CREDIT MANAGEMENT PRACTICES AND FINANCIAL PERFORMANCE OF MICROFINANCE INSTITUTIONS IN NAIROBI CENTRAL BUSINESS DISTRICT, KENYA

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ABSTRACT

The link between credit management practices and financial performance remains unclear especially in the Microfinance Sector in Kenya. Though there are studies on performance of MFIs in Kenya, few have sought to explain the same in view of credit management practices. Much of the available local empirical literature is in the banking context. Hence, this remains an area of empirical interest: this formed the motivation of the study. The study sought to determine the effect of credit management practices (client appraisal, credit risk, collection policy, and credit terms) on financial performance of MFIs in Nairobi Central Business District, Kenya. A descriptive survey design was adopted for the study; the target population comprised of 165 members of staff of the MFIs studied. Primary data was collected using questionnaires. Purposive sampling was used to pick 165 respondents. Of the 165 questionnaires dispatched, 158 were filled and returned. Descriptive analysis and multiple regression analysis were used to analyze data. The study found that credit risk control, client appraisal, collection policy and terms of credit were all statistically significant in explaining financial performance of the MFIs studied. The study further established that credit risk control, client appraisal, collection policy and terms of credit had a positive relationship with financial performance. The study concludes that unit increase in credit risk control, client appraisal, and collection policy and terms of credit results to better financial performance of MFIs. Hence, the MFIs should endeavour to invest more on the credit management practices as a way of improving their financial performance. The study’s contribution to knowledge was equally highlighted.

Key words: Capital Adequacy, Client appraisal, Client Capacity, Collection policy, Credit period and Credit risk.

I. Introduction and Background

Herrmann (2008) indicates that when seeking improved operational performance and profitability, firms are seeking ways to improve their performance in operations in a bid to increase profitability competition has risen up as new technologies and new firm structures crop
up. This has made firms seek new ways of lowering their operational costs to improve their profitability. In the same way, micro finance institutions financial performance is determined in terms of the profitability and their return on investment. Herrmann (2008) contends that firm profitability is usually determined by the organization earnings compared to its sales/owners and assets investment or the value in shares. This leads to common measures of profitability including return on equity (ROE), Income statements, Earnings per share (EPS), Return on total assets (ROA) and Price/Earnings ratio or P/E ratio.

Credit management is an essential process for any firm that engages in the business of credit. The process when done in the right manner ensures that the customer pays on services delivered. According to Myers and Berkley (2013) credit management practices are the strategies used by an organization to ensure that the level of credit in the firm is acceptable and it is managed effectively. It is part of financial management that comprises of the analysis of credit, rating of credit, classification and reporting of credit. Nelson (2012) defines credit management as the practices used by an organization to manage the sales they make on credit. It is an essential practice for all the organizations that have credit transactions since some have managed their credit activities so well that they have zero credit risk.

Credit management is the strategies one uses to collect and control credit payments from clients. Myers and Berkley (2013) define these practices as the strategies that organizations use to have an acceptable level of credit and to manage this level effectively. It is part of financial management that comprises of the analysis of credit, rating of credit, classification and reporting of credit. When credit management is done right, then the capital with debtors reduces and the possibility of bad debts is also reduced. Edwards (2013) contends that if you are a business and you have not included into your selling price any costs associated with late payment or you have a way of recovering the costs by charging an interest, then your profits is bound to be affected by such costs. Some firms are tempted to provide credit when they think of the possibility of increased business operations. However, businesses have to be certain that there will be more revenue from the high sales that will outweigh the cost of credit to avoid losses.

In order to ensure better performance, MFIs are seeking to become commercial entities and are seeking to improve their profitability. Thus it is likely that those MFIs that are self-sufficient will not be providing the most expensive or the smallest loans to the prior people (Woodcock, 2009). According to the Kenyan Central Bank Supervision Annual Report (2016), the net loan portfolio in the MFI sector increased by 13.3% however, there was a decrease before tax that decreased by 19% between 2014 and 2015. The decrease in profits was as a result of more provisions for loans that were none performing which are a credit risk in itself. According to AMFI (2016), the quality of portfolio seems to be the most pressing issues since in 2013 59.3% of the respondents agreed that credit risk was at the top or the second top risk of the banking sector.

II. Statement of the Problem

The relationship between credit management practices and financial performance of MFIs in Kenya is largely unclear, and inconclusive. The available empirical work has largely dwelt on
financial performance without attributing the same to credit management yet this is the core of MFIs. The increased number of MFIs leads to higher forms of credit risks due to the use of credit standards, credit analysis and appraisal and credit control as the firms seek to use the proper practices in credit management (Mathara, 2011). However the issue of loan delinquency is still a challenge for many of these firms even if they have tried to follow credit guidelines and policies and tried to lend prudently (Mathara, 2011). According to the MFIs quarterly financial report there is an increase in the loan default rate (16%) and the non performing rate increased by 15% from Sh70.3 billion in March 2016 to Sh77.3 billion in 2017 which is as a result of the practices used for credit management in the sector among other factors (CBK, 2017). Such a trend is a threat to the sustainability of the institutions and also prevents them from achieving their mandate which they sought to meet when they were formed. These include the provision of quality loans and providing services that could satisfy the needs of those that could not afford to get loans from the traditional financial firms (Parrenas, 2015).

The success of Micro Finance Institutions more often is dependent on the effectiveness of credit management which improves the repayment rates and leads to higher profits (Sifunjo & Simiyu, 2014). The Kenyan MFIs use various credit management practices, policies, regulatory and credit scoring systems. However, despite taking these measures the institutions still have high default rates (16%) that have a negative effect on the firm’s financial performance (Muturi, 2016). Ayodele, Thomas, Raphael and Ajayi (2014) studied the impact of credit policy on the performance of Nigerian Commercial Banks and found that, a good credit policy is important for any organization as it helps reduce bad debts. Owizy (2013) assessed the impact of credit management on financial performance of Nigerian banks, with particular reference to UBA Plc. The study found that the practices used in credit management significantly affected the Nigerian banks profitability. Muturi (2016) assessed the effect of credit management practices on loan performance in deposit taking microfinance banks in Kenya and found that credit collection policies, terms of credit, the standards of credit and the credit policies used had an effect on the performance of the institutions. Although the MFIs are known to adopt credit management practices, very few studies (Simiyu, 2008; Owizy, 2013; Muturi, 2016) have been done on this area. Despite the few empirical studies in this era, there is increased need to evaluate the relationship between credit management practices and financial performance especially in the context of MFIs in Nairobi CBD, Kenya. This was a good basis for the current study. Hence, the current research sought to determine the effect of credit management practices on financial performance of MFIs in Nairobi CBD, Kenya.

III. Objectives of the Study

The specific objectives of the study were:

i. To determine the effect of client appraisal on financial performance of microfinance institutions in Nairobi Central Business District, Kenya

ii. To establish the effect of credit risk control on financial performance of microfinance institutions in Nairobi Central Business District, Kenya
iii. To determine the effect of collection policy on financial performance of microfinance institutions in Nairobi Central Business District, Kenya

iv. To assess the effect of terms of credit on financial performance of microfinance institutions in Nairobi Central Business District, Kenya

*Null hypotheses were formulated and tested (at a significance level of 0.05) in regards to each respective specific objective.

IV. Significance of the Study

The study outcome will be of significance to various stakeholders. Academicians and researchers will use the findings to consider further research in areas that the study found unique. Researchers will also use the empirical studies found in the current study for their research. The research will equally use the study to enrich the body of knowledge in the finance discipline and bridge the gap existing in the study of credit management; the current study will make contributions to improve the practice and the existing knowledge on financial performance and credit knowledge.

From a theoretical viewpoint, the study provides a comprehensive framework of looking at the changes occurring in credit management and financial performance. The study will also assist policy makers to make better policies in the sector. The findings in this study would be of great help to those firms under study and to others in the financial sector. Even the organizations from other sectors may greatly benefit from the research results since the findings will help firms in all sectors reorganize their credit management policies and to critically review their operations so as to come up with better processes of dealing with credit systems.

V. Review of Literature

The study reviewed relevant theories and empirical literature as captured hereunder.

A. Theoretical Review

The section highlights four theories that the study is anchored upon. They include: asymmetric information theory, transaction cost theory, portfolio theory and loanable funds theory. This theory was proposed by Swedish economist Knut Wicksell (1851-1926). It major assumption is that the demand for loans and supply of credit determine the credit interest rates. Another assumption of the theory is that there is an inverse relationship between interest rates and loanable funds. In case there is a change in the supply and demand of credit then the rate of interest will be determined by the movement of the demand and supply curve of the credit. The theory explains that the demand of credit comes from foreign borrowers, consumers, domestic borrowers and government. The supply (on the other hand) is from domestic savings and from money created from foreign lending and from the banking sector. These are the factors that affect interest rates in the long term however in the short term, interest rates are determined by the economy’s monetary and financial conditions (Gorder, 2009). This theory will be used in the
study to explain the effect of client appraisal on financial performance of microfinance institutions.

The asymmetric information theory was first explained by Akerlof’s in the 1970. The theory explains that information asymmetry exists when banking lending applications are being assessed (Binks & Ennew, 1997). This theory explains when important information is unknown to every party involved in a transaction (Ekumah & Essel, 2003). Espy (2005) explains the condition whereby the parties that are part of transaction are not aware of all the important facts. The theory explain that when information asymmetry is perceived then financial institutions have two core challenges including moral hazard, in the monitoring of the behaviour of the entrepreneur and adverse selection whereby the firm makes errors as it lends to the wrong people. Transaction cost theory provides an important framework that is used to make decisions that are in regard to the organizations vertical boundaries. Williamson (2000), points out that transaction happens if a service or good is transferred across technologically separable interfaces. When one activity ends another commences. This theory was first explained by Schwartz (1974), whereby according to him, suppliers have an upper hand compared to lenders as they can get information on the credit worthiness of their customers. Suppliers are also able to monitor and ensure full payment of debts by their customers. These advantages give suppliers an advantage in terms of cost compared to traditional lenders.

Portfolio theory first came up in the 1950s to early 1970s and was seen as an advancement in the mathematical modelling of finance. From its development there have been numerous practical and theoretical criticisms against the theory. One of these is that financial returns are not based on a Gaussian distribution or any symmetrical distribution for that matter (Michael & Sproul, 1998). Portfolio theory models assets return as elliptically distributed or a normally distributed portfolio, the risk is defined as the standard deviation of return and the portfolio is modelled as a combination of weighted assets such that the portfolio return is a weighted combination of assets returns. Different assets are combined that do not have a perfectly positively correlated returns which allows the theory to reduce the portfolio return variance. The theory further assumes that the market is efficient and the investors are able to make rational decisions (Sharpe, 1964).

B. Empirical Review

The study reviewed several empirical studies which were related to the variables under study. Gizaw, Kebede and Selvaraj (2015) examined the impact of credit risk on profitability of commercial banks in Ethiopia. The study objective was to look into how credit risk affected the profitability of Ethiopian commercial banks. The data obtained for the study was obtained from 8 sample commercial banks for a period of 12 years (2003-2014) from annual reports of the different banks and National Bank of Ethiopia. Descriptive statistics and panel data regression was used for data analysis. According to the research findings, loan loss provisions, non-performing loans, credit risk measures and inadequacy in capital affected the commercial banks profitability in Ethiopia.
Byusa and Nkusi (2012) investigated the effects of credit policy on bank performance in selected Rwandan Commercial banks. The objective of the research was to look into how credit policy affected the performance of the commercial banks selected. According to the findings the banks selected had an increase in their accounts and account base while there was an improvement in their financial indices which increased their profits. There was competition in the banking sector which increased spreads. The high spreads and a high interest rate margin is evidence of inefficiency and poor competition.

Djankov, McLiesh and Shleifer (2007), studied the effects of credit management on loan repayment in private credit in 129 countries in Eastern Europe, the managers in the finance department were interviewed and an analysis of the data was done by use of descriptive statistics. According to the conclusion of the study, credit management practices facilitated payment of loan.

Muturi (2016) assessed the effect of credit management practices on loan performance in deposit taking microfinance banks in Kenya. This study sought to find out how credit management affected loan repayment. A descriptive research method was used. Analysis of the primary data was done using standard deviation and mean. The researcher also used inferential statistics with the help of linear regression models. The model established the effect credit risk management had on the repayment of loans. From the findings, the study found that the terms of credit, credit standards, collection policy and credit policy had an effect on the performance of the firms. According to the study findings, the proper credit management system is an essential party of any firm and cannot be ignored by any firm that deals with credit services. Proper Credit management increases the profitability and stability of a firm.

Moti (2012) studied the effectiveness of credit management system on loan performance: empirical evidence from microfinance sector in Kenya. The goal of the research was to determine how effective credit management was on the performance of loan in MFI. The specific goals was to determine the effect of control measures, credit terms, credit risk, credit collection policies and credit appraisal on the performance of loans. The study used a descriptive research method. The respondents who provided the data were officers who worked at MFI in Meru. The findings showed that the collection policy highly affected the repayment of loans with =12.74, P=0.000 at 5% significance level.

Pyle (2013) studied the bank risk management and identified that the banks among other financial firms need to meet the requirement for management of their risks and capital. However this was not the only essential requirement for the firms to establish proper system for risk management. It was also recommended that managers needed to give proper insights on the best places to direct the firm’s resources where the best rewards could be obtained. The managers were required to estimate the accurate possible loses of each of the risk so that they could stay within the limits of the firm’s capital. They were required to seek mechanisms that could enable them take the required risks by individuals and the different departments.

Owizy (2013) examined management of credit impact on financial performance of Nigerian banks, the case of UBA Plc. Banks annual reports provided the secondary data which was
obtained from sampled and accounts for three years 2004-2008. For data analysis regression, descriptive and correlation methods were used. According to the results management of credit did affect Nigerian banks profitability.

Mwangi (2010) investigated on factors that affect MFIs credit risk management practices in Kenya. The study’s specific objectives included how portfolio quality, market infrastructure and market concentration affected the credit risks of MFIs. According to the study results the three factors did affected credit risk of MFIs. Nyakeri (2012) carried out a research on how practices relating to management of credit affects financial performance in SACCOS in Nairobi . The research specific objectives included the effect of credit approval process, loan portfolio, credit score and the Risk analysis on the profitability of the MFIs. According to the findings the credit risk analysis improved the firm’s profitability, loan portfolio and returns of the MFIs.

Nagarajan (2011) assessed the risk management for MFIs in Mozambique concluded that the process of managing risks is ever changing and could be developed and tested when risk occurred. The processes need to consider the commitment of all the firm stakeholders for it to be planned and executed properly. An encouraging finding was that minimizing losses was possible by managing cash flow properly management of cash flows and portfolios, by coming up with robust institutional infrastructure, use of skilled employees and insisting of client discipline and effectively coordinating the stakeholders.

VI. Methodology

The section provides an overview of the key methodology adopted for the study. The research used a descriptive survey design. The target population is usually characterized by differing traits and is sometimes referred to as theoretical population. In view of Association of Microfinance Institutions (2016), there are 55 MFIs in Nairobi Central Business District, Kenya. The study adopted a census of all the 55 MFIs. In particular, the study selected 3 respondents from each of the 55 MFIs hence a target population of 165. In particular, these were: credit managers, finance managers and credit officers in the microfinance institutions in Nairobi Central Business District that is one credit manager, one finance manager and one credit officer in the MFIs to be studied. Purposive sample was used to pick respondents who were credit managers, finance managers and credit officers.

The study used questionnaire for purposes of primary data collection. Questionnaires were administered using drop-and-pick-later method. Data was analyzed using descriptive analysis (mean, frequencies and standard deviation) and multiple regression analysis. Tests for normality, multicollinearity and heteroscedasticity were conducted to ensure that data was suitable for purposes of regression analysis. The results on the 3 tests were in the affirmative. Output was presented in tables and graphs. SPSS software was used to aid data analysis.

The regression model is presented below:

\[ Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \varepsilon \]
Where:

\[ Y = \text{Financial Performance}, \beta_0 = \text{constant}, \beta_1, \ldots, \beta_4 = \text{Coefficients}, X_1 = \text{Client appraisal}, X_2 = \text{Credit risk control}, X_3 = \text{Collection Policy}, X_4 = \text{Terms of Credit}. \]

VII. Results and Findings

The study administered 165 questionnaires out of which 158 were filled and returned. This constituted a 96% response rate. Data analysis, interpretation and discussion are presented hereunder.

A. Descriptive Analysis

The first objective of the research study was to determine the effect of client appraisal on financial performance of MFIs in Nairobi CBD. Results are shown in table 1

<table>
<thead>
<tr>
<th>Statements</th>
<th>Strongly Disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly Agree</th>
<th>Mean</th>
<th>Std. Dev.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Appraisal of client is a useful strategy for credit management.</td>
<td>9</td>
<td>26</td>
<td>22</td>
<td>77</td>
<td>24</td>
<td>3.5127</td>
<td>1.11010</td>
</tr>
<tr>
<td>Personnel of Microfinance Institutions are competent for performing appraisal of clients.</td>
<td>11</td>
<td>26</td>
<td>14</td>
<td>61</td>
<td>46</td>
<td>3.6646</td>
<td>1.24977</td>
</tr>
<tr>
<td>Client appraisal puts into consideration the personality of the customers looking for facilities to offer credit.</td>
<td>14</td>
<td>18</td>
<td>15</td>
<td>48</td>
<td>63</td>
<td>3.8101</td>
<td>1.31213</td>
</tr>
<tr>
<td>Collateral aspects are put into consideration while carrying out client appraisal.</td>
<td>10</td>
<td>16</td>
<td>30</td>
<td>42</td>
<td>60</td>
<td>3.7975</td>
<td>1.22998</td>
</tr>
<tr>
<td>Loan defaults can emerge in the instances when customer’s capacity is not assessed.</td>
<td>14</td>
<td>16</td>
<td>29</td>
<td>62</td>
<td>37</td>
<td>3.5823</td>
<td>1.20622</td>
</tr>
<tr>
<td>Appraisal of client examines on customer’s ability to fulfil his financial obligations.</td>
<td>17</td>
<td>16</td>
<td>33</td>
<td>48</td>
<td>44</td>
<td>3.5443</td>
<td>1.28982</td>
</tr>
</tbody>
</table>

Source: Research Data, 2018

From the results presented in table 1 above, the study established that mean values of range 0.5 to 2.4 indicate disagreement, 2.5 to 3.4 indicate neither agreeing nor disagreeing results, and 3.5 to 4.4 indicate agreement. From the results in table 4.2 above the mean values are between 3.5 to 4.4 therefore, the respondents agreed that appraisal of client is a useful strategy for credit
management, personnel of Microfinance Institutions are competent for performing appraisal of clients, client appraisal puts into consideration the personality of the customers looking for facilities to offer credit, collateral aspects are put into consideration while carrying out client appraisal, loan defaults can emerge in the instances when customer’s capacity is not assessed and appraisal of client examines on customer’s ability to fulfil his financial obligations.

Inkumbi (2009) contends that capital or equity and the security provided by the borrower as the major challenges entrepreneurs face when they want to get capital. This is so common especially for those starting out in business or those who lack sources of capital or assets that they can provide as collateral to lenders. Efforts taken up to address the challenges existing in access to finance should look into the challenge that entrepreneurs face when trying to access capital or collateral required by most financial institutions. A collateral is one of the most used ways to guarantee that the borrower will pay and if not the collateral can be used as security.

The second objective of the study was to establish the effect of credit risk control on financial performance of microfinance institutions in Nairobi Central Business District. Results are as shown in table 2 below.

Table 2: Effect of Credit Risk Control on Financial Performance

<table>
<thead>
<tr>
<th>Statements</th>
<th>Strongly Disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly Agree</th>
<th>Mean</th>
<th>Std. Dev.</th>
</tr>
</thead>
<tbody>
<tr>
<td>A useful strategy in improving organization performance is to impose limits on loan size</td>
<td>11</td>
<td>11</td>
<td>23</td>
<td>55</td>
<td>58</td>
<td>3.8734</td>
<td>1.18770</td>
</tr>
<tr>
<td>Enhancing performance of an organization can be achieved by use of credit checks on regular basis</td>
<td>7</td>
<td>12</td>
<td>22</td>
<td>48</td>
<td>69</td>
<td>4.0127</td>
<td>1.13422</td>
</tr>
<tr>
<td>Loan repayment can be improved through Flexible repayment periods.</td>
<td>9</td>
<td>15</td>
<td>19</td>
<td>77</td>
<td>38</td>
<td>3.7595</td>
<td>1.09678</td>
</tr>
<tr>
<td>Customers get committed when Penalty for late payment is introduced.</td>
<td>5</td>
<td>18</td>
<td>18</td>
<td>71</td>
<td>46</td>
<td>3.8544</td>
<td>1.06374</td>
</tr>
<tr>
<td>By using customer credit application forms there is improvement in monitoring and management of credit as well</td>
<td>8</td>
<td>15</td>
<td>18</td>
<td>46</td>
<td>71</td>
<td>3.9937</td>
<td>1.18642</td>
</tr>
<tr>
<td>involvement of credit committees in making decisions concerning controls of credit risk</td>
<td>11</td>
<td>18</td>
<td>16</td>
<td>81</td>
<td>32</td>
<td>3.6646</td>
<td>1.13211</td>
</tr>
</tbody>
</table>
are important in minimizing default performance of MFI is affected by interest rates charged on loans affect

| 7 | 16 | 25 | 32 | 78 | 4.0000 | 1.21036 |

Source: Research Data, 2018

In view of the results in table 2 above, The study established that credit checks on regular basis enhances organization performance, interest rates charged on loans affect performance of MFI, the use of customer credit application forms improves monitoring and credit management as well, imposing loan size limits is a viable strategy in improving organization performance, penalty for late payment enhances customers commitment to loan repayment, flexible repayment periods improve loan repayment and credit committees involvement in making decisions regarding credit risk controls are essential in reducing default/credit risk. Essential credit controls used include loan product design, delinquency management and credit committees (Churchill & Coster, 2011).

The third objective of the study was to determine the effect of collection policy on financial performance of microfinance institutions in Nairobi Central Business District. The results are as shown in table 3 below.

Table 3: Effect Collection Policy on Financial Performance

<table>
<thead>
<tr>
<th>Statements</th>
<th>Strongly Disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly Agree</th>
<th>Mean</th>
<th>Std. Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>Collection policies available have helped in effective management of credit practices.</td>
<td>9</td>
<td>14</td>
<td>17</td>
<td>93</td>
<td>25</td>
<td>3.7025</td>
<td>1.02522</td>
</tr>
<tr>
<td>Microfinance institutions have been facing a challenge in the formulation of policies regarding collection.</td>
<td>7</td>
<td>16</td>
<td>20</td>
<td>68</td>
<td>47</td>
<td>3.8354</td>
<td>1.09928</td>
</tr>
<tr>
<td>implementation of guarantee policies gives a chances to recover loan in case in the instance of defaulters</td>
<td>11</td>
<td>14</td>
<td>27</td>
<td>50</td>
<td>56</td>
<td>3.7975</td>
<td>1.21435</td>
</tr>
<tr>
<td>In the process of improving recovery of delinquent loans, an effective way is staff</td>
<td>6</td>
<td>19</td>
<td>18</td>
<td>106</td>
<td>9</td>
<td>3.5886</td>
<td>.91087</td>
</tr>
</tbody>
</table>

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incentives.

To better the state of management of credit, reviews concerning collection policies have been done on a regular basis.

A strict policy is effectual in recovery of debt compared to a moderate policy.

Source: Research Data, 2018

The results in table 3 above indicate that regular reviews have been done on collection policies to improve state of credit management, a stringent policy is more effective in debt recovery than a lenient policy, formulation of collection policies have been a challenge to the microfinance institutions, enforcement of guarantee policies provides chances for loan recovery in case of loan defaults, available collection policies have assisted towards effective credit management practices and staff incentives are effective in improving recovery of delinquent loans. Many financial firms send letters to clients who do not pay on time for instance after ten days pass after the payment date. Others will call but if the money is not provided within thirty days then the details of the borrower might be given to a collection firm.

This kind of policy is important for those who might not be in a hurry to make their payments on time or those who have a history of not paying (Stiglitz & Weiss, 1981). Therefore such efforts quicken the payments from slow payers and reduce the bad debts. Payments when made in time increase cash flow and keep the bad debts at manageable levels. However the policy should not have extreme practices especially to loyal customers as they might seek alternatives (Padilla & Pagano, 2000).

The final objective of this research study was to assess the effect of terms of credit on financial performance of microfinance institutions in Nairobi Central Business District, Kenya. The findings are as shown in table 4 below.

<table>
<thead>
<tr>
<th>Statements</th>
<th>Strongly Disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly Agree</th>
<th>Mean</th>
<th>Std. Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit terms specifies the credit period given to customers.</td>
<td>8</td>
<td>11</td>
<td>15</td>
<td>78</td>
<td>46</td>
<td>3.9051</td>
<td>1.05751</td>
</tr>
</tbody>
</table>
Credit terms specify the interest rates charged on the loans advanced to customers.

Terms of credit include the period of time for loans approval.

Credit terms are assessed by client’s position according to the ratio analysis.

Credit terms are evaluated by the trends in cash flow.

Credit terms are evaluated by the looking at capital position.

Credit terms are important in ensuring that customers do not default their loan repayment.

Table 5: Credit management practices, Competition, Regulatory framework and financial performance

| Source: Research Data, 2018 |

In view of the results presented in table 4 above, the study established that credit terms are evaluated by the looking at capital position, credit terms include the length of time to approve loans, credit terms specify the interest rates charged on the loans advanced to customers, credit terms are important in ensuring that customers do not default their loan repayment, credit terms are evaluated by the trends in cash flow, credit terms specifies the credit period given to customers and credit terms are evaluated by the position of the client as indicated by the ratio analysis.

Riach (2010) indicates that terms of credit are usually determined by the instrument used to advance credit, credit period terms of discount and the credit amount. The terms can be the length of time taken to approve the loan which is the time taken since a customer applies a loan to when it is disbursed. It is affected by ratio analysis, capital position and availability of cash flow. Another credit term factor is the loan maturity which is the duration it takes for the loan and its interest to mature. Cost of the loan is yet another factor. This is the interest that the loan attracts. Different financial institutions charge different rates depending on their competitor’s interest rates (Padilla & Pagano, 2000).
The output in table 5 above indicates that regulatory framework has a significant effect on the relationship between client appraisal and financial performance and competition has a significant effect on the relationship between client appraisal and financial performance. The management of credit starts when the sale is done and it becomes complete when the total payment is made. The payment part is just as important as the sale (Scheuf, 2012). What’s more, a sale is only successful when the payment is done. It is therefore paramount that the lender will ensure that the person he lends to is able to make timely and full payments otherwise failure to follow such good principles of lending results to defaults which reduces profits (Nzotta, 2004).

**B Regression Analysis**

The study used multiple regression analysis to further analyze the data. Model summary is used to analyse the variation of dependent variable due to the changes of independent variables. The study analyzed the variations of financial performance of MFIs due to client appraisal, credit risk control, collection policy and terms of credit.

<table>
<thead>
<tr>
<th>Table 6: Model Summary</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Model</strong></td>
</tr>
<tr>
<td>1</td>
</tr>
</tbody>
</table>

Source: Research Data, 2018

From the results in table 6 above, the simple correlation coefficient (r) indicates the nature and strength of relationship between the study variables. The study finds a strong positive relationship between the study variables as shown by 0.990. Adjusted R-squared is 0.981 indicating that 98.1% variation of financial performance of MFIs is attributed to changes of client appraisal, credit risk control, collection policy and terms of credit collectively. The remaining 1.9% is attributed to other factors beyond the scope of this study.
The analysis of variance ANOVA is used to determine whether the model overall is a good fit. From the ANOVA statistics, the processed data (population parameters) had a significance level of 0.000. This shows that the data is ideal for making conclusions on the population’s parameter as the p-value is less than the significance level of 0.05.

In view of the results in table 7 above, The F calculated was greater than F critical $1979.664 > 2.431$. This shows that project top client appraisal, credit risk control, collection policy and terms of credit significantly influences financial performance of MFIs.

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>Do</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Regression</td>
<td>210.032</td>
<td>4</td>
<td>52.508</td>
<td>1979.664</td>
</tr>
<tr>
<td></td>
<td>Residual</td>
<td>4.058</td>
<td>153</td>
<td>.027</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>214.090</td>
<td>157</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Research Data, 2018

The regression equation was extracted from table 8 above is as follows:

$$Y = 0.257 + 0.062 X_1 + 0.514 X_2 + 0.219 X_3 + 0.270 X_4$$

In view of the results in table 8 above, Client appraisal is statistically significant in explaining financial performance of MFIs as shown by ($\beta = 0.062$). This shows that client appraisal had significant positive relationship with performance of the MFIs. This is an indication that a unit...
increase in client appraisal will result to an increase in financial performance of the MFIs. Credit risk control is statistically significant in explaining financial performance of MFIs as shown by \((\beta = 0.514)\). This shows that credit risk control had significant positive relationship with financial performance of MFIs. This implies that a unit increase in credit risk control will result to an increase in financial performance of the MFIs. In addition, Collection Policy is statistically significant in explaining financial performance of MFIs as shown by \((\beta = 0.219)\). This shows that Collection Policy had significant positive relationship with financial performance of the MFIs. This implies that a unit increase in Collection Policy will result to an increase in financial performance of the MFIs. Terms of Credit is statistically significant in explaining financial performance of the MFIs as shown by \((\beta = 0.062)\). This shows that Terms of Credit had significant positive relationship with performance of MFIs. This is an indication that a unit increase in Terms of Credit will result to an increase in financial performance of MFIs.

The statistical significance of the independent variables in explaining financial performance is captured throughout the p-values. Collection policy is statistically significant in explaining financial performance of MFIs as indicated by \((P = 0.017)\). This is an indication that collection policy has a significant and positive effect on financial performance of the MFIs studied. In addition, terms of credit have a statistically significant effect in explaining financial performance of MFIs as shown by \(P = 0.000\). (Client Appraisal is statistically significant in explaining financial performance of MFIs as indicated by \(P = 0.253\); this suggests that client appraisal has a significant and positive effect on financial performance of the MFIs. Credit Risk Control is statistically significant in explaining financial performance of MFIs as indicated by \(P = 0.000\); this indicates that it has a positive and significant effect on financial performance of the MFIs

Consequently, with respect to hypothesis testing, the study supports the null hypothesis that Client appraisal does not have a significant effect on financial performance of MFIs in Nairobi CBD, Kenya while it rejects the rest of the null hypotheses that Credit risk control, Collection policy and Terms of credit do not have a significant effect of financial performance of MFIs in Nairobi CBD, Kenya.

VIII. Conclusions and Recommendations
The study makes several conclusions from the findings; recommendations are equally made out of the findings and conclusion as captured below.

A. Conclusion
The study found that client appraisal was statistically significant in explaining financial performance of the MFIs. This indicates that client appraisal had a positive relationship with financial performance. The study concludes that a unit increase in client appraisal would lead to an increase in financial performance. In addition, Credit risk control was statistically significant in explaining financial performance of the MFIs. This is an indication that credit risk control has a positive relationship with financial performance of the MFIs. The study concludes that increase in credit risk control leads to increased financial performance the MFIs studied. In addition, collection policy was statistically significant in explaining financial performance of the MFIs.
This indicates that collection policy had significant positive relationship with financial performance of MFIs. The study concludes that positive increase in collection policy would result to an increase in financial performance of micro financial institutions. Finally the study established that terms of credit were statistically significant in explaining financial performance. This shows that terms of credit had significant positive relationship with financial performance of the MFIs. The study concludes that positive increase in terms of credit will result to an increase in financial performance of micro financial institutions.

**B. Recommendations**

The study also recommends that the MFIs need to enhance their client appraisal techniques to avoid having un-credit worthy clients leading to loan delinquency. This will enable improvement of financial performance by having credits being paid and having a positive performing loan portfolio in terms of recovery. Micro-finance institutions have suffered loan losses through relaxed lending standards, the borrower’s perception and unguaranteed credits. The study therefore recommends that the MFIs enhance their credit risk controls by creating profile assessment database of prospective and current borrowers and guarantors that can be shared among the MFIs to help minimize non-performing loans. This will help in improving their financial performance.

**IX. Contribution to Knowledge**

The makes several contributions that are noteworthy. Academicians will use the research outcome as a basis for discussion on financial performance and credit management for financial institutions especially micro enterprises. The study will also be an addition to the body of knowledge in the finance discipline and bridge the gap existing in the study of credit management especially in the Kenyan Microfinance context where there is scanty empirical literature. The study also makes contributions to improve the practice and the existing knowledge on financial performance and credit knowledge.

**Areas for Further Studies**

This study suggests further empirical investigation on credit appraisal and why it does not seem to significantly affect financial performance of MFIs studied though this has a strong support from theory in terms of being a key factor in explaining financial performance of financial institutions. The study found that MFIs experience loan defaulting from clients, a study should be done on the reasons for loan defaults from clients’ perspective in microfinance institutions. Further study can be done on the effectiveness of collection policies adopted by MFIs.

**REFERENCES**


