectively. For microfinance institutions to be sustainable, they need to have high portfolio quality which is 100 percent repayment (Addae-Korankye, 2014). According to Samuel (2011), several studies have been undertaken on sustainable lending methods, microfinance fundamentals, and yet non-performing loan levels have increased. This study focused on establishing the influence of lending terms on loan performance to reduce non-performing loans, particularly in Kenya women microfinance bank in Kisii County Kenya.

### Research Objectives

i. To determine the influence of loan standards on loan performance of Kenya women microfinance bank in Kisii County
ii. To establish the influence of credit period on loan performance of Kenya women microfinance bank in Kisii County
iii. To examine the influence of collateral value on loan performance of Kenya women microfinance bank in Kisii County

## LITERATURE REVIEW

### Agency Theory

As suggested by Ross and Mitnick (1970), Agency theory suggests that management activities are different from those needed to optimize shareholder returns in the modern association. Equity ownership is generally owned (Berle & Means, 1932; Pratt & Zeckhauser, 1985). The owners are principals in agency theory, and the managers are agents. An agency loss is a degree to which the residual applicants return; the owners fall below what they would have been if the directors, the owners, had exercised total control of the company (Jensen & Meckling 1976). The organizational theory explains processes that minimize losses

for agencies (Eisenhardt, 1989). These include incentive plans for executives who are financially rewarded for optimizing the needs of shareholders. Such schemes typically entail procedures for the purchase of shares by senior management, perhaps at a discounted price, to balance managers' financial interests with shareholders (Jensen and Meckling 1976).

Some similar schemes link the rate of executive compensation and benefits to shareholders' returns. To reward the company's long-term profit maximization and prevent short-term executive activity detrimental to corporate value, part of the executive compensation has been postponed to the future. In other words, the related organizational economics theory is concerned with the prevention of "opportunistic actions" of management, which means shaking and giving up unwanted opportunities at the cost of shareholder interests (Williamson, 1985).

## Asymmetry Theory

According to the asymmetric data theory, distinguishing between good and bad borrowers can be difficult (Auronen, 2003 & Richard, 2011), resulting in adverse selection and moral hazards. The model emphasizes that a party with more data on a particular commodity to be exchanged on the market would negotiate better terms for the transaction than the other party (Auronen, 2003). As a result, a group with less knowledge of the same particular item to be processed will make correct or incorrect payment decisions. Negative selection risks have resulted in a substantial particularly in the non-bank loans (Bester, 1994).

In this scenario, it is feasible that the microfinance, the borrower, would have had more understanding of the risks of the project for which it raises funds than the lender. This exacerbates the issues of adverse selection and moral hazard (Matthews & Thompson, 2008). Moral hazard refers to the possibility that a party to an agreement could provide misleading information about its properties, liabilities, or credit potential or, in a desperate attempt to make a profit before the contract is concluded, have an opportunity to take unusual risks. Usually, a party to a transaction cannot enter into a good faith contract and therefore provide false details of its properties, liabilities, or credit power. Moral hazard issues are believed to be caused by asymmetric data, difficult to distinguish between good and bad borrowers (Richard, 2011). It is also noted that moral risk has contributed to a significant accumulation of NPLs (Bofondi & Gobbi, 2003).

## Pecking Order Theory

The Pecking Order was developed by Donaldson (1961) and was amended by Stewart C. Myers and Nicolas Majluf (1984). It states that, due to the high expense of borrowing, firms give priority to their type of funding, opting to raise equity as the last source of payment. Therefore, the internal funds are used first, and the equity is released when the debt is exhausted, and it is not sensible to issue any obligations. As management believes more about the opportunities, challenges, and value of their business than external investors, the principle starts with asymmetrical expertise. Asymmetric evidence supports debt over equity, as the

debt issue shows the Board's trust that investment is adequate and that the current stock price is undervalued. It asserts that, with asymmetrical experience, the cost of financing increases. The financial and social success of MFIs has a direct impact on their interest rate planning.

## Conceptual Framework

A conceptual framework refers to the conceptualization of the relationship between variables in the analysis, according to Mugenda and Mugenda (2003), and it is seen diagrammatically. In addition to showing the research course, the researcher may establish the relationships of the various structures the researcher seeks to examine through the conceptual framework. This study's independent variables are loan standards, credit terms, credit period, and collateral value, while the dependent variable is loan performance.

## Conceptual Framework

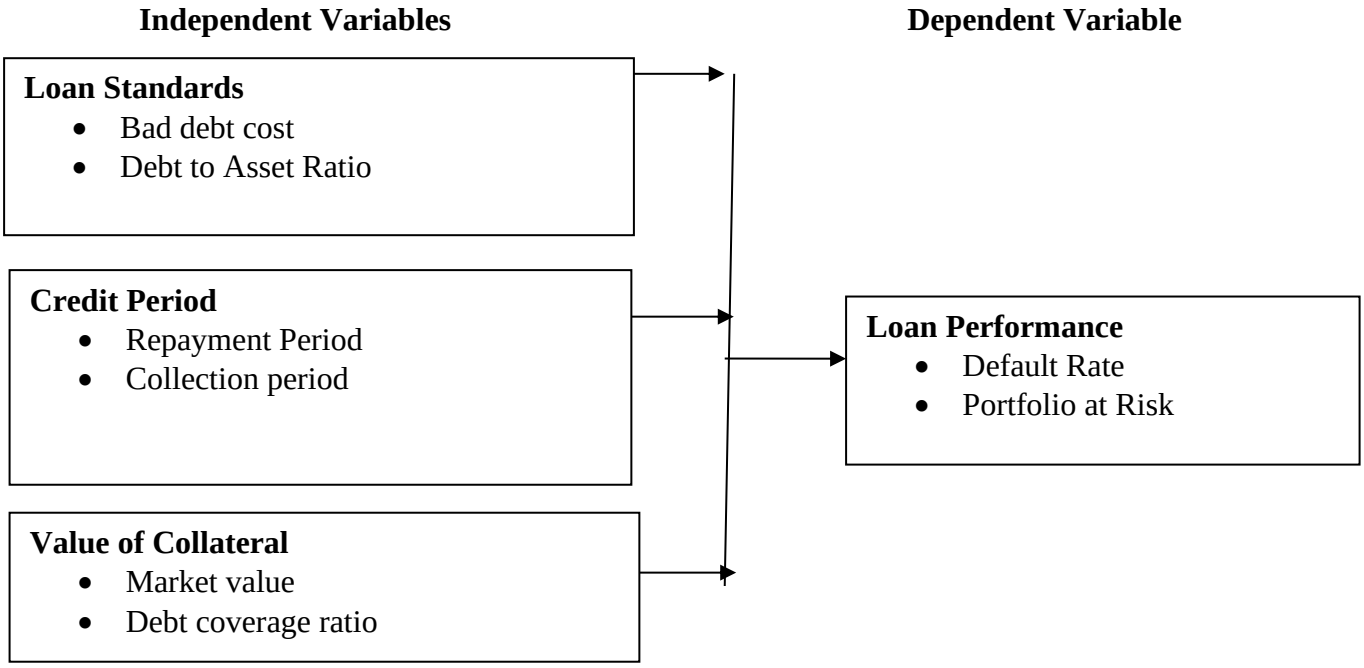


***Figure: 2.1 Conceptual Framework***

## Empirical Review

### Influence of Loan Standards on Loan Performance

Loan standards apply to Pandey's approach when choosing clients for the intention of loan extension (2010). The firm can only decide to offer credit to the most keep the relationship and those financially secure. It can also have strict loan standards, primarily by selling on a cash basis. This result in fewer administration expenses and no lousy debt defaults, but not much growth of the company's revenues. Thus, more periodic cost savings relative to the benefit of lost sales. Loses the company's lending requirements to high transactions but raises the debtors, which increases the cost of credit administration and bad debt losses.

According to Van Home (1994), customer worth is affected in two ways by loan standards: the default rate and the period taken by clients to repay the loans taken. He found out that optimum credit policy would reduce the tight and loose loan standards' weaknesses, raising the firm's profitability. Kakuru (1998) showed that the increase in return and growth in costs trade-off influences loan standards.

Across the planet, financial institutions face immense risks of non-performing loans (NPLs). In this regard, it is also prudent for financial institutions to set up processes to track borrowers' actions. It has been noted that since the 1990s, the value of credit risk management has intensified for both borrowers and lenders, especially in developing countries (Summers & Wilson, 2000). As a result, the scholars stated that political institutions were forced to amend their terms of lending.

Mwaura (2003), who sought to ascertain the responsiveness of manufacturing firms to credit terms, aimed to find out how prudent the credit policy of individual manufacturing firms was. He used a descriptive survey framework targeting all of Kenya's manufacturing firms. He found that manufacturing firms did not devise prudent credit terms and that the lack of these terms influenced their results. He concluded that it was necessary to develop a sensible credit term for individual manufacturing firms. The concept of prudent credit terms for institutions of this nature is essential to avoid losing their market to their rivals and help them boost their performance in terms of growth.

In the Indian scenario, it is perceived that the lending terms of MFIs could have a critical impact on non-performing loans (Reddy, 2004). He critically analyzed various issues relating to the terms of credit of Indian banks and argued that 'the factor of power has no impact on illegal activity. The Indian view of the principles of "credit culture" due to Reddy (2004) and "risk pricing" due to Mohan (2003) confirms with several studies listed above that, apart from the business cycle, MFIs' lending terms could play an essential role in the management of credit defaults.

## Influence of Credit Period on Loan Performance

Saleh and Zeitun (2007) have shown that the credit period is the amount of time taken to accept the borrowers' loan repayments. According to Kariuki (2010), to guarantee the continuous and consistent collection and the need for a group strategy, which should seek to tighten the group of slow payers and reduce government debt defaults. Some consumers are fully non-payers, and others do not even consider the time factor; thus, the collection policy extends to them. He also found that for a rapid turnover of working capital, keeping collection costs and bad debts within limits, and efficiently managing the collection, the prompt collection is required.

Pandey (1995) stated that the collection policy should lay down methodological approaches to the collection. The inadequate compilation of loans shows inefficiency at the management level. Inefficiency in the allocation of loans to clients is thus a strategy that is calculated by

the cost per loan property as the average cost per loan charged to clients in monetary terms determined by the overall cost and the total of the loan ratio.

Wamasembe (2012) defines the terms of credit as the caveat by which the company makes credit sales to its customers. The provisions shall apply to cash discounts and credit periods. The culture and practice of the industry will guide the credit duration of the business. The firm may extend the credit period or shorten the credit period. The firm tightens the credit cycle by increasing revenues and extending credits, thereby increasing operating profits: increased revenue and extended credit duration.

According to Kakuru (1998), it has been identified that credit card improves the contributions due from customers and is used as a method to maximize sales. This will contribute to a decrease in the level of debtors and related costs. Credit terms in practice include the cash discount period, the net credit period, and the cash discount period. Failure of customers to pay the loan within a given credit period will lead to negative debts. The lending terms shall be determined by determining the cost of lousy debt when microfinance institutions agree to lend the amount of the assets to the debtor with the scheduled repayment within a fixed period.

Otieno (2013) undertook research on the determinants of lending terms on the levels of non-performing loans (NPLs) of commercial banks in Kenya, which revealed that lending terms had a significant effect on loan portfolio results, provided that the terms of individual banks' loans had an impact on the levels of non-performing loans. According to the research, most locally owned commercial banks have changed loan conditions to accommodate the local market and gain a competitive advantage. However, this is likely to impact the loan's efficiency; the result was agreed with Swaren (1990), who proposed that the most prevalent area of risk is excessively aggressive lending. It is a dangerous practice to extend the lending terms beyond the useful life of the accompanying collateral. Besides, lending to borrowers already overburdened with debt or possess unfavorable credit history can expose MFIs to unnecessary default and credit danger. To reduce these risks, MFIs need to consider some standard applicants' particulars, such as debt-to-income ratio, company and credit background and performance record, and their time at work or length of time for individual borrowers (Wangai, Bosire & Gathogo, 2014).

## Influence of Value of Collateral on Loan Performance

The guarantee acts as a creditor's security towards default by the borrower. It can be used to cover the debt if the borrower fails to pay the interest and principal reasonably under the terms of the loan agreement. Security that collateral usually provides lenders with lower interest rates on loans that have collateral. If the borrower fails to pay, the borrower sacrifices the assets guaranteed as collateral, and the lender becomes the property owner. The price at which the asset can sell in a competitive environment is the price used by microfinance institutions to decide the collateral that the borrower can position as insurance.

In anticipation of the risk of non-payment that contributes to NPLs, MFIs have introduced standard loan application protocols and conditions, typically included in the Credit Policy Manual, to direct credit officers and clients. A few of the considerations considered by the MFIs before the awarding of loans have the following, which is often alluded to as the canons of successful lending: The nature of the potential borrower; the sum demanded by the customer; the margin (interest margin, commissions, and fees, etc.); the intent of the loan; the willingness of the borrower to handle the company successfully; the repayment (repayment source must be credible); insurance (customer insurance) and the technological and financial feasibility of the business.

According to Batar (2008), the lender will classify the financial services needs of the MFI target customers, address their concerns, ascertain their nature and ability to service, and decide the necessary cost of the loan by using the financial expertise of Batar et al. (2008). The firm can establish its ad hoc approach to numerical credit scores to assess the trustworthiness of customers. The attributes defined by the firm may be assigned weights based on their value and may be combined to produce a total score.

It is advised that a credit review of different lenders should really be undertaken to evaluate the default risk of borrowers and, eventually, to make decisions on borrowing. It has been noted that, due to the large size of non-performing liabilities, credit risk is by far the most significant risk facing Nigerian banks (Agu & Okoli, 2013). In an analysis of non-performing loans in Italy, Sergio (1996) showed that the rise in the risk of lending assets is embedded in a bank's lending strategy leading to a relatively selective and insufficient evaluation of the sector's prospects.

According to Fidrmuc et al. (2007), who aimed to determine if a creditor can expand the payment period to customers, Fidrmuc et al. consider the risk that customers may be incapable or unwilling to comply as their goal. This study followed a research survey methodology targeting all forms of lenders. He noticed that lenders had to formulate policies and practices to ensure who would obtain credit for how long and how much. He also figured that lenders could build up their terms of the loan to about five of the loans that characterize capacity capital collateral and the conditions for them to be profitable.

On credit practices in rural banks in Ghana, Owusu (2008) identified that credit card applications' assessment did not sufficiently evaluate the underlying creditworthiness to adopt good credit decisions directly. It also observed that the credit financial disclosures drawn up by the two banks lacked basic credit management features such as the credit distribution mechanism, the financial risk mix, the marketing framework, the handling of loan portfolios, amongst many others, to render them sufficiently effective. Its proposals indicated that the sum of credit should be carefully calibrated for the projects listed to ensure sufficient support. Louzis et al. (2012) based their research on the influence of bank-specific characteristics such as management efficiency, policy decisions, size, and market power on problematic loans. A case in point linked to unique bank factors has been demonstrated in Greece, where the country's financial sector experienced a decline in the 2007 financial crunch. This was

attributed to the inefficient administration of advance loans without considering borrowers' reputations and the undermining of regulators.

Moti et al. (2012) carried out a study on the credit management system's efficacy in loans' performance. They found that credit quality, interest rates paid, credit risk control, and collection policies impacted the performance of loans in Kenya. Similar to Western and other African countries, Wondimagegnehu (2012) also commissioned a survey in Ethiopia on the determinants of non-performing loans and found to be inadequate credit appraisal, failure to track loans, undernourished credit culture, lending terms and conditions, aggressive lending, compromised credibility, weak institutional capability, unfair competition between banks, and diversion of funds.

To access default settings, The MFIs should closely review the lending process's monitoring and control phase (Sheila, 2011). Anjichi (1994) noted that most of the anguish and grievances of sluggish and troubled loans could be prevented by a necessary modification of the loan, which tends to keep the line of credit sound. This is achieved by visiting the creditors' property to examine the overall status quo and verify borrowers' moral status, and the scale is defined as finished goods. The general corporate policies and recommendations shall be considered. If the MFI is responsive to market growth, it will amend its credit terms and loan processes and advise its customers.

To distinguish defaulters from non-defaulters of agricultural bank recipients in Iran, Koopahi and Bakhshi (2002) used a discriminatory analysis. The results showed that the use of equipment, the duration of the repayment period, and the bank's supervision of the loan use had a significant and positive impact on the repayment performance of the agricultural credit. The waiting time for receipt of the loan, on the other hand, had a substantial effect on its repayment. To prevent delays in repayment, Paxton (1996) applied the 100 percent rule to a report on determinants of effective loan repayment, i.e., no new credit was issued before the former's complete refund. Subsequently, this provision was relaxed, and loans were given as long as the interest rate met 90% of the outstanding loan. To access credit, any borrower had to have savings amounting to 20 percent of the loan. To access credit, every member had to subscribe to some shares. For credit beyond defined amounts, Guarantor-ship was also needed (Paxton, 1996).

A study was done by Wakuloba (2010) on the possible failure in loan modes in Uasin Gishu Subcounty Trade Development Joint Loan Board Scheme. The findings showed that the program had high and rising default rates over the period. Bad business outcomes, diversion of funds, and domestic problems were the fundamental causes of failure. Measures can be adopted so that the board can be reinforced to ease up the processing of loans and ensure timely disbursements through capacity building in computer applications.

## Critique of Literature Review

From literature reviews, this study focuses on establishing the influence of lending terms on loan performance to reduce non-performing loans, particularly in Microfinance institutions. The study done by Moti et al. (2012) carried out a study on the credit management system's efficacy in loans' performance. They found that credit quality, interest rates paid, credit risk control, and collection policies impacted the performance of loans in Kenya. Similar to Western and other African countries, Wondimagegnehu (2012) posited in Ethiopia on the determinants of non-performing loans. The study that inadequate credit appraisal, failure to track loans, undernourished credit culture, lending terms and conditions, aggressive lending, compromised credibility, weak institutional capability, unfair competition between banks, and diversion of funds affect performance of banks.

Idama et al. (2014) argued that credit risk had become a threat to microfinance affecting their sustainability. Munyiri (2018) argued that lending risk management affect performance of commercial banks. The findings quite a several micro-finance had increased levels of non-performing loans recently but their study did not analyze lending terms on loan performance of microfinance banks in Kisii county.

## Research Gap

Micro-financial institutions play a significant role in stimulating the economy of a country. The empirical literature was precisely reviewed above on the influence of lending terms on performance. There are various challenges facing lending terms, and they have been discussed. Multiple authors have researched lending approaches and the effect of loan default in financial institutions. For instance, a study conducted by Wenner (1995) focused on determining whether the methods adopted on lending funds affected repayment performance. Wydick (2009) stated that the utilization of data amongst 137 Guatemalan team members showed a cohesion impact on group performance regarding repayment terms and procedures. Ajayi(2005) conducted a study on the factors influencing defaulting in mortgage financing amongst financial institutions, particularly to the Federal Mortgage Bank of Nigeria. Another study carried out by Hunt (2006) focused on determining credit rationing technology on lenders repayment characteristics in rural micro-financial institutions, whereby the study sampled 504 individuals for data collection purposes. These studies focused on different aspects, which led to the arrival of different potential conclusions. Therefore, this study sought to fill the gap and enhance understanding of lending terms' influence on selected microfinance institutions' loan performance in Kenya.

## RESEARCH METHODOLOGY

This research had embraced a descriptive research design. This study targeted 181 respondents comprising of 14 employees and 167 customers of Kenya women microfinance Bank in Kisii County. This study adopted census to select employees. Primary data was collected using semi-structured questionnaires.

## RESULTS AND DISCUSSION

The data collected was analyzed descriptive statistics that are; frequency, percentage, mean and standard deviation. Inferential statistics that is correlation analysis and regression analysis was conducted to establish the relationship independent variables and dependent variables. The researcher adopted the Statistical Package for Social Science Programme (SPSS) version 24.

### Influence of Loan Standards on Loan Performance

The researcher focused on determining the influence of loan standards on loan performance, and the findings are as tabulated below;-

**Table 4. 1 Influence of Loan Standards on Loan Performance**

| Statements | Sd | D | N | A | Sa | Mean | Sd |
|---|---|---|---|---|---|---|---|
| Loans are provided in different categories to different groups of individuals | 10<br>7% | 27<br>18% | 12<br>8.0% | 47<br>32.0% | 53<br>35% | 3.79 | .84 |
| Loans provided comply with government regulations offered . | 10<br>7% | 10<br>7% | 27<br>18.4% | 51<br>34.2% | 51<br>33.4% | 3.06 | .94 |
| The loan standards provided have reduced the tedious processes previously provided by the MFIs. | 6<br>4% | 36<br>24.2% | 12<br>8.1% | 75<br>50% | 20<br>13.7% | 3.89 | .84 |
| Borrowers are allowed to provide suggestions that can lead to an improvement in loan standards. | 3<br>2% | 6<br>4% | 49<br>33% | 75<br>50% | 16<br>11% | 1.89 | .92 |

From table 4.1, the study presented the findings on the influence of loan standards on loan performance of the selected microfinance institutions. The results showed that on the statement that loans provided in different categories to different groups of individuals have a SD=.84, loans provided comply with government regulations offered by the CBK has SD = .94, the loan standards provided have reduced the tedious processes previously provided by the MFIs had SD=.84, borrowers are allowed to offer suggestions that improve their loan standards had a SD=.92. This shows that loan standards had a significant influence on loan performance.

These study findings are supported by the study done by Pandey (2010), who stated that loan standards have a significant effect on loan repayment. The loan standards provide methods followed by microfinance when selecting a client for a particular credit extension purpose. Microfinance can decide to offer credit to the most loyal and reliable customers and those who are stable financially. Microfinance can as well provide stringent loan standards through

mainly selling on cash terms. This can result in fewer administration costs with no terrible debt losses but not for microfinance sales. The study concluded that microfinance's open loan standards on a large scale increase the debtors and, in return, increase credit costs and bad debt losses.

## Influence of Credit Period on Loan Performance

The researcher sought to establish the credit period's influence on loan performance, and the results are as tabulated in seen in Table 4.2.

**Table 4. 2 Influence of Credit Period on Loan Performance**

| Statement | Sa | A | N | D | Sd | Mean | Std |
|---|---|---|---|---|---|---|---|
| The customers and credit officers agree on the repayment period | 30<br>13.7% | 85<br>57.4% | 8<br>5.7% | 21<br>14.1% | 5<br>3.7% | 3.18 | .8134 |
| The MFIs offers training on the need to make partial payments and clear their loans on time | 21<br>14.1% | 85<br>57.0% | 10<br>7.0% | 25<br>16.5% | 8<br>5.4% | 3.28 | .8235 |
| The credit period is based on the amount on the loan | 33<br>22.2% | 76<br>51% | 11<br>7.4% | 23<br>15.4% | 6<br>4% | 2.67 | .8734 |
| The MFIs provides friendly payment modes and terms | 26<br>17.7% | 86<br>57.7% | 9<br>6.3% | 21<br>14.6% | 7<br>5% | 2.47 | 1.117 |
| The MFIs gives customers extension time after elapse of the repayment period | 32<br>21.5% | 87<br>58.2% | 11<br>7.6% | 14<br>9.5% | 5<br>3.2% | 2.65 | .9282 |
| The MFIs follows the Central Bank of Kenya regulations when it comes to the handling of defaulting customers as well as their information | 18<br>12.0% | 75<br>50.6% | 11<br>7.6 % | 27<br>18.4% | 18<br>11.4 % | 2.77 | .8421 |

In table 4.3 above, the study presented findings on the influence of credit period on loan performance, and the results are as follows. The statement that the customers and credit officers agree on the repayment period had SD=.8134, the MFIs offer training on the need to make partial payments and clear their loans on time had SD=.8235, the credit period is based on the amount on loan had SD=.8734, the MFIs provide friendly payment modes, and terms have SD=1.117; the MFIs give customers extension time after elapse of repayment period had SD=.9282, the MFIs follow Central Bank of Kenya regulations when it comes to handling defaulting customers and their information, had SD=.8421. This general position is that the credit period influenced loan performance.

The study findings concur with the study carried out by Kariuki (2010), who argued that the credit period needs to be well stated to facilitate regular and prompt collection. This will enhance faster collection from slow payers and reducing bad debt losses. It is noted that some customers are non-payers completely, and others do not even put the time factor into consideration. The credit period caters to the loan collection period. He further added that working capital's fast turnover, maintaining costs of collection, and bad debts within efficient loan collection limits. The study findings collaborate with the conclusions from Otieno (2013), who studied the effect of lending terms on levels of Non-performing loans of commercial banks in Kenya. The study established that lending terms had a significant effect on the loan portfolio to a great extent. The credit period was one of the lending terms.

## Influence of Value of Collateral on Loan Performance

The researcher focused on determining the influence of collateral on loan performance, and the results are as tabulated below;-

**Table 4.3 Influence of Value of Collateral on Loan Performance**

| Statement | SA | A | N | D | SD | Mean | Std |
|---|---|---|---|---|---|---|---|
| The MFIs require a deposit of collateral before taking a loan. | 18<br>12.0 % | 79<br>53% | 7<br>5% | 35<br>23% | 10<br>7.0% | 3.89 | .8001 |
| The deposited collaterals are assessed and valued against the amount to be issued. | 9<br>6% | 41<br>28% | 12<br>8% | 62<br>42% | 25<br>16% | 2.78 | .8543 |
| The MFIs provide training to the borrowers on the need to have collaterals | 10<br>7.0% | 74<br>49.4% | 10<br>7.0% | 42<br>28.5% | 13<br>8.1% | 2.92 | 1.254 |
| Collaterals from defaulted customers are brought on sale for purposes of recovering the loan issued. | 20<br>13.3 % | 75<br>50.6% | 8<br>5.1% | 34<br>24.1% | 12<br>6.0% | 1.99 | .9341 |

The study findings in Table 4.3 above established that on the statement that the MFIs requires a deposit of collateral before taking a loan had a SD=.8001, the deposited collaterals are assessed and valued against the amount to be issued had a SD=.8543, the MFIs provide training to the borrowers on the need to have collaterals had SD=1.254, Collaterals from defaulted customers are brought on sale for purposes of recovering the loan issued had SD=.9441. The majority of the respondents agreed that the value of collateral influenced loan performance.

This study results are in line with the study conducted by Batar (2008) and noted that the lender could adopt appropriate measures which facilitate identification of target clients, evaluate their demands, examine their character and their capacity for loan repayment, and also determine the proper loan amount with the aid of financial expertise. A microfinance organization can develop its ad hoc methods of numeric credit scoring, which can be applied to determine the target

The correlation analysis was carried out to establish the relationship between lending terms and loan performance of microfinance banks. The lending terms are independent variables; Loan standards, credit Period and Value of Collateral and loan performance are the dependent variable. The correlation was done using the Pearson's product moment correlation at 0.05 level of significance and results captured on Table 4.4.

**Table 4.4 Correlations matrix**

| | | Loan standards | Credit Period | Value of Collateral | Loan Performance |
|---|---|---|---|---|---|
| Loan standards | Pearson Correlation | 1 | .037 | -.072 | .655** |
| | Sig. (2-tailed) | | .656 | .381 | .000 |
| | N | 149 | 149 | 149 | 149 |
| Credit Period | Pearson Correlation | .037 | 1 | .288** | .776** |
| | Sig. (2-tailed) | .656 | | .000 | .001 |
| | N | 149 | 149 | 149 | 149 |
| Value of Collateral | Pearson Correlation | -.072 | .288** | 1 | .786* |
| | Sig. (2-tailed) | .381 | .000 | | .023 |
| | N | 149 | 149 | 149 | 149 |
| Loan Performance | Pearson Correlation | .655** | .776** | .786* | 1 |
| | Sig. (2-tailed) | .000 | .001 | .023 | |
| | N | 149 | 149 | 149 | 149 |

**. Correlation is significant at the 0.01 level (2-tailed).

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

From the results presented in table 4.4; value of collateral had a strongest positive relationship and statically significant at <.05 to loan performance (r =-.786 p-value = .023), followed by credit period had a strong positive correlation and statistically significant at p<.05 on loan performance (r = .776, p-value =.001), loan standard had a positive correlation and statistically significant to loan performance at p<.05 supported by (r = .655**, p-value =.000). The results showed that the value of collateral was highly correlated to loan performance while loan standards correlated moderately which has statistically significant effect. Hence, there was a relationship between lending terms and loan performance of Kenya women microfinance bank in Kenya.

Regression model summary was determined in table 4.5, the R of .808 indicate the strength of a relationship between independent variables and dependent variable. The adjusted R2 commonly known as multiple regression coefficient of determination of .653 shows that 65.3% was accounted for dependent variable (loan performance) and the remaining 34.7 % is explained by other variables not identified in this study. These variations of percentages are determined by any change made to each of independent variable (lending terms) in a regression line.

**Table 4.5 Model Summary**

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate |
|---|---|---|---|---|
| 1 | .808[a] | .653 | .465 | .12014 |

a. Predictors: (Constant), Value of Collateral, Loan standards, Credit Period

The study implied that Value of Collateral, Loan standards, Credit Period had a direct relation to loan performance of microfinance banks in Kisii County. This means that change in Value of Collateral, Loan standards, Credit Period lead to an improvement of loan performance of microfinance banks.

**In testing goodness of model fit, Analysis of Variance (ANOVA) was conducted and these results was shown in Table 4.6.**

**Table 4.6 ANOVA[a]**

| Model | | Sum of Squares | Df | Mean Square | F | Sig. |
|---|---|---|---|---|---|---|
| 1 | Regression | 5.274 | 3 | 1.758 | 5.065 | .002[b] |
| | Residual | 50.327 | 145 | .347 | | |
| | Total | 55.602 | 148 | | | |

a. Dependent Variable: Loan Performance

b. Predictors: (Constant), Value of Collateral, Loan standards, Credit Period

Predictors (Value of Collateral, Loan standards, Credit Period) remain constantly with its calculated F statistics of 5.065 implied that the model was fit and statistically significant on the three lending terms and loan performance at .002 p<.0.05. Thus, lending terms can be used to predict loan performance in microfinance banks.

The study conducted multiple regression analysis to determine the nature of a relationship between independent variable and dependent variable. The result in table 4.6 was used to establish regression equation based model. The study used unstandardisized coefficients to interpret the effects of each independent variable outcomes on dependent variables. The interpretation of regression model indicates the strength using Beta values β where the significant values explain.

**Table 4.6 Regression Coefficients[a]**

| **Model** | | **Unstandardized Coefficients** | | **Standardized Coefficients** | t | Sig. |
|---|---|---|---|---|---|---|
| | | **B** | **Std. Error** | **Beta** | | |
| 1 | (Constant) | 2.440 | .411 | | 5.941 | .000 |
| | Loan standards | .358 | .154 | .085 | 2.325 | .045 |
| | Credit Period | .584 | .101 | .178 | 5.782 | .003 |
| | Value of Collateral | .623 | .194 | .196 | 3.258 | .001 |

a. **Dependent Variable: Loan Performance**

From the regression coefficients, the study established the following regression equation;
Yi =2.440+.358X1+.584X2+.623X3+ei
Where Yi=Loan Performance

The results in Table 4.6, Regression coefficients indicate that holding other factors constant, p-value = .000, β 2.440 implied that a variation of one independent variable (loan terms) would lead to 2.440 in loan performance (dependent variable).

The loan standards had a p-value = .045, β .358 results to an increase in loan performance of microfinance banks by 35.8% and was statistically significant at 5%.

Credit period had a p-value = .003, β .584 which implied that a unit change in credit period of loans would results to an increase in loan performance of microfinance banks by 58.4% and was statistically significant at 5%.

The value of collateral had p-value = .001, β .623, this implied that an increase in the value of collateral would results to an increase in loan performance of microfinance banks by 62.3%

and was statistically significant at 5%. This means that microfinance banks apply value of collateral as most important lending terms on improving their loan performance. However, when microfinance banks apply loan standards as one of the lending terms indicates the lowest variation in loan performance.

## CONCLUSIONS AND RECOMMENDATIONS

### Conclusions

The study concluded that spike in the loan standard causes an increase in the lending output of Kenya women microfinance bank in Kenya. Based on inferential statistics, there is a positive relationship between loan standards and loan performance of Kenya women microfinance banks and was statistically significant.

The study concluded that Kenya women microfinance banks offers training on the need to make partial payments and clear their loans on time. The credit cycle influences Kenya women microfinance bank loan output in Kenya. This study indicates that the credit period was scientifically useful in describing the lending efficiency of Kenya Women microfinance bank. There was a positive relationship between Credit period and loan performance of microfinance banks and was statistically significant.

The study concluded that the microfinance banks require a deposit of collateral before the client take a loan. A change in the value of collateral leads to an increase in Kenya women microfinance bank loan performance. Based on this study, it is further concluded that collateral value was positively correlated and statistically significant on loan performance of Kenya women microfinance bank.

### Recommendations

The following recommendations were made based on the findings;-
The study recommended that borrowers should be allowed to provide their suggestions on the type of loan standards. Kenya women Microfinance bank need to have credit officers and customers involved in formulating loan standards; this is because the credit officers are the people who deal with the customers. Therefore, a more comprehensive understanding of the best loan standards should be embrace on borrower’s lending terms and conditions.

On credit period, the study recommended that Kenya women microfinance bank should provide friendly payment modes and terms. There is need to consider the credit period with 5'cs model of client appraisal to determine a particular customer's credit period.

The study further recommended that collaterals from defaulted borrowers should be auctioned on sale for the purposes of loan recovery. Microfinance banks should consider borrower’s ability to pay based on the collateral submitted value, repayment history, and the need to make site visits and assess the collateral value by the credit officers. Microfinance

institutions need to put in place stringent policies for any customers accessing their loans. This is because the rigorous guidelines enhance loan performance.

## Suggestions for Further Study

The study aimed to determine the effect of lending terms on the loan performance of Kenya women microfinance bank in Kenya. The research suggests similar studies to be done to assess the effect of the lending conditions on financial performance of other micro-financial institutions. Other scholars should perhaps explore the influence of credit reference office on performance of the loan.

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