

3000h


**FACTORS CONTRIBUTING TO NON-PERFORMANCE OF LOANS IN  
AGRICULTURAL FINANCE CORPORATION OF KENYA NAIROBI REGION**

**BY  
KIPKIRUI SOO SELOTE  
D53/PT/CTY/13844/2009**

**KENYATTA UNIVERSITY LIBRARY**

**A RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILLMENT OF THE  
AWARD OF THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION  
(FINANCE OPTION), SCHOOL OF BUSINESS KENYATTA UNIVERSITY**

**OCTOBER. 2011**  
Kipkirui, Soo Selote  
*Factors contributing  
to non-performance of*




2012/391359

**DECLARATION**

This research project is my original work and has not been presented for examination in any other university. No part of this entire project may be reproduced without a prior permission of Kenyatta University or the Author.

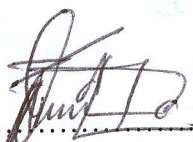
**STUDENT**

Name: KIPKIRUI SOO SELOTE

Signature.......... Date..... 27/10/2011.....

**SUPERVISORS**

This project has been submitted for examination with our approval as the University appointed supervisors.

Signature.......... Date..... 27/10/2011.....

DR. JAGONGO A.O

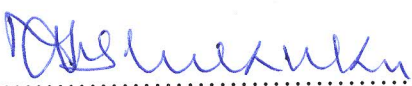
Lecturer, Department of Accounting & Finance

Signature.......... Date..... 28-10-11.....

MR. J.MUTURI

Lecturer, Department of Accounting & Finance

This Research Project has been submitted for examination with my approval as the Chairman of department.

Signature.......... Date..... 27/10/2011.....

MR. FREDRICK S. NDEDE



## **DEDICATION**

This piece of work is dedicated to all whose prayers and support enabled me to get everything I ever needed while in my academic endeavours.

Special dedication goes to my employer, work mates and classmates for their total support and encouragement they accorded me during this course. Thank you for being there for me and sacrificing so much to make sure I succeed in this program.

I also sincerely dedicate this project to God The Almighty who despite my heavy working schedule, disappointment and demand of academic environment provided me with the strength, courage, confidence and endurance to overcome the many obstacles that came under my way to academic excellence.

## ACKNOWLEDGEMENT

First and foremost is my inexpressible gratitude goes to God Almighty for giving me the opportunity and the strength to go through this program. It is by His sufficient and abundant grace and mercy that i am able to complete it, God i am very grateful indeed.

I also want to acknowledge my dear parents Mr. Mathew Biwott and the late Mrs. Ruth Biwott for laying this foundation of education in my life. They sacrificed a lot that I may go to school and without this sacrifice I would not be where I am today. Thank you mum and dad

Special thanks go to my supervisors Dr. Jagongo.A.O and Mr.J.Muturi for their guidance, support and positive criticism that enabled me to complete this project. You were always there for me when I needed you and I am so grateful to you. You graciously gave me the benefit of your knowledge and went beyond the call of your duties in painstakingly my work and guiding me throughout the writing of this project.

On home front, my profound heartfelt gratitude goes to my parents, my sisters and brothers whose financial assistance and moral support enabled me to pursue the whole course successfully.

Finally, I wish to solely take responsibility and do seek penance for all the literacy and editorials in this work and appreciate my dear ones not mentioned here in for their encouragement.

I salute you all and May God bless you all!

Thank You

## ABSTRACT

In the recent past particularly in the last five years thus 2005-2010 the AFC has experienced huge non-performing loan portfolio. This has been to the tune of Ksh.7 billion comprising of 1,632 clients. This kind of scenario unless expeditiously dealt with could in the long- run bring down this giant Agro-financing institution. The root causes of these non-performing loan portfolios are not yet fully established. The purpose of this study therefore is to establish the factors contributing to non- performance of loans at Agricultural Finance Corporation of Kenya. It seeks to determine the effect of initial loan appraisal, extent to which loanees' level of financial management skills affect NPLs, effect of credit policies and loan recovery strategies on non-performance of loans at AFC. This research will be conducted within a business environment that is turbulent to all agro-financial institutions. This business environment is not only volatile, but surprising in nature. This is witnessed in the rising economic inflation, world recession, increase in cost of fuel, drought and famine, scanty harvest by farmers, among others. The study adapted a case study research design. Data was collected by use of questionnaires which were administered by the researcher. The research targeted a single study unit AFC. A total of 4 heads of departments from credit, debt collection and recovery, finance and audit were targeted to response to the questionnaires. The selections of the four heads were based on purposive sampling. An additional 39 loan defaulters and 3 non-defaulters who were farmers were selected by use of stratified and random sampling as respondents to the study. This gave a total of 46 respondents. The purpose of choosing the heads was because they were in charge of the loans management and therefore they had adequate information on reasons of non-performance of loans from the company's point of view. The purpose of selecting farmers as respondents was due to the fact that they were the direct users and beneficiaries of the loans and therefore they had accurate information on the reasons for non-performance of loans.

The overall response rate was 64% of the 46 target respondents. All the 4 heads of departments and 25 farmers out of 42 responded to the questionnaires. Data was analyzed by use of descriptive statistics utilizing SPSS .This was useful in correlation analysis of the variables under study. The presentation of data was done by way of graphs, tables, pie charts and frequency distribution tables. The research study found out that the loan recovery strategies had the greatest contribution to NPLs at AFC. This was followed by level of loanees financial skills which contributed to NPLs to a greater extent. The third and fourth ranked factors contributing to NPLs were found to be AFC credit policies and initial loan appraisal respectively. This study recommends that AFC top management creates a working relationship with other lending institutions to ensure that the farmers do not abuse the well kept farming financial records to acquire more loans from the other financial institutions whose recovery would create huge NPLs on the part of AFC loans advanced to them. Also, the Government through the relevant ministry should set out less bureaucratic processes for "grant of permission to carry out research" in state parastatals. Finally, AFC management should improve her loan appraisal and credit policies or rather outsource partially the services of recovery of non-performing loans specifically and embrace business development and new technology requirements as a basis for improved productivity by loanees in order to minimize NPLs.

## TABLE OF CONTENTS

TITLE PAGE.....	i
DECLARATION .....	ii
DEDICATION .....	iii
ACKNOWLEDGEMENT .....	iv
ABSTRACT.....	v
TABLE OF CONTENTS.....	vi
OPERATIONAL DEFINITION OF KEY TERMS .....	viii
ABBREVIATIONS AND ACRONYMNS .....	ix
LIST OF FIGURES .....	x
LIST OF TABLES .....	xi
<b>CHAPTER ONE</b> .....	<b>1</b>
<b>INTRODUCTION</b> .....	<b>1</b>
1.1 Background of the Problem .....	1
1.1.1 Agricultural Finance Corporation development and Future Outlook.....	6
1.2 Statement of the Problem.....	7
1.3 Objectives of the Study.....	8
1.4 Research Questions.....	8
1.5 Significance of the Study .....	9
1.6 Scope and limitations of the Study .....	10
1.7 Summary .....	11
<b>CHAPTER TWO</b> .....	<b>12</b>
<b>LITERATURE REVIEW</b> .....	<b>12</b>
2.1 Introduction.....	12
2.2 Theoretical Orientation.....	12
2.3 Loaning Terms and Conditions.....	15
2.4 Loaning Procedures .....	16
2.5 Cost of Loan Capital .....	18
2.6 Capital Assets Pricing Model –CAPM .....	21
2.7 Theoretical Framework.....	22
2.7.1 Portfolio theory .....	23
2.7.2 Liquidity Preference.....	23
2.7.3 Austrian Theory of the Business Cycle .....	24
2.9 Conceptual Framework.....	26
2.9 Conceptual Framework.....	27
2.9.1 Financial Management skills of loanees .....	28
2.9.2 Initial Loan Appraisals.....	28
2.9.3 A.F.C Credit Policies .....	28
2.9.4 Loan Recovery Strategies .....	29
2.9.5 Inflation, Natural calamities and loanees attitude.....	29
<b>CHAPTER THREE</b> .....	<b>31</b>
<b>RESEARCH METHODOLOGY</b> .....	<b>31</b>
3.1 Introduction.....	31
3.2 Research Design.....	31
3.3 Target Population.....	31

3.4 Sample and sampling techniques .....	32
3.5 Data Collection Instruments .....	33
3.5.1 Pilot Testing .....	34
3.6 Data Analysis and Presentation .....	34
<b>CHAPTER FOUR</b> .....	35
<b>DATA ANALYSIS AND FINDINGS</b> .....	35
4.1 Introduction.....	35
4.1.1 Respondents personal data.....	35
4.1.2 Response According to Gender parity .....	36
4.1.3: Response in duration of service for HODS and business experience for loanees ..	36
4.1.4 Response in Accordance to Academic qualification .....	37
4.1.5 Response on financial management skills by loanees .....	38
4.1.6 Response in how often the farmers maintained their books of farm records.....	39
4.2: Response in terms of the clustered amounts of loans under default.....	41
4.2.1 Response by loanees for justification of default.....	42
4.3 Response on effect of AFC loaning procedures on NPLs by HODs .....	43
4.3.1 Response by loanees on effect of AFC loaning procedures .....	45
4.4 Response by loanees on borrowing from other financial institutions.....	46
4.5 Response on effect of loan recovery strategies employed by AFC on reduction or elimination of NPLs.....	47
<b>CHAPTER FIVE</b> .....	49
<b>SUMMARY, CONCLUSIONS AND RECOMMENDATIONS</b> .....	49
5.1 Introduction.....	49
5.2 Summary of findings.....	49
5.3 Conclusion .....	52
5.4 Recommendations.....	55
5.5: Recommendations for Further Research.....	55
REFERENCES .....	56
APPENDICES .....	60
APPENDIX I .....	60
INTRODUCTORY LETTER.....	60
APPENDIX II .....	61
QUESTIONNAIRE TO HEADS OF DEPARTMENT.....	61
APPENDIX III.....	66
QUESTIONNAIRE FOR FARMERS.....	66

## OPERATIONAL DEFINITION OF KEY TERMS

- Non- performing loans** - Loans whose repayment period has expired and there is no likelihood of it being made good. They exist beyond their recovery period
- Interest rate** - A charge made by lender to a borrower for use of the borrowed funds. It is the price for liquidity foregone by a loanees
- Principal sum** - Amount of money borrowed by farmers under a debt instrument. It is the final sum before the interest factor is loaded
- Inflation rate** - This is the rise in general price levels of farm inputs and produce with a corresponding decrease in purchasing power of the farmers .There exists an inverse relationship between them.
- Risk** - The degree of potential variability of outcomes from expected values. It is the uncertainty associated with the forecasted loan amounts to be recovered
- Impaired loans-** Same as non- performing loans but when the term used in accounting

## ABBREVIATIONS AND ACRONYMNS

CBK	Central Bank of Kenya
AFC	Agricultural Finance Corporation
ICDC	Industrial & Commercial Development Corporation
IDB	Industrial Development Bank
NPLs	Non- Performance of Loans
CAPM	Capital Asset Pricing Model
KUSCCO	Kenya Union of Savings and Credit Co-operatives
FI	Financial Institution(s)
FPIP	Forceful Property in Possession
SPIP	Sale of Property in Possession

## LIST OF FIGURES

Figure 2.1 Conceptual Framework .....	27
Figure 4.1: Age of Respondents.....	35
Figure 4.2: Gender Responses .....	36
Figure 4.3: Duration of service and business experience .....	37
Figure 4.4: Academic Qualification for HODs.....	37
Figure 4.5: Academic Qualification for loanees .....	38
Figure 4.6: Percentage of loanees who maintained accounting records .....	38
Figure 4.7: Maintenance of financial records .....	39
Figure 4.8 : Graduate loans advanced under default.....	41
Figure 4.9: AFC loaning terms and conditions.....	43
Figure 4.10: The most challenging and mandatory credit loan term and conditions by AFC.....	44
Figure 4.11: AFC loaning procedures.....	45
Figure 4.12: loans expensed for non-intended AFC purpose .....	46
Figure 4.13: Percentage of Loanees.....	46
Figure 4.14: AFC Loan recovery strategies .....	47

## LIST OF TABLES

Table 3.1: Category of Loanees, number of defaulters and loanees sample.....	33
Table 3.2: Sample size .....	33
Table 4.1: The reasons given by loanees for records keeping purposes.....	40
Table 4.2: Loanees' justification for default.....	42
Table 5.1: The Rating of factors contributing to NPLs at AFC.....	54

# CHAPTER ONE

## INTRODUCTION

### 1.1 Background of the Problem

Agro-based financial institution that offers savings and credit services to farmers which is a closed shop is facing realities of market competition due to the liberalization of the economy, excess liquidity in commercial banks, inadequate financial resources resulting to low liquidity in lending institutions among other factors (David & Murungi, 2004). The institutions have now become a household-name as millions of Kenyans rely on them, almost entirely for their basic needs of food, shelter and clothing and even school fees and medical expenses. They exist as viable and credible alternatives to formal banking institutions which to a large extent are beyond the reach of ordinary Kenyans. They provide the financial support and advantage which lies in the strong structure and shared values of trust mutual and development. They have mobilized funds over kshs.150 billion making them one of the major contributors to national savings (KUSCCO, 2007). The agro-based financial Act 2008 required that loans policy and procedures manual specifying the criteria and procedures applicable in the evaluation, processing, approval, documentation and release of loan or credit facilities are put in writing by every licensed society. Loans must be disbursed according to the established credit policy and procedures as given by David & Murungi, 2004.

Rose (2002) observed that written policies set the levels of authority for granting loans. The policies defined the type of loans offered, loan terms, interest rate policies, loan ceiling and concentration limits. The lending policies provided guidelines for eligibility, information requirements, security and collateral requirements and terms of review. The development commented that most institutions did not have clear loaning policies which they should strictly comply with when granting loans to management committees, staff and farmers (KUSCCO, 2007). The loan policy gave the management specific guidelines in making individual loan decisions and in shaping the institution's overall loan portfolio. This ensured that regulatory standards were met and promoted profitability in the organization. A written loan policy statement was beneficial as it communicated to employees in the loan department what procedures they must follow and what their

responsibilities were. Therefore it helped the organization to move towards a loan portfolio, controlling its risk exposure and satisfying regulatory requirements (Rose, 2002). Any exceptions to the policy should be fully documented and reasons for it listed. While any written policy must be flexible due to continuing changes in economic conditions and regulations, violation of loan policy should be infrequent events. Loans department should consider all such changes and periodically review all loans until they reach maturity. Loan review is crucial as it helped management to identify problematic loans more quickly and acted as a continuing check on whether loans policy was adhered to by loan officers. The commercial banks reviewed loans more efficiently such that they were able to top up loans-faster using modern technology unlike institutions (Rose, 2002)

According to Mwaura (2003), it was revealed that the study underscored the need to formulate a prudent credit policy for individual manufacturing firms as well as the need for a conducive macro and micro environment in order to synchronize benefits of using credit facilities to facilitate financial mobilization of firms which can be likened to institutions also. Therefore formulation of a prudent credit policy for institution is important to avoid loss of its market to its rivals and improve performance in terms of development. According to David & Murungi (2004), the types of loan offered by institutions are mainly short-term and long-term loans. The short-term loans are those repayable within a year and are usually meant for school fees and other emergency expenses. The amounts are generally small is guaranteed by government and did not help farmers to increase their overall earning capacity. Long-term or development loans are for larger amounts and had a longer term effects. They helped farmers to increase their earning capacity through success of projects financed by these loans. Repayment period was usually for more than one year, No collaterals are given by members in form of property pledged except the secured guarantors and thus management should consider securing them in that manner.

There was evidence that repayment of institutions loans was not being taken seriously by members due to low interest rate charged, lack of suitable guarantors and poor management systems for loan collection. As a result most of them were caught up in

serious cash flow problem. The situation was complicated further by overdrafts whereby institutions negotiated with commercial banks at higher interest rates are loaned to members at lower interest rates (David & Murungi, 2004)

Credit analysis refers to what makes a good loan. The credit department must answer three questions regarding each loan application (Rose, 2002)

- a) Is the borrower credit worthy?
- b) Can the loan agreement be properly structured and documented for adequate protection of stakeholders and ensure that customer's probability of loan repayment is high without excessive strain?
- c) Can the institution perfect its claim against the assets or earnings of the customer so that, in the event of default the funds can be recovered rapidly at low cost and with low risk?

The borrower's credit worthiness is the ability of a customer to pay out the credit as and when due with a comfortable margin of error. This usually involves a detailed study of five aspects of loan application: character, capacity, cash, collaterals and conditions.

Character refers to customer's responsibility, truthfulness, serious purpose and intention to repay loan. If the customer is insincerely promising to use borrowed funds as planned and in repaying as agreed, the loan should not be made to avoid a credit problem. The loan officer must be convinced that a customer has a well defined purpose for requesting a credit and has a serious intention to repay.

Capacity to borrow money refers to the authority to request a loan and the legal standing to sign a binding loan agreement by a customer. Thus the borrower must not be a minor and supportive documents must be provided for example a copy of resolution of a borrowing company or pay-slip of an employee. According to Garman & Fogue (1997) capacity refers to the income available to make repayment. Having a substantial income, holding the same job for several years and having few other debt payments suggest a strong financial capacity to repay.

Cash Capital refers to the borrower's ability to generate enough cash in form of cash flow to repay the loan. Generally there are three sources used by a customer to repay a loan which includes cash flow from sales or income, sale or liquidation of assets or funds

raised by issuing debt or equity securities. There is strong preference for cash flows as the principal source of loan repayment because asset sales can weaken a borrowing customer and make the creditors position less secure. The institutions consider the current pay-slips of members to show their current pay which determines their capital base for loan consideration. Collateral refers to borrower's possession of adequate network or quality assets to provide adequate support for the loan. It is property offered and pledged to secure repayment of a loan and subject to seizure should the borrower fail to repay as defined by Garman & Fogue (1997). Lenders view credit backed by collateral as more secure. The loan officer is particularly sensitive to such features as age, condition and degree of specialization of borrower's assets. If the assets are technologically obsolete, they will have limited value as collateral due to difficulty of finding a buyer in case of loan default.

Credit risk management should include strict delinquency monitoring, loan-loss provision and collection procedures. Credit risk is measured most accurately when loans are approved and processed on the basis of "five Cs"-character, capital or cash, capacity, collateral and conditions. Loans must be disbursed according to established credit policies and procedures. Loan analysis should therefore be guided by the formula: purpose, repayment schedule, amount applied for, collaterals, terms of loan agreement, interest rate chargeable, applicant's character and experience that a member or loanee has to fulfill the purpose of loan. IMF edition, (2000) describes non-performing loan as that loan that is in default or close to default. Many loans become non-performing after being in default for three months, but depend on the contract terms. A loan is non-performing when payments of interest are past due by 90 days or more or at least 90 days of interest payments have been refinanced or delayed by agreement or payments are less than 90 days overdue but there are other good reasons to doubt that payments will not be made in full.

Credit is major form of external finance used by households, firms and governments in economy (Carthart, 2000). Credit finance encompasses any financing which requires unconditional payment or settlement in the future. In Kenya, credit continues to play an

important role in the country's economy. The Central Bank of Kenya has estimated that the total domestic credit as at 30<sup>th</sup> June 2009 was reckoned Kshs. 408billion (CBK, 2009). When borrower approaches a financial institution for a loan facility the intention is to use it to finance a planned project and eventually repay the loan. Customers borrow funds for various reasons. The most common objectives for borrowing are for acquisition of assets like house, land or cars. As for business people, the need for funds would be to increase stock -in- trade, capital level or meet some current expenditure .In addition to the above primary needs the borrowers do sometimes approach financial institutions for bridging finance to take care of short-term needs.

Risks associated with borrowing differ on the basis of duration, size of the loan and whether it's a company or an individual borrowing. A multitude of factors initiate shifts in the supply for funds providing changes in interest rate, for instance inflation expectation, treasury policy, business cycle and the state of the budget. Most financial institutions have until recently had to nurture excessive risk averse attitude. It is the role of these institutions to mobilize funds and channel them to borrowers. It is the availability of the credit in the economy that growth may be enhanced therefore the Central Bank through an amendment to the Banking Act allowed for sharing of information about clients' credit worthiness.

Kimango (2002) indicated in his study that the wealth creation is a vital factor in a growing economy. Wealth cannot be created unless the citizens of a country are engaging in constructive business activities. These business activities require funds which are obtainable from lending institutions such as banks and other lenders through the credit financing. Agricultural Finance Corporation is one of the financial corporation's operating in Kenya. Corporations are organizations set up by the law to run services or industries on behalf of the government. The board is responsible for the day-to-day running of a corporation but gives account to the minister in charge. Kenya has several number of corporations engaged in distribution, transport, trade finance and communication to support the public. The government corporation that features prominently in distribution is Kenya Trading Corporation which was established in 1965

with sole responsibility of distribution of sugar and salt items. In transport industry, there is Railways Corporation. In financial sector, there is Industrial and Commercial Development Corporation (ICDC), Industrial Development Bank (IDB) and Agricultural Finance Corporation (AFC). The objective of these governmental financial institutions was for the government to channel funds to assist the citizens in their various development goals. Agricultural Finance Corporation was established back in 1963 through an Act of parliament to assist in development of agriculture and agro-industry in Kenya. At inception, the corporation was incorporated to take over credit of pre-independence Europeans and Africans Agricultural boards. The main function of the corporation those days was to assist in the effective and peaceful transfer of land from Europeans colonial settlers to indigenous African farmers. It also injected new capital into the farm to spur farming developments.

### **1.1.1 Agricultural Finance Corporation development and Future Outlook**

Agricultural Finance Corporation is the leading non-bank government financial institutions lending agricultural credit facilities to farmers. It has wide range of products that it finances depending upon the agri- logical sustainability of the environment. The products are basically the loan facilities that are given to farmers in order to produce the desired products; they are tailored to suit the individual farmer's unique requirement. Recently, the corporation is considering assisting their clients apart from loans to assist in farm development to include fees, loans to cope up with the divergent requirement of the clients. The outlook of the corporation looks bright especially in achieving its mission of farmers' development. This is due to the recent injection of funds by the government through Ministry of Agriculture. Other funds were also allocated by the treasury.

Furthermore, the company has done tremendous efforts in the training its workforce especially the branch managers. This is expected to bear fruits that include the harness of everyone's commitment through full utilization of each individual resource and talent to spur corporations' mission. Elsewhere, the government announcement of allocating funds to this financial institution for the next five years would in result lead to self-sustainability by the corporation. The major activity of the corporation is offering loans

subject to the provision of Agricultural Finance Corporation Act (Cap.323), which is to assist in development of agriculture and agricultural industry by making loans to co-operative societies, private Companies, local authorities and agricultural industries amongst others.

## **1.2 Statement of the Problem**

Agro-based financial institutions do not have elaborate loaning policies which they should comply with when granting loans to management staff, members and farmers as well. Thus many of them have experienced problems arising from favoritism in loan approval and fraud practiced by leaders and management. The credit policy must be flexible due to continuous changes in economic conditions and regulations. Loans department must be sensitive to these changes and periodically review all loans until they reach maturity as it is a necessity for sound lending programmes. These institutions have quality assets thus there is need to ensure that loans captured as assets should be made good as and when they fall due .When they are not being serviced or classified as non-performing then the quality of assets become poorer .It is from this poorness of assets that the term non- performance of loans arose .According to the Central Bank non - performing loans stood at 114.4billion as at March 2009, which was 50% of aggregate advances loaned out. This was attributable to certain economic variables such as inflation and general economic performance that lead to non-performance of loans. Agricultural Finance Corporation (AFC) has written off Ksh.6 billion of non-performing debt portfolio owed by farmers. This came as a relief for thousands farmers who have over the years been locked out of credit access due to inability to repay their loans. AFC puts the amount of non-performing portfolio debt comprising of 1,632 clients at a close to Ksh.7 billion as at April, 2010.

It is also imperative to note that while several researches have been undertaken on management of credit and related financial matters, little if any research has been done in the area of factors influencing non-performance of loans. Kimango, (2002) for example carried out a Study of Banks Credit Policies in Nairobi. This study highlighted the credit policies that are applicable to Nairobi banks without pointing out their significance on the

non-performance of bank loans. On the other hand, a study undertaken by Central Bank of Kenya, (2009) on the Growth in the Banking Industry, identified factors hindering the growth of banks in Kenya. Factors such as mismanagement and diversion of funds for purposes not intended for plays a major role in the increased level of impaired loans. Furthermore, lack of information has also been a factor behind high default rate and natural calamities such as death of the borrower, theft and property destruction by fire which affect the growth of firms. This research did not shade light on factors contributing to non-performance loans especially in parastatals where AFC falls. Opande (2003) examined how lending organizations predicted loans default rates among its clients .The findings showed that organizations used a "sit back" approach when dealing with the aspect of risk. His focus was on ICDC, a non-banking body .Accordingly, the seemingly never ending huge portfolio of non-performance of loans at AFC coupled with lack of adequate research on the same ,require to be addressed as a matter of urgency. Unless this is done and a lasting solution sought, AFC may in the long run be put under receivership. It is on this basis then that research needs to be undertaken on factors contributing to non-performance of loans at AFC thus the basis for this study.

### **1.3 Objectives of the Study**

This study was guided by the following specific objectives:-

- a) To find out the effect of initial loan appraisals on the NPLs at AFC
- b) To establish the extent to which loanees level of financial management skills affect NPLs at AFC
- c) To determine the effects of credit policies on non-performance of loans at AFC
- d) To examine the effects of loan recovery strategies on NPLs at AFC

### **1.4 Research Questions**

This study sought to answer the following questions:-

- a) What effect does initial loan appraisal have on NPLs at AFC?
- b) To what extent does the loanee's level of financial management skills affect the NPLs at AFC?
- c) What is the effect of AFC credit policies on non-performance of loans?
- d) What impact does the AFC loan recovery strategies have on NPLs?

## 1.5 Significance of the Study

Credit has been cited as one of the major constraints to the operation and growth in the republic of Kenya. It is therefore important that data on factors contributing to non-performance of loans in agro based financial institution will be generated by this study. Such data is important to policy makers as well as other stakeholders in formal and informal sector development policy framework in the country. The study will benefit the Agricultural Finance Corporation in particular in identifying and assessing credit worthy clients hence reduce if not eliminate non-performance of loans and realize its profit motive. This is because the study will help to address the key drivers contributing to non-performance of loans. It is the process of analyzing the attributes to good fund seekers. The approval of loans must be put under serious scrutiny in order that only deserving and prioritized cases are processed for disbursements. The efficiency with which these cases are handled need to be paramount as time, uncertainty and cost aspects must be taken into account.

The study findings will help the prospective loan seekers to make an optimal decision whereby they are able to choose a source of finance with minimum cost and optimum benefits both in the short run and long run period. Thus their choice of either institution loan or commercial bank loan will be a knowledgeable decision unlike the scenario whereby many people are ignorant about the cost element of loan capital specifically. The study will assist the government in achieving the national millennium goal if the measures to be recommended by the study are adopted for the sustainability and future survival of institutions such as AFC which is crucial for employment creation and poverty alleviation. From the government service report, by 2006 46% or 16.5 million of the 35.5 million population lived below the poverty line which indicated that more Kenyans were living generally a better life today than they did six years ago which needs to be reduced further. The study will further provide background information to other researchers or scholars who would like to investigate more on factors leading to non-performance of loans and determine other factors affecting institution loaning systems apart from loaning policies that impact into loans default.

## **1.6 Scope and limitations of the Study**

The information that was obtained from respondents was basically the real causes of factors contributing to non-performance of loans in agro-based financial institutions. AFC has adequate and qualified workers in the department of loan management and recovery and that the government is in support of defaulters. Credit is a major form of external finance used by household, firms and governments in economy. Lack of credit is one of the major constraints in the development of farming and farmer's lack adequate working and investment capital. Since the study was confined to Nairobi region, the outcomes could not therefore be generalizable to other regions. The researcher encountered the following limitations during the study:-

### **Financial Constraints**

Due to inadequate financial resources at hand, the research was limited only to the AFC. However; the findings were expected to be reliable and representative of AFC as whole.

### **Time Constraints**

The time frame set for this research study was considered inadequate and the researcher could not be able to study a larger sample due to wider dispersion of loanees across the region of Nairobi. Nevertheless, the researcher created more time and commitment in order to come up with a well researched paper

### **Co-operation of respondents**

Some respondents were unwilling to co-operate thus giving insufficient information. The researcher mitigated this by designing a simple and suitable questionnaire and made a frequent follow up and assured them that the data and information would be exclusively used for academic purposes only and was to be treated with utmost confidentiality

### **Inaccessibility to respondents**

The researcher spent more than 2 months to go through the bureaucratic processes of acquiring permission to be allowed to undertake research at the AFC. This was in addition to the fact that the loanees or farmers were widely dispersed all over the region and both the loanees and the AFC heads of department had a busy schedule which could not allow them take adequate time to respond to the issues raised in the questionnaire. All these were taking place against a backdrop of university deadlines for submission of research findings.

The scope of the proposed study was the departmental heads of Agricultural Finance Corporation of Kenya at headquarters in Nairobi as well as its loanees who are farmers. The headquarter was considered since it is the central decision making body as far as the disbursements of loans is concerned. Agricultural Finance has its head-quarters in Nairobi at Development house along Moi Avenue and other offices in all the provincial head-quarters. Other branches are found in district head-quarters. They were established to facilitate faster development in the agriculture sector countrywide. The corporation has a board of directors and management team headed by the managing director. It has ten departments, five regional offices and 31 branches. Presently the staff compliment is 570 consisting of 10 senior managers, 51 middle managers, 142 supervisors and 367 support staff. It is the corporations' policy to process all loans at branch level starting from clients' recruitment appraisal. The loan approval is the prerogative of the board of directors and the disbursement of loans is done both at head office and branches as well.

### **1.7 Summary**

This chapter brings out the background of the study, the statement of the problem and the research objectives. It also deals with research questions, significance of the study as well the scope and limitations of the study.

## CHAPTER TWO

### LITERATURE REVIEW

#### 2.1 Introduction

This chapter deals with the literature review of the study. It gives an overview of Agro-based financial institutions in Kenya, loan terms and conditions, loaning procedures and cost of loan capital. It also deals with capital asset pricing model, research gaps, and the theoretical framework of the study, among others

#### 2.2 Theoretical Orientation

Over the last few years the literature that examines non-performance of loans has expanded in line with the interest afforded to understanding the factors responsible for financial vulnerability. This situation may be attributed to the fact that impaired assets plays a critical role in financial vulnerability as evidenced by the strong association between NPLs and banking and financial crises in Argentina, East Asia and Sub-Saharan African Countries during the 1990s. In this section we review the existing literature so as to formulate a theoretical framework to investigate the determinants of non-performance of loans in AFC. There is significant empirical evidence of a negative relationship between the growth in real GDP and NPLs ( Salas and Suarina, 2002; Rajan & Dhal. 2003; Fofack, 2005; and Jimenez and Saurina, 2005). The explanation provided by the literature for this relationship is that strong positive growth in real GDP usually translates into more income which improves the debt servicing capacity of borrower which in turn contributes to lower non-performance of loans. Conversely, when there is a slowdown in the economy (low or negative GDP growth) the level of NPLs should increase.

The literature also provides evidence of a positive relationship between the inflation rate and non-performance of loans. Fofack (2005), for instance, shows that inflationary pressures contribute to the high level of impaired loans in a number of Sub-Saharan African countries with flexible exchange rate regimes. According to this author, inflation is responsible for the rapid erosion of commercial banks' equity and consequently higher credit risk in the banking sectors of these African countries.

Jimenez and Saurina (2005) used logit model for analyzing the determinants of the probability of default (PD) of bank loans in terms of variables such as collateral, type of lender and bank-borrower relationship while controlling for the other explanatory variables such as size of loan, size of borrower, maturity structure of loans and currency composition of loans. Their empirical results suggested that collateralized loans had a higher PD, loans granted by savings banks were riskier and a close bank-borrower relationship had a positive effect on the willingness to take more risk. At the same time, size of bank loan had a negative effect on default while maturity term of loans i.e. short-term loans of less than one year maturity had a significant positive effect on default.

Bloem and Gorter (2001) suggested that a more or less predictable level of non-performing loans though it may vary slightly from year to year is caused by an inevitable number of wrong economic decisions by individuals and plain bad luck (inclement weather, unexpected price changes for certain products, etc.). Under such circumstances, the holders of loans can make an allowance for a normal share of non-performance in the form of bad loan provisions, or they may spread the risk by taking out insurance. Enterprises may well be able to pass a large portion of these costs to customers in the form of higher prices. For instance, the interest margin applied by financial institutions will include a premium for the risk of non-performance on granted loans.

The magazine (KUSCCO, 2007) documented that an Economic Recovery Strategy of Wealth and Employment creation was developed by the government in 2003 to address the challenges of alleviating poverty which had risen from 38% in 1990 to 56% of the population in 2001. The agro-based institutions were identified as important vehicles through which these goals could be achieved leading to creation. According to new Government survey 46% of the population lived below the poverty line in 2006 which means a reduction of 10% in poverty levels six years ago. The government attached great importance to the agro-based institutions sector so that it can play a leading role in the economic recovery of the country by creating a conducive environment for growth of the agro-based institutions.

Most sectors of the economy have undergone comprehensive policy and legal reforms to revitalize their performance through liberalization and privatization. Agro-based institutions were currently undergoing a turbulent period trying to adjust to the liberalization of the economy. The reforms in the financial sector have led to stabilization of interest rates charged by banks and other institutions, hence encouraging more borrowing for developmental purposes. The clients have now gained a lot of confidence in bank loans and thus are lured to their offer of unsecured loans as the interest rate charged was almost the same as that of APC institution of 12% p.a. (Jeremiah & Joseph, 2007). The agro-based institution has been faced with weak marketing structures, poor management and leadership capacity and weak capital base. As a result agro-based financial performance has been declining and a majority of them have not been able to compete effectively (National Development Plan 2002-2008 pages 38, Government of Kenya).

Most financing institutions are member-owned financial institutions that offer saving and credit services to farmers. AFC provides farmers with financial services to improve their economic and social well being through asset accumulation and income generation. They mainly served the interests of farmers as a result of pooling their resources together. They offered a range of financial services, most significantly they focus against farmers share capital (David & Murungi, 2004). Agro-based financial institutions served farmers, industry and informal- sectors which helped in narrowing the gap between the rich and poor. They served farmers at all socio-economic levels and contributed to employment opportunities in both urban and rural areas. Urban Agro-based draws their clients from farmers, industries, parastatals and informal sector. Banks on the other hand being the main competitor was governed by the Companies Act and the Banking Act. Thus ultimate benefits of agro-based financial institutions were to the farmers as owners and customer who were also the sole decision makers. In the case of banks, customers served are neither involved in decision making nor shared in the profits earned (David & Murungi, 2004). Agro-based financial institutions are the most common type of institutions in developing countries. Their main function was mobilization of savings and channeling the mobilized and other external funds to farmers as loans at affordable

interest rates. Origin of this type of institutions was recorded at Germany in the mid 19<sup>th</sup> century. In Kenya there was a need to develop the German aspect of outsourcing funds at favorable terms and channeling to farmers as development loans although this was discouraged. The Agro-based financial institutions were dominantly urban based and did not have secondary institutions but were affiliated at national level through KUSCCO Limited (David & Murungi, 2004)

### **2.3 Loaning Terms and Conditions**

According to the study by Jeremiah & Joseph (2007), the lending procedure used by Agro-based financial institutions have been bound by banks as an entry point through developing a very simple and unsecured procedures that include the submission of loanees identification card, letter of introduction from employer. Kenya Revenue Authority P.I.N. number, a loan form duly filled and current pay slips for at last three months. Terms and conditions of Agro-based financial institutions are many and rigid unlike banks because a member is required to provide guarantors, boost his share savings and cannot be advanced a loan which will attract a deduction of more than two thirds of his or her basic pay despite the amount of shares held, which allows him to get a loan of about three times his/her shares. This eventually leaves the amount of loan disposable to farmer less than that advanced by banks thus becomes preferred by many members (KUSCCO Report, 2007)

Ouma (1987) observed that the main loan security for agro-based financial institutions was farmer's salary and his/her good character while banks required collaterals such as title deed which was more demanding to acquire. This was the case until 2001 when unsecured loans were introduced by commercial banks targeting the Agro-based financial institutions farmers among other potential clients. Ndungu (2008) observed that, unless the loan applied for is equal to or less than farmer's shares, it must be secured by guarantors who must be farmers of the society while in banks there is no such condition. At present, most financial institutions are facing competition especially from commercial banks due unattractive credit terms which adversely affects its clients and in turn the general performance. The credit terms are measured using ease of meeting them by

considering the total number of loan applications received and those not eligible due to not observing certain terms of the policy as well as farmers perception and attitude.

#### **2.4 Loaning Procedures**

Loaning procedures usually involves a detailed study of five aspects of loan application: character, capacity, cash, collaterals and conditions. Character refers to customer's responsibility, truthfulness, serious purpose and intention to repay loan. If the customer is insincerely promising to use borrowed funds as planned and in repaying as agreed, the loan should not be made to avoid a credit problem. The loan officer must be convinced that a customer has a well defined purpose for requesting credit and has serious intention to repay. Capacity to borrow money refers to the authority to request a loan and the legal standing to sign a binding loan agreement by a customer.

Collateral refers to borrower's possession of adequate network or quality assets to provide adequate support for the loan. Cash Capital refers to the borrower's ability to generate enough cash in form of cash flow to repay the loan. Generally there are three sources used by a customer to repay a loan which includes cash flow from sales or income, sale or liquidation of assets or funds raised by issuing debt or equity securities. Conditions refer to the terms and conditions pegged on loans offered (Rose, 2002).

The procedure of obtaining loans from agro-based financial institutions is lengthy in that after submission of loan application forms there is loan appraisal, its approval and verification by different departments before loan disbursement and finally cheques are dispatched. Normal loans are processed monthly while for emergency loan is granted on request from agro-based financial institutions. Ndungu (2008) ,noted that bureaucracy and long delays in loan processing by Agro-based financial institutions have led to members' seeking for alternatives from banks and other FIs which readily offer loans without delay. The bureaucracy of loan granting process by credit committee has also caused some dissatisfaction amongst farmers especially in case of emergency loans. Yash Ghai et al (1972) stated that excessive bureaucracy is one of the main causes of inefficiency in Agro-based financial institutions. There is ease in obtaining an unsecured loan from commercial banks within two to four days, after submission of loan forms with

all supportive documents, which is very fast compared to the case of Agro-based financial institutions normal loan which takes around one month.

Due to advancement in technology KCB will start issuing loans faster through adoption of credit quest. This will facilitate faster analysis of the customers' credit history and enable periodic credit reviews, thus will reduce time and manage credit risks more effectively. Being the first to adopt the software in Africa implied that other banks will follow suit. Turban et al (1996) stated that the way a firm views -its business, consumers and competition is critical to the successful aligning of its business and information technology strategies. Information technology is used to automate processes and augment the skills of the organizational staff. Organizations develop new knowledge, skills and competence through marketing research which is lacking in Agro-based financial institutions unlike banks. Hence Agro-based financial institutions have failed to accommodate the dynamic nature of a modern business in a fast changing environment (Kabianga, 2003). Robson (1997) stated that strategically successful organizations obtain market feedback continuously and rapidly and adapt to the feedback ahead of the rivals. They exploit the potential of strategic as well as competitive and operating information systems which occurs in banks not in agro-based financial institutions.

Mwaura, (2003) indicated that information technology changes are among the most important forces that can alter rules of competition because most activities of an organization generate and utilize information. Thus with the aggressiveness of commercial banks of embracing the latest technology in provision of loans and other services, Agro-based financial institutions face a bigger challenge of cut throat competition in the financial sector. This is because institutions generally are slow to adopt ICT as only four percent of the registered ones can operate information and communication systems (Jeremiah & Joseph, 2007). The loan procedure was measured using the total number of processed loans within a month, the period of processing after receipt of required documents by the agro-based financial institutions and farmer's perception

## **2.5 Cost of Loan Capital**

According to Mwaura (2003) it was revealed that interest rate contributed the highest percentage of the cost of credit of manufacturing firms listed at the NSE. The commercial banks were fully blamed for crippling the Kenyan economy by charging exorbitant interest rates ranging between 30% p.a. and 70% p.a. in 1993. This led to the publication of Donde bill in early 2002 to regulate the interest rate on borrowing to be 3% above the treasury bill rate. This bill was not passed in parliament due to the adverse effects it was likely to have on the economy such as rise in inflation. The commercial bank lending interest rates ranges from 12.18% p.a. to 25.50% p.a at present (CBK ,2007) while that of agro-based financial institutions has always remained constant at 12% p.a disregarding all conditions of credit policy. The interest rates charged by banks change due to changes in the economy while for agro-based financial institutions remain static in most cases as they are determined by members through an AGM. Thus clients are affected negatively when interest rates rise as they will pay more for bank loans than before unlike the Agro-based financial institutions loans. Majority of the agro-based financial institutions members are ignorant of these facts and thus are vulnerable to exploitation by banks.

The Central Bank of Kenya commissioned Research International in August 2007 to carry out a survey on the cost of bank services due to low transparency and a complicated price structure. The research picked on two loans of Kshs 500,000 and Kshs 50,000 over 36 and 24 months repayment periods respectively for commercial banks. The outcome was that the Kshs 500,000 loan was repaid with total amounts ranging from Kshs 593.888 to Kshs 661.875 excluding other charges. While the total repayment for Kshs 50.000 loan ranges between Kshs 56.344 to Kshs 63,281 excluding other charges. The interest rate varied between 12.18% p.a and 25.50% p.a. at flat rate and other charge by the banks ranged from Kshs 5,000 to Kshs 55,000 (CBK. 2007).According to a letter to agro-based financial institutions from KUSCCO head office on agro-based financial institutions loan charges, the total loan repayment at an interest rate of 12% p.a on reducing balance for Kshs 500,000 over 36 months is Kshs 590.000 and Kshs. 50,000 over 24 months is Kshs 56,000. There were no other additional charges for agro-based financial institutions loans and hence were cheaper than bank loans. The members of agro-based financial

institutions were not aware of these extra charges levied by banks and therefore were fully exploited.

According to first discussion draft by Centre of Corporate Governance (2004), financial operated at cost and kept their prices as low as possible, below competing businesses yet they were subject to the same market conditions, or instance interest rates maintained at 12% p.a. since inception. Thus a made the Agro-based financial institutions less competitive as it minimized the amount of revenue raised through interest charged on loans which in turn reduced the amount of loan disposable to members. The members demand for loans was higher than the supply of loans by the Agro-based financial institutions which led to shifting for large amounts with fewer conditions.

David & Murungi (2004) recommended that there is now need to develop the German aspect of getting external funds at favorable terms and lend it as loans to members in order to meet their high demand for loans although it is discouraged within the co-operative movement. The study has found out that the recommendations given were implemented by the Agro-based financial institutions but not satisfactorily. Cost of credit was measured using interest rate and other additional charges. Historically, the occurrence of financial sector crisis has often been associated with a massive accumulation of non -performing loans which can account for a sizable share of total assets of insolvent financial institutions. According to Caprio and Klingebiel (2002), 60 banks that collapse in Indonesia during crisis had non- performing loans represent 75% of the total loan portfolios. It is the cause of this collapse of most banks in sub-Sahara Africa in the 1990s. Non-performing loans generally refers to loans which for a relatively long period of time do not generate income; that is principal and interest has been left unpaid for at least 90 days (Caprio and Klingebiel (2000)). The criteria for identifying non performing loans is even more variable across Sub-Saharan African if one were to take into account the multiplicity of regulatory agencies and institutions and the marked difference in the level of minimum capital requirements in these countries (Bloem and Gorter (2001)). However, based II commission emphasizes the need to evolve towards a standardized and internal rating-based approach. It recommends aligning bank's capital

requirements with prevailing modern risk management techniques. Moreover, to ensure comparability across banks, this commission has established minimum qualifying criteria for the use of internal credit risk assessment capabilities.

The economic and financial costs of these impaired loans are significant. Potentially these loans may negatively affect the level of private investment, increased deposit liabilities and constrain the scope of bank credit to private sector. These loans also have potential for reducing private consumption, and in the absence of deposit guarantee mechanisms to protect small depositors, can be a source of economic contraction. The fiscal costs of impaired loans are important as well, and vary with the scope and length of the crisis (Cortavarria et al (2002). Demirguc-Kunt and Detragiache (1998) classify episode of financial distress as full-fledged crisis if the ratio of non-performing loans to total assets exceeds 10%. When left unresolved, non performing loans can compound into financial crisis, the moment these loans exceed bank capital in a relatively large number of banks and non banking financial institutions. In Sub-Saharan Africa the non performing loan related risks are compounded by the structure of the banking system often dominated by a few large banks. However, despite the implications of non-performing loans for banking crisis for investment and economic growth and for anticipating future banking and financial crises, the leading causes of these loans remain unknown. By 2002, non-performing loans accounted for 12% of total loans in sub-Saharan Africa. Although non performing loans remain relatively high compared to estimates recorded in industrial countries where credit risk is generally below 10% (Barth and Nolle (1997), this represents a significant improvement, reflecting the implementation of banking and financial sector restructuring undertaken in a number of the impaired loans, the financial costs and implications of Sub-Saharan Africa. In dollar terms, the financial costs of these loans exceeded US\$ 6 billion in Sub-Saharan Countries in 2002. The accumulation of non-performing loans is generally attributable to a number of factors including economic downturns/meltdown and macroeconomic volatility, terms of trade deterioration, high interest rates, excessive reliance on overly high-priced interbank borrowings, insider lending and moral hazard (Goldstein and Turner (1996).

Although by regional standards Kenya's financial system is relatively well developed and diversified, major structural impediments prevent it from reaching its full potential (Thorsten Beck Michael Fuchs (2004). The limited information sharing on debtors, deficiencies in the legal and judicial system, the limited number of strong reputable banks and non-transparency and uncertainty in the banking market are major impediments to Kenya's financial system to reducing spreads and to widening access

## 2.6 Capital Assets Pricing Model-CAPM

Sharpe et al, (1964) argues that in a competitive market, the expected risk premium varies in direct proportion to before. Therefore, expected risk premium on stock equals to beta multiplied by expected risk premium on market. Stock sensitivity to changes in the value of the market portfolio is known as the beta. Beta measures the marginal contribution of the stock to the risk of the market portfolio. If one holds the market portfolio and if beta measures each security's contribution to the market portfolio risk, then it is not a surprise that the risk premium demanded by investors is proportional to beta that is what CAPM says that an investor can lend or borrow at risk free rate of interest, one efficient portfolio is better than all the others. This is the one that offers the highest ratio of risk premium to standard deviation. The capital asset pricing model states that the expected risk premium from any investment should lie on the security market line.

The basic principles of portfolio selection boils down to a common statement that investors try to increase the expected return on the portfolio and to reduce the standard deviation of that return. Portfolio that gives the highest expected return for a given standard deviation or the lowest standard deviation for a given expected return is known as efficient portfolio. To work out which portfolios are efficient an investor must be able to state the expected return of stock and degree of correlation between each pair of stocks. Investors who can borrow and lend at given rate of interest should choose the best common stock portfolio regardless of their attitudes to risk. Having done that they can set the risk of their overall portfolio by deciding what portfolio of their money they are willing to invest in stocks. The most efficient portfolio offers the highest ration of forecasted risk premium to the portfolio standard deviation. A stock marginal

contribution to portfolio risk is measured by its sensitivity to changes in the value of the portfolio. CAPM concludes that each security's expected risk premium should increase in portfolio to its beta. Thus, expected risk premium =  $\beta \times \text{market risk premium}$

## 2.7 Theoretical Framework

Financial service management is characterized by a number of aspects that endorse it as an important facet in any organization. It requires a great attention and monitoring due to the risks attached to services or products offered by various institutions. The variables involved in determining or evaluating those entitled or eligible to finances are basically future estimates. A lot of uncertainty is associated with the future cash flows, tax rates and economic life span of projects, inflation rate and selling price of products. The problem associated with credit appraisal is the difficulty in gauging the true position as that future date. Certain variables are hard to determine yet they are those that cannot be measured with reasonable certainty. It is therefore a question of limiting the default rate or maintaining bad debts at levels that will not affect the overall objective of the lending institution. Paul (1997) was once the richest man in the world observed that "If you lend the bank \$100 million that is your problem," if you owe it \$100 million that turns to be the bank's problem". To be sure, lending to businesses, governments and individuals is one of the most important services banks and financial institutions provide of the closest competitors provide the riskiest.

However risky or not, the principal reason for being issued with charters of incorporation is to make loans to their customers. Lenders are expected to support the local communities with an adequate supply of credit for all legitimate business and consumer financial needs and to price that credit reasonably in line with competitively determined market interest rates. Despite all the benefits of lending for both the institution and their customers the lending process bears careful internal and external monitoring at all times. When a financial institution gets into serious financial trouble, its problem usually spring from loans that have become uncollectible due to mismanagement, illegal manipulation misguided lending policies or an unexpected economic downturn.

### **2.7.1 Portfolio theory**

Markowitz (1997) draws attention to the common practice of portfolio diversification and shows exactly how an investor can reduce the standard deviation of portfolio returns by choosing stocks that do not work exactly together. However, Markowitz did not stop there, he went ahead to work out the basic principles of portfolio construction. The principles are the foundation for much of what has been written about the relationship between risk and return. Normal distributions can be defined by two non-averages or expected returns, variance and standard deviation. The investor under such circumstances needs to consider only the two. The portfolio risk is less than the average risk of the separate stocks due to diversification. The whole idea has to do with increasing expected return and minimizing risk. It is the efficient portfolios that have these qualities or characteristics. Money can be lent or borrowed thus borrowing is negative lending therefore financial institutions must borrow from this theory the fact that portfolio diversification guarantees the elimination of unsystematic risk which is common to all firms in the industry .This implies that lending institutions such as AFC and commercial banks must demand for higher rate return for riskier investments (CBK, 2007). Despite the positive contribution of this theory in the management of risky investments, portfolio theory is not clear on how lending institutions could divert from core business of lending and venture into more investments for purposes of risk reduction .This clearly leaves a knowledge gap particularly on the factors contributing to non-performance of high risk products such as loans-the basis of this study

### **2.7.2 Liquidity Preference**

The theory explains the traditional upward sloping yield curve as puts forward by Keynes John Maynard, (1936).The logic is that investors prefer short term securities which give them greater liquidity because due both interest risk and default risk the longer a security must be held till maturity. Holders of long-term securities bear the risk that interest rates will rise during the period making their fixed rate investments less valuable. Similarly unfavorable changes in the financial conditions of the company are also a function of time and today are more certain than tomorrow, next month is more certain than next year and thus the possibility of default increases over a longer period.

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

### **2.7.3 Austrian Theory of the Business Cycle**

The Austrian theory of the business cycle emerges straight forwardly from a simple comparison of a savings induced boom (Garrison R.W, 1997). An increase in savings by households and credit expansion orchestrated by the central bank sets into motion market processes whose initial allocation effects on the economy's capital structure are similar but whose ultimate consequences are sharply different. The general argument of the theory though not the full argument can be stated in terms of the conventional macro-economic aggregates of savings and investments. The levels of investment are determined by the supply of and demand for loanable funds. Supply reflects the willingness of households to save at various rates of interest; demand reflects the willingness of business to borrow in order to finance investment projects. Each represents a state of equilibrium in the loan market. An increase in the supply of loanable funds has obvious initial effects on the rate of interest and on the level of investment borrowing. But the ultimate consequences differ importantly depending upon whether the increase supply of loanable funds derives from increased saving by households or from increase credit creation by the central bank. Even in this simple loanable funds framework many aspects of the Austrian theory of the business cycle are evident. The natural rate of interest is the rate that equates saving and investment. The bank rate diverges from the natural rate as a result of credit expansion. When new money is injected into credit

markets, the injection effects which the Austrian theorist emphasizes over price level effects take the form of too much investment.

Other significant aspects of the Austrian theory of the business cycle can be identified only after the simple concept of investment is replaced by the Austrian vision of a multi-stage time-consuming production process. The rate of interest governs not only the level of investment but also the allocation of resources within the investment sector. The economy's inter temporal structure of production consist of investment sub-aggregates which are defined in terms of their temporal relationship to the consumer goods they help to produce. Some stages of production such as research and development and resources extraction are temporally distant from the output of consumer goods. As implied by standard calculations of discounted factor values interest rate sensitivity increases with the temporal distance of the investment sub aggregate or stage of production from final consumption. An increase in the rate of saving implies a change in the preferred consumption pattern such that planned consumption is shifted from the near future to the remote future. A savings induced decrease in the rate of interest favors investment over current consumption. Significance in Austrian theorizing it favors investment in more durable over less durable capital and in capital suited for temporally more remote rather than less remote stages of production. These are the kinds of changes within the capital structure that are necessary to shift output from the near future to the more remote future in conformity with changing inter temporal consumption preferences.

This theory puts more emphasis on long-term investments running into the remote future with emphasis that such remoteness is likely to fetch higher interest rate for the firm.

While this sounds prudent in theory, in practice such financial management principle may end up starving the organization of the short-term interest to run its day to day operations in anticipation of future booming interests. In any event even the time value of money is also not catered for in this theory. By extension the theory also does not provide a caveat on exactly what happens in the event that the interests payable and even the capital accrued from long -term loans is not forthcoming. This is a research gap that must be

filled so as to determine the factors influencing non-performance of loans especially in public financial corporations.

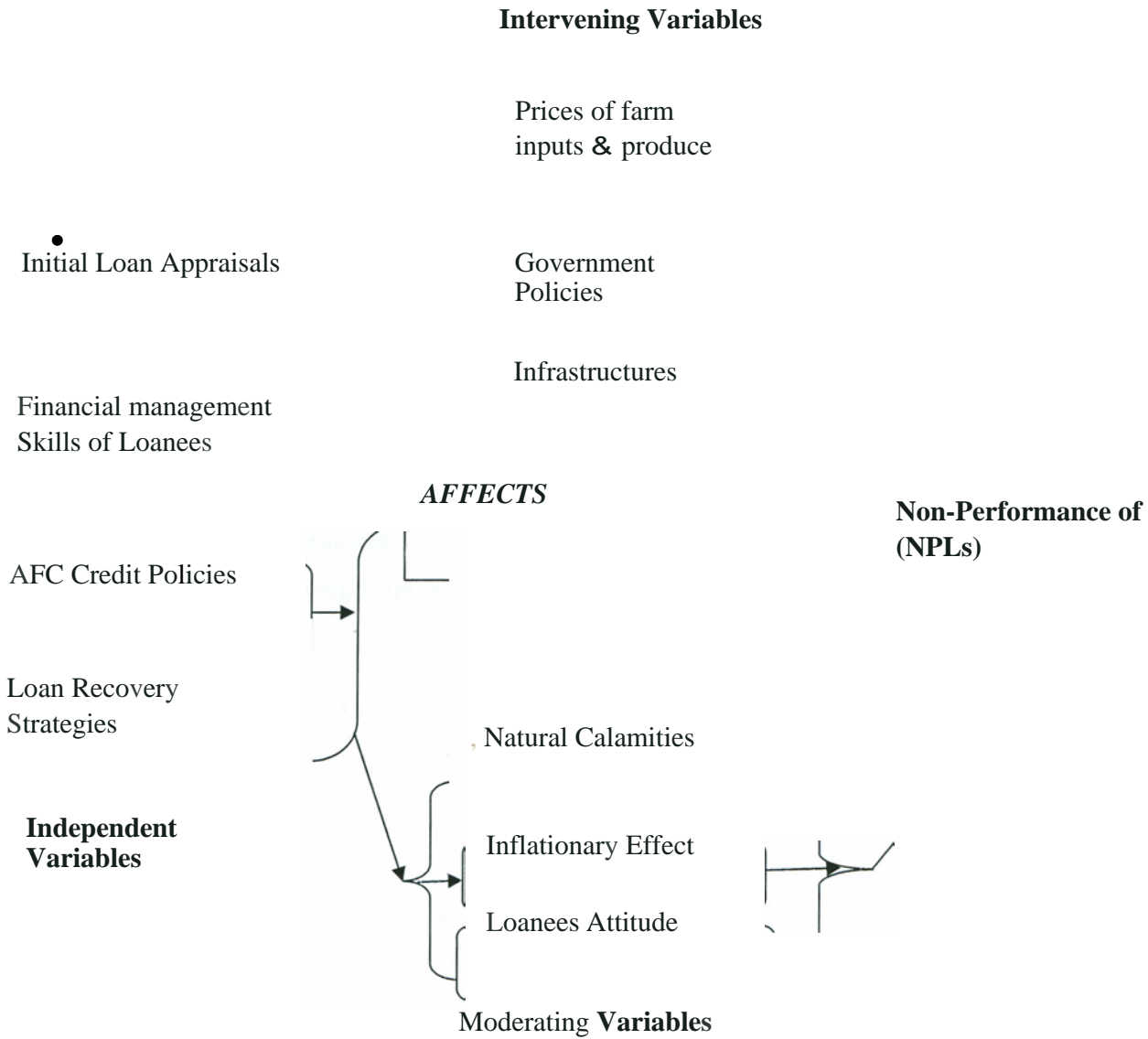
From the above discussions, it is evident a research gap exists in the area of non-performance of loans in agro- financial institutions. Hence ,little research have been done in this area of study and thus there is a need to carry out more research in the future in order to address non-performance of loans .It is also notable that fewer studies have been done on the non-banking financial institutions. Having found minimal literature and appropriate information regarding this topic attempts into furtherance of this research has led to an interest to carry out this study. This research will assist in acknowledging and filling the gap that exists in both financial and non-financial sectors in terms of information sharing and implementation of management policies.

## **2.9 Conceptual Framework**

The independent variables considered in the study are initial loan appraisal, financial management skills of loanees, AFC credit policies and loan recovery strategies. At the same time there are moderating variables leading to NPLs .This includes inflation, natural calamities and farmer's attitude towards repayment of government loans. On other hand, there are intervening variables which have an impact on NPLs at AFC. These include prices of farm inputs and produce, state of infrastructures and government policies on agricultural sector, among others. For all these variables, it is the independent variables which have the greatest impact on the non-performance of loans, which is the dependent variable. This relationship between the various variables is best illustrated in figure 2.1

## 2.9 Conceptual Framework

Figure 2.1 Conceptual Framework



Source: Researcher (2011)

### **2.9.1 Financial Management skills of loanees**

The financial management skills of loanees had a direct impact on NPLs. The loanees existing financial management skills, level of education and nature of business was likely to influence the performance of loans. The loanees who failed to use the borrowed funds strictly for the intended purpose are likely to become loan defaulters. An injection of loans into wrong investment projects from the intended ones especially by semi-literate loanees led to depletion of the funds. This placed the borrowers in a very tricky position that made loan repayment almost impossible.

Also failure of the borrowers to put into consideration the advice given by the lenders or mutual firms led to mismanagement of funds and thus resulting in eventual defaulting of the loans repayment

### **2.9.2 Initial Loan Appraisals**

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

### **2.9.3 A.F.C Credit Policies**

At the same time the nature of credit policies including loaning terms and conditions as well as loaning procedures had the long term effect on NPLs. The basic requirements a member was required to meet to qualify for a loan in the institution determined whether or not that member would honour the loan repayment in future. Liberal, stringent and lenient credit policies had long-term consequences on the performance of loans. For instance, it was highly likely that lenient and liberal policies would almost automatically created a huge portfolio of NPLs. This was ranked the third factor of NPLs.

#### **2.9.4 Loan Recovery Strategies**

The loan recovery strategies employed by AFC contributed to non-performance of loans to a greatest extent. Poor loan recovery strategies for example created a huge portfolio of debt uncollected thus led to non-performance of loans and vice versa.

#### **2.9.5 Inflation, Natural calamities and loanees attitude**

When inflation is high it would cause the value of the currency to go down. This would not always go well with the borrowers because it means that compound interests had to be raised by financial institutions to counter check the upsurge. This might happen without putting into consideration the plight of those who had already borrowed the loans. This change would cause the borrowers to pay more than were supposed to pay during the time of borrowing or negotiations thus had an impact on performance of loans. Natural factor had an effect on the poor performance on loan advances to customers. These were such events as the death of the loanee or proprietor, seasonal variations in weather conditions prevalence, damage of property by fire or lightening and theft amongst others. This resulted in increased default rate. Some natural catastrophes were termed as extraneous variable which the researcher had no control of at all.

Loanees' attitude towards government loans led to laxity in loans repayment. More often than not loanees particularly in the rural areas and with lesser financial wisdom perceived that government loans were a form of free financial subsidy to their incomes. They therefore lacked the moral obligation and commitment to repay the loans as and when they fell due.

#### **2.9.6 Prices of farm produce Government Policies and Infrastructure**

The intervening variables such as prices of farm produce, government policies and infrastructure influenced the performance of loans indirectly. The internal management practice of the firm did not have direct intervention strategies of these variables because they are external to the firm. Increased in prices occasioned especially by rising inflation led to high costs of production in agriculture rendering loans repayment an uphill task. At the same time government legislation for example increasing taxation on farm inputs and exports had the final consequence of reduced profitability which led to NPLs. The lack of a reliable and sustainable physical infrastructures in addition to unpredictable weather

patterns normally created an imbalance in the way of doing business especially in loans repayment planning by loanees .This in essence contributed to NPLs

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

This chapter contains the details about the research design, target population, sampling techniques, sample size, instrumental validity and reliability. It also includes the method that was used in collection of data and methods for analysis of the data in order to come up with answers to the research problem.

#### **3.2 Research Design**

This research project adopted a case study research design of Agricultural Finance Corporation of Kenya. Case studies place more emphasis on a full contextual analysis of fewer elements or conditions and their interrelations which rely on qualitative data (Cooper & Schindler, 2008). Research studies that have effectively used a case study include studies by Muturi (2006), Mogeni (2008), Keranga (2009) and Okiro (2006), among others. The case study involved an in-depth investigation of the factors contributing to non-performance of loans in AFC. The study was conducted as response to the increased rate in non-performance portfolio debt at AFC where the research study was conducted. Both primary and secondary data were collected during the study. The case study research design was the best suited here due to lack of data over a longer continuous period of time taking cognizant that most financial approaches are emergent in nature.

#### **3.3 Target Population**

The AFC constituted the single most unit of interest and, therefore, the one under investigation. The respondents to the questionnaire were the heads of the departments at the AFC. A total of 4 heads of department were targeted. These were the heads of finance, debt collection and recovery, credit and audit. These top managers responded to questionnaires. This was because this is the group empowered to oversee the management and recovery of loans at AFC. At the same time a total of 42 farmers who were loanees at AFC were targeted to response to the questionnaires to bring the total number of targeted respondents to 46.

The farmers were targeted as respondents because they are the direct users and beneficiaries of loans and, therefore, they had the first hand information of the factors

contributing to NPLs. The population of AFC constituted both the internal and external customers to the AFC. The external customers were those who transacted business with AFe. The internal customers were the employees themselves. The AFC employees are approximately 570, while the external customers were over 1,632 farmers.

### **3.4 Sample and sampling techniques**

Due to the nature of target population involved in the study, the researcher used a purposeful sampling technique. In this case the researcher selected purposefully to target the heads of department at AFC. This was for the sole purpose of getting the correct responses since these were the staff concerned with loan policy management at AFC. The sample selected constituted of heads of department and farmers. Four heads of the department were selected. These were from the departments of finance, debt collection and recovery, credit control and appraisal, and internal audit at AFC.

For the selection of farmers who were respondents, the researcher used stratified and random sampling. Out of a total of 1632 loan defaulters, 39 were selected as a sample as follows:

Using stratified sampling, loans default clusters with a range of Ksh.200,000 starting with loans default of Ksh.400,000 and above were considered. This was because the bulk of the outstanding non-performing portfolio debt of Ksh.7 billion fell in this category. This accounted for 60% of the non-performing loan portfolio at AFC as at 2009 ([www.afc.co.ke](http://www.afc.co.ke)). From stratified sampling (table 3.4.1), there was a total of 130 defaulters in this category. Out of the 139 loanees, 39 who were defaulters representing 30% of the number of defaulters and 3 non-defaulters were selected based on samples taken directly proportional from each of the loan categories as shown in table 3.4.1:

Table 3.1 Category of Loanees, number of defaulters and loanees sample

Category of Loanees ( Ksh)	Population Size (Number of defaulters)	Sample size (30%)
0	9	3
400,001-600,000	32	10
600,001-800,000	13	4
800,001-1000,000	18	5
1,000,001-1,200,000	16	5
1,200,001-1,400,000	12	4
1,400,001-1,600,000	15	5
1,600,001-1,800,000	10	3
1,800,0001-2,000,000	8	2
2,000,001 and Above	6	1
<b>TOTAL</b>	<b>139</b>	<b>42</b>

Source: AFC Credit Department

The summary of the sample size is illustrated in table 3.4.2

Table 3.2: Sample size of the Respondents

Category of Respondents	Sample Size
HODs	4
Non-loan defaulters	3
Loans defaulters	39
<b>TOTAL</b>	<b>46</b>

Source: Researcher (2011)

### 3.5 Data Collection Instruments

Methods of data collection used involved collection of both primary and secondary data.

Primary data were collected from questionnaires distributed to the 4 heads of departments in AFe and 42 farmers who are loanees. The researcher identified loanees who had postal and e-mail addresses and used them to post their questionnaires to them. A follow-up

approach was adopted to get back the responses from this group of loanees. The questionnaires administered had closed-ended and open-ended questions and covered factors contributing to non-performance of loans in APC. The researcher personally administered the questionnaires to the 4 heads of department and a number of loanees who could be easily located and reached within the region. Secondary data were gathered from library material, AFC journals and reports, media publications and various internet search engines covering loan management and recovery strategies.

Questionnaires allowed for confidentiality of the respondents to be kept. Also, they enabled detailed collection of data by the researcher. Open ended questions restricted the respondents to provide precise and accurate information. The responses from such questions would be easy to analyze using descriptive statistics.

### **3.5.1 Pilot Testing**

The questionnaires used needed to be effective through the process of pilot testing. A small representative of the sample was used in the pilot testing. Two heads of department and 5 farmers participated in the pilot test. Pilot testing was necessary for unforeseeable corrections to be undertaken before the final questionnaire was released to the respondents. It also ensured that correct wording, formatting, typographical errors and the nature of the questions were rectified in advance. An effective questionnaire for pretesting required both open-ended and closed ended questions. This was required for purposes of easier statistical analysis of the data to be collected.

### **3.6 Data Analysis and Presentation**

Data were analyzed by the use of descriptive statistics utilizing SPSS. Content analysis was equally used in data analysis and presentation since the data collected were qualitative in nature. Content analysis was used mostly to arrive at inferences through a systematic and objective identification of the specific messages. Researchers such as (Annule, 2003), (Keranga, 2009), (Mogeni, 2008) and (Karambu, 2004) have successfully used content analysis in their research studies. The presentation of data was by way of graphs, tables, pie charts and frequency distribution tables.

## CHAPTER FOUR

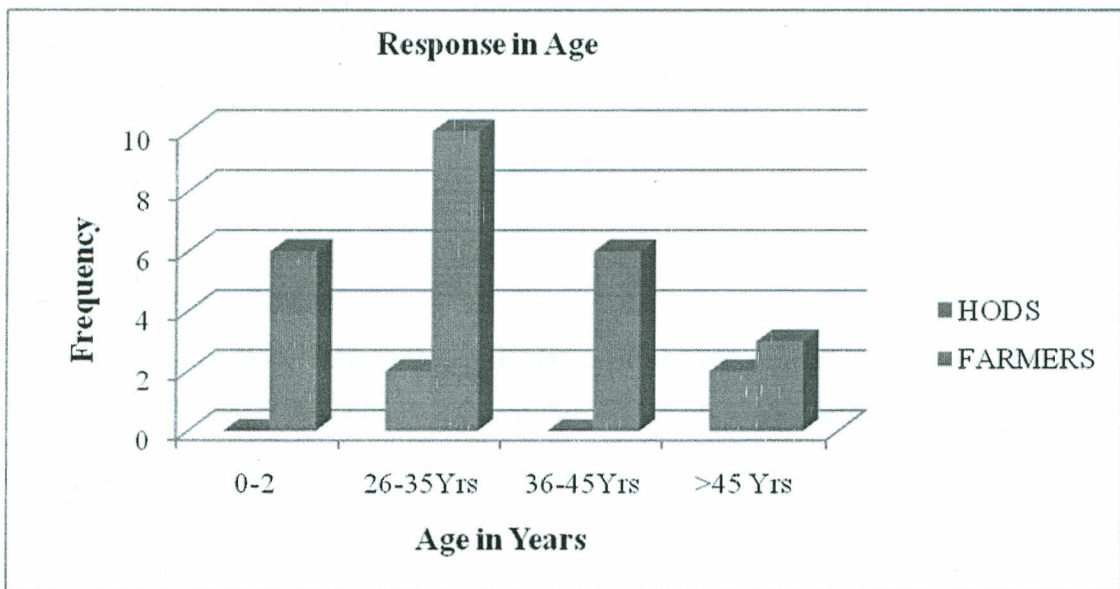
### DATA ANALYSIS AND FINDINGS

#### 4.1 Introduction

This chapter presents a report on interpretation of the findings of the study. It focuses on a descriptive and quantitative analysis of the factors contributing to non-performance of loans at AFC. In this chapter, an attempt is made to empirically assess the effect of initial loan appraisals on the NPLs, establish the extent to which loanees level of financial management skills affect NPLs, determine the effects of credit policies on non-performance of loans and examine the effects of loan recovery strategies on NPLs at AFC. This chapter also brings out the response bio-data, response rate according the gender parity, loaness and HODs business and work experience as well as their academic and professional qualification. It captures reasons for loans default, rating of credit terms and conditions, loaning procedures and loan recovery strategies used by AFC among others.

#### 4.1.1 Respondents personal data

**Figure 4.1: Age of Respondents**



**Source:** Author (2011)

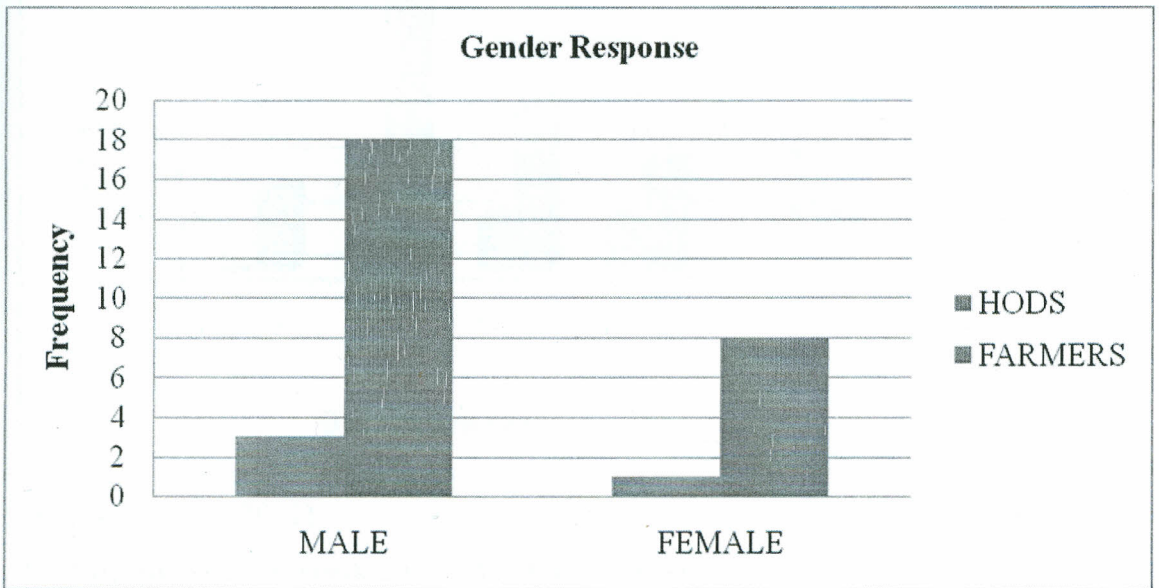
As shown from figure 4.1 above, the majority of respondents from the HODs were from the age groups of 26-35 and over 45 years. This means that most of the HODs at AFC are middle aged. On the other hand the majority of the respondents from the farmers'

category were also from the age group of 26-35 years. This was followed by those under the ages of 26 and those of 36-45 and over 45 years respectively.

#### 4.1.2 Response According to Gender parity

From figure 4.2 below, the respondents 'gender' in general stood at 68% for male while 32% were female. This represented 3 out of 4 or 75% male HODs respondents and 25% or 1 out of 4 female HODs respondents. From the farmers category male respondents were 17 out of 25 who responded to the questionnaires while the rest were female at 8 in number. The gender disparity therefore is more inclined towards male respondents for both HODs and farmers who were loanees.

**Figure 4.2: Gender Responses**



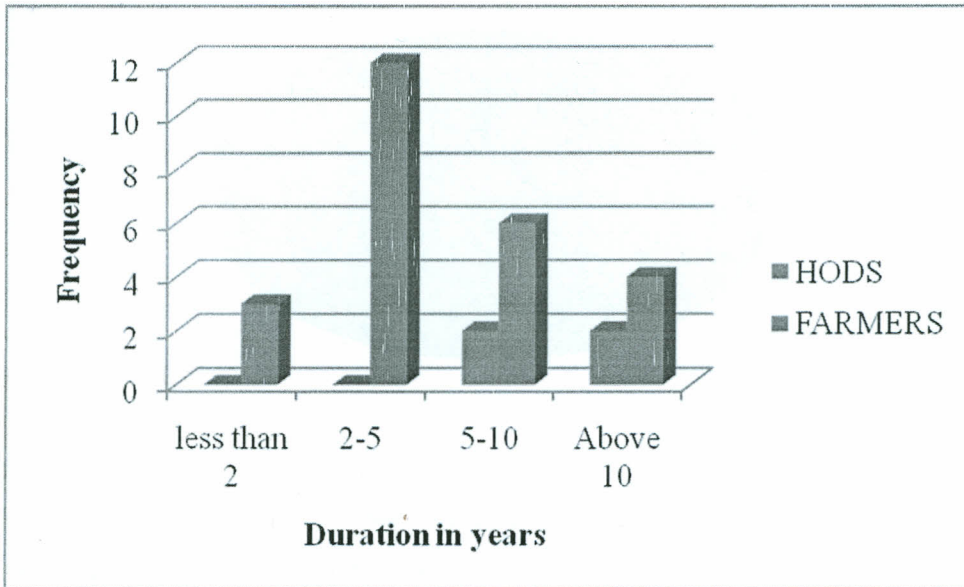
Source: Author (2011)

#### 4.1.3: Response in duration of service for HODS and business experience for loanees

From the figure 4.3 below, the findings indicate that all HODs have duration of service of over five years. Two of the HODs had 5-10 years experience. The same numbers of HODs have working experience of over 10 years. AFC did not have any heads of department with less than 5 years work experience. It remains to be seen whether the business experience of loanees and work experience of heads of department contribute to NPLs at AFC.

From the findings, majority of the respondents have been farming for between 2-5 years. This were 12 farmers out of 25 farmers who responded to the questionnaires. This represents 48% of the farming community. This is closely followed by 6 or 24%, 4 or 16% and 3 or 12%farmers with a farming experience of less than two years , between 5-10 years and above 10 years respectively. The result indicate therefore that more farming is carried out by farmers with less than five year experience of 72% of the farming community.

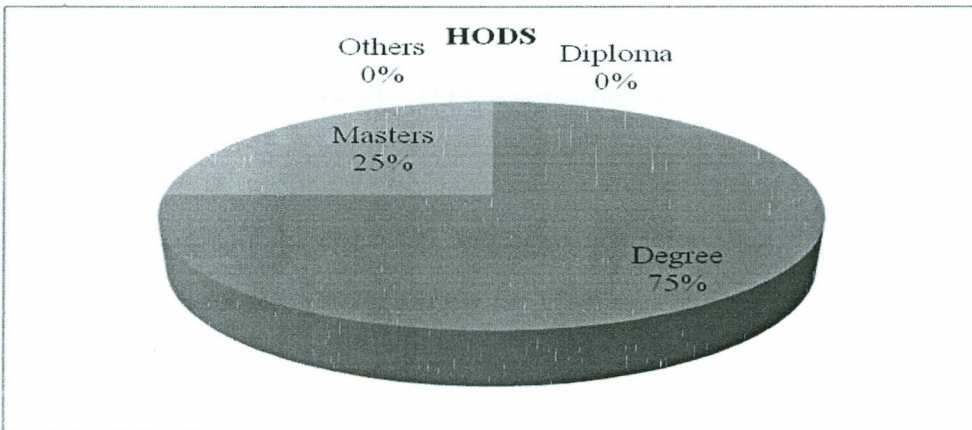
**Figure 4.3: Duration of service and business experience**



Source: Author (2011)

#### 4.1.4 Response in Accordance to Academic qualification

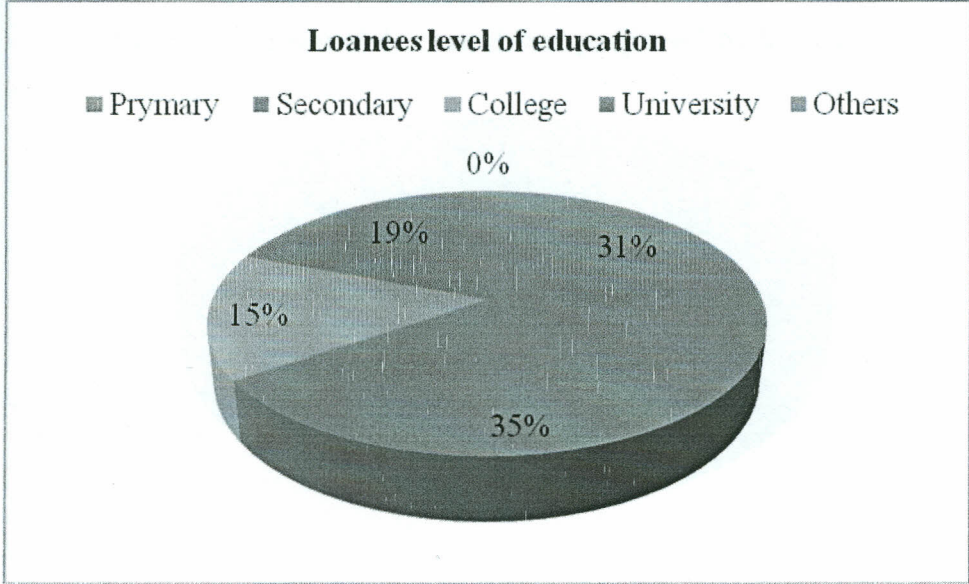
**Figure 4.4: Academic Qualification for HODS**



Source: Author (2011)

In response to the academic qualifications 75% or 3 HODs out of 4 have a degree while 1 out of 4 HODs or 25 % has a masters' degree. This clearly shows that academic qualification is considered before HODs are appointed to hold any positions within the organization as shown in figure 4.4 above.

**Figure 4.5: Academic Qualifications for loanees**

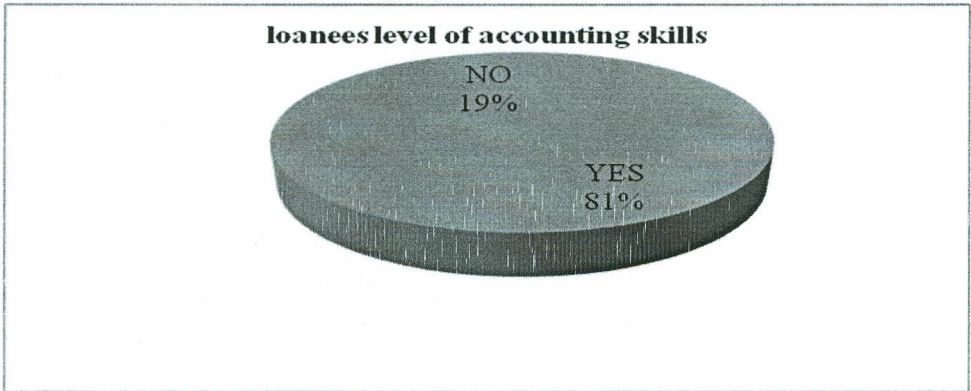


Source: Author (2011)

As shown in figure 4.5 above, from the farmers' category most respondents thus 35% were secondary school certificate holders and 31% of the respondents had primary level of education. 19% of the respondents had also been to University while 15% of the respondents had no academic qualifications to their name

**4.1.5 Response on financial management skills by loanees**

**Figure 4.6: Percentage of loanees who maintained accounting records**

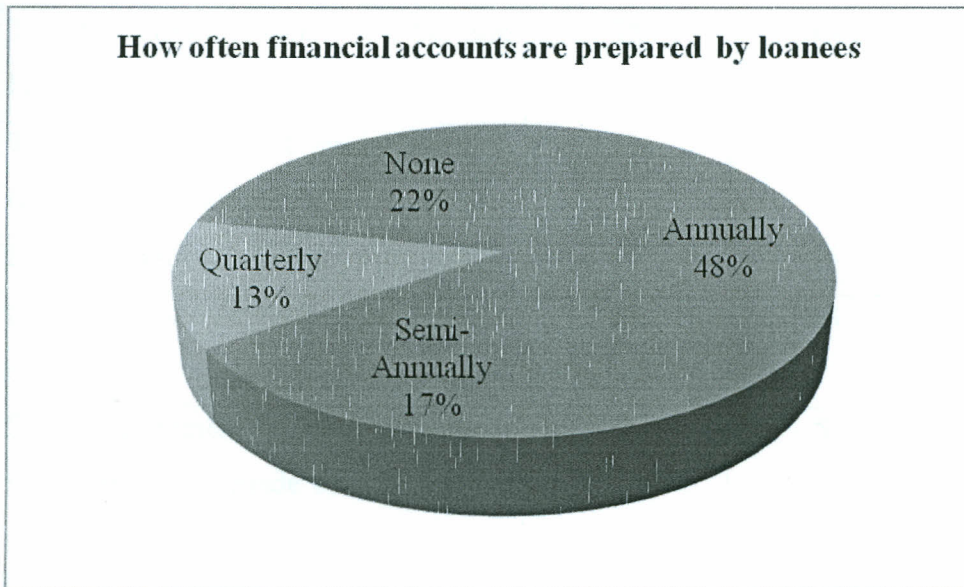


Source: Author (2011)

From the figure 4.6 above, it illustrates that the financial management skills of the loanees which stood at 81% of the farmers who responded have basic accounting skills like book keeping while 19% of them did not have any accounting skills.

#### 4.1.6 Response in how often the farmers maintained their books of farm records

**Figure 4.7: Maintenance of financial records**



**Source:** Author (2011)

In relation to how often the financial records are prepared by those who have financial management skills, figure 4.7 illustrates these facts. 48% of the respondents who had financial management skills prepared their financial records annually. This was followed by 22% of the farmers who did not prepare financial statements at all, 17% prepared financial statements semi-annually while 13% prepared financial statements quarterly.

**Table 4.1: The reasons given by loanees for records keeping purposes**

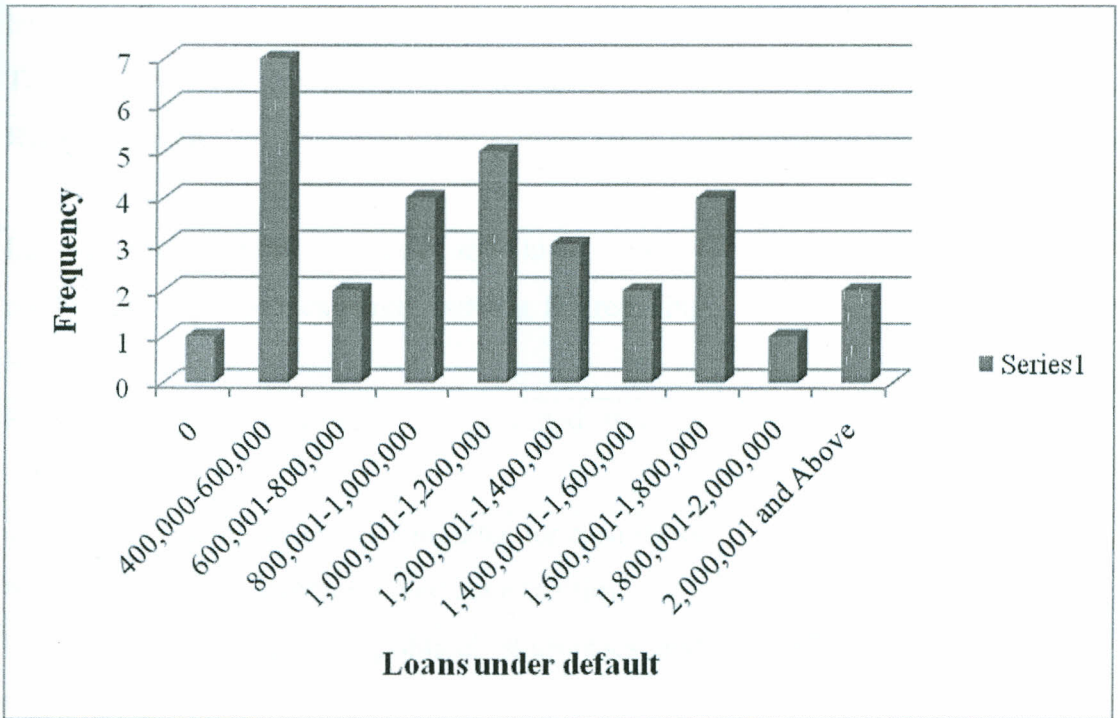
<b>Justification</b>	<b>Frequency</b>	<b>Percentage (%)</b>	<b>Rank</b>
For adequate planning and control of business	<b>19</b>	<b>17</b>	<b>1</b>
To determine returns on farming business	<b>15</b>	<b>14</b>	<b>4</b>
To determine cost of production and turnover from output	<b>13</b>	<b>12</b>	<b>5</b>
For cost control and monitoring costs	<b>17</b>	<b>16</b>	<b>2</b>
For tax assessment & computation purposes	<b>13</b>	<b>12</b>	<b>5</b>
It is a requirement by AFC before any loan approval is made for costing the project(s)	<b>9</b>	<b>8</b>	<b>6</b>
To ensure funds are use for intended purpose and avoid mismanagement	<b>16</b>	<b>15</b>	<b>3</b>
For use in negotiating for funds with lending firms-refinancing	<b>7</b>	<b>6</b>	<b>7</b>
<b>TOTAL</b>	<b>109</b>	<b>100%</b>	

**Source:** Author (2011)

From the findings as tabulated in the table 4.1 above, the loanees indicated that three most important reasons for keeping financial records were for adequate planning and control of business, for cost control and monitoring costs and to ensure funds are use for intended purposes and avoid mismanagement ranked 1, 2 and 3 respectively. The minor reasons for keeping the records were identified as for use in negotiating for refinance with lending firms, it is a requirement by AFC before loan approval, costing the project, for tax assessment and computation purposes and to determine cost of production and assess turnover from farm output, these are ranked 7, 6 and 5 respectively.

#### 4.2: Response in terms of the clustered amounts of loans under default

Figure 4.8 : Graduate loans advanced under default



Source: Author (2011)

The findings as indicated by figure 4.8 above shows that the most amounts advanced out to farmers under default falls in the category of Kshs.400, 000 to Kshs. 600,000. This is followed by the bands of Kshs.1, 000,000 to 1,200,000, Kshs 800,001 to 1,000,000 and Kshs 1,600,001 to Kshs 1,800,000 respectively. A few defaulters exist in the category of above Kshs. 1,800,000 to Kshs.2, 000,000.

### 4.2.1 Response by loanees for justification of default

From the findings the reasons the farmers they gave for loans default are summarized in table 4.2.

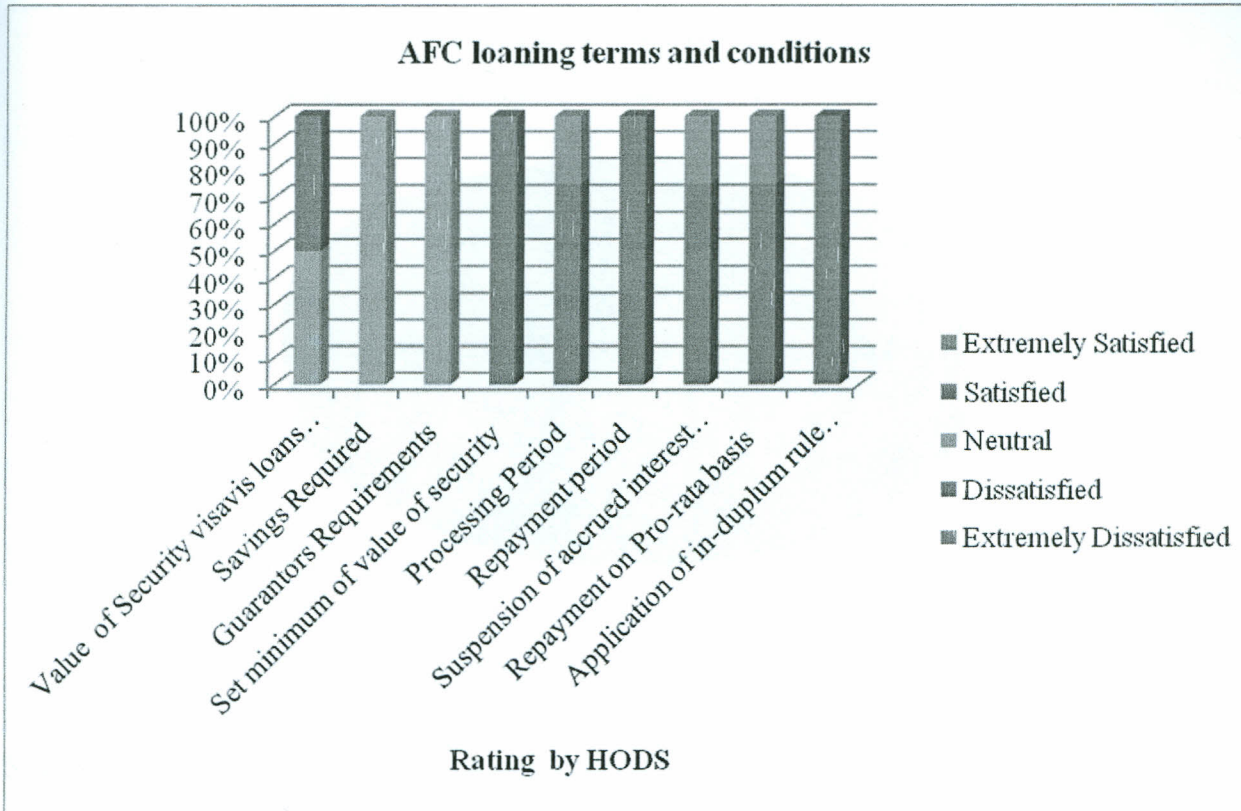
**Table 4.2: loanees' justification for default**

Reasons given	Frequency	Percentage (%)	Rank
Low prices of farm produce and high cost of production which leaves barely nothing for repaying loans	19	15	1
Poor harvest due bad and unprecedented weather conditions	18	14	2
Too much dependence on farm produce for cash flows which is marred by unprecedented uncertainties	13	10	4
Political interferences i.e. political skirmishes and land disputes	17	14	2
Economic inflation coupled high cost of living causing financial distress	14	11	3
Lack of adequate financial management skills that lead to mismanagement of funds and poor planning	14	11	3
Over borrowing which cannot be accommodated by cash inflows generated by the overtraded projects during repayment process-over ambitions	17	14	2
Others: <ul style="list-style-type: none"> <li>▪ Farmers reluctance attitude</li> <li>▪ Dishonest pretences and practices by loanees</li> <li>▪ Divergence of funds for non-intended uses</li> </ul>	13	10	4
<b>TOTAL</b>	<b>125</b>	<b>100</b>	<b>0</b>

Source: Author (2011)

### 4.3 Response on effect of AFC loaning procedures on NPLs by HODs

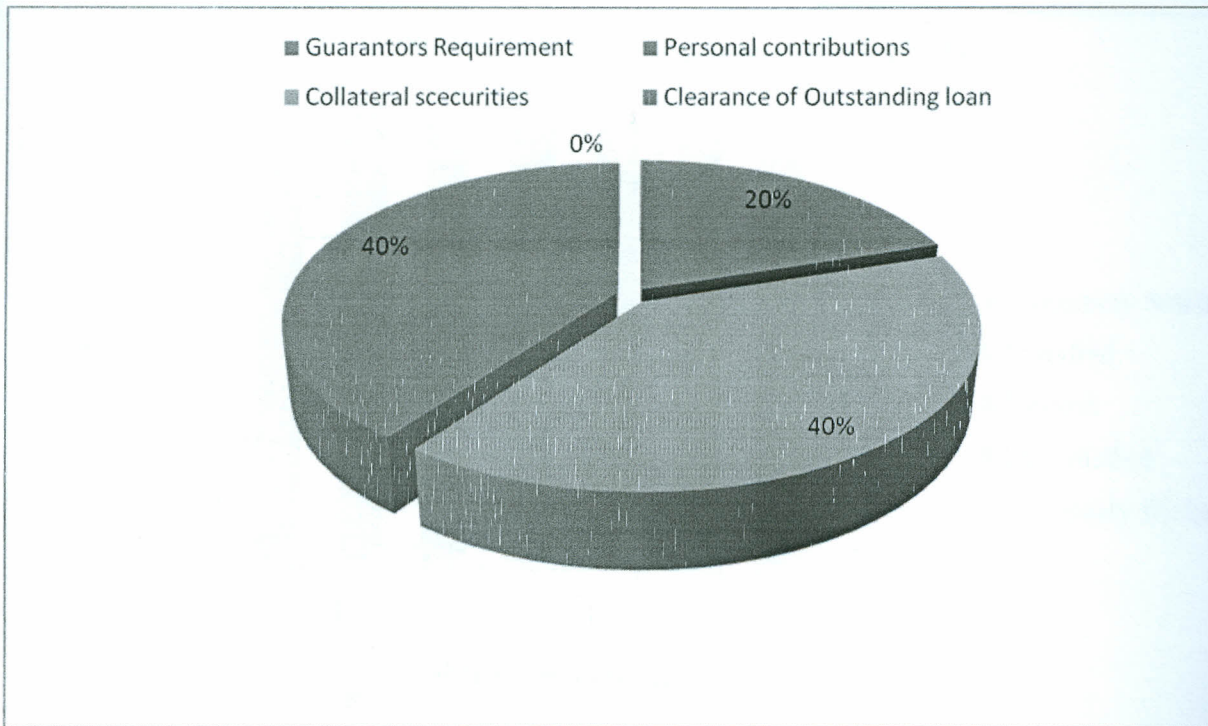
Figure 4.9: AFC loaning terms and conditions



Source: Author (2011)

From the figure 4.9 above, it shows the effect of AFC loaning procedures on NPLs. The HODs indicated that repayment period had the greatest impact on loan recovery procedure and 99% of the customers are extremely dissatisfied with this loan procedure. This is also the same case for application of in-duplum rule, set minimum value of security and value of security vis-à-vis loans (the Banking Amendment Act, 2006). 96 % of the customers were extremely satisfied with repayment on loan processing period, repayment on pro-rata basis, processing period. Over 90 % of the loanees were neutral on savings required and guarantors' requirements. Less than 50% were dissatisfied on the set minimum of value of security and value of security vis-à-vis loans. 70% of the customers were satisfied on loan processing suspension of interests and repayment on pro-rata basis

**Figure 4.10: The most challenging and mandatory credit loan term and conditions by AFC**

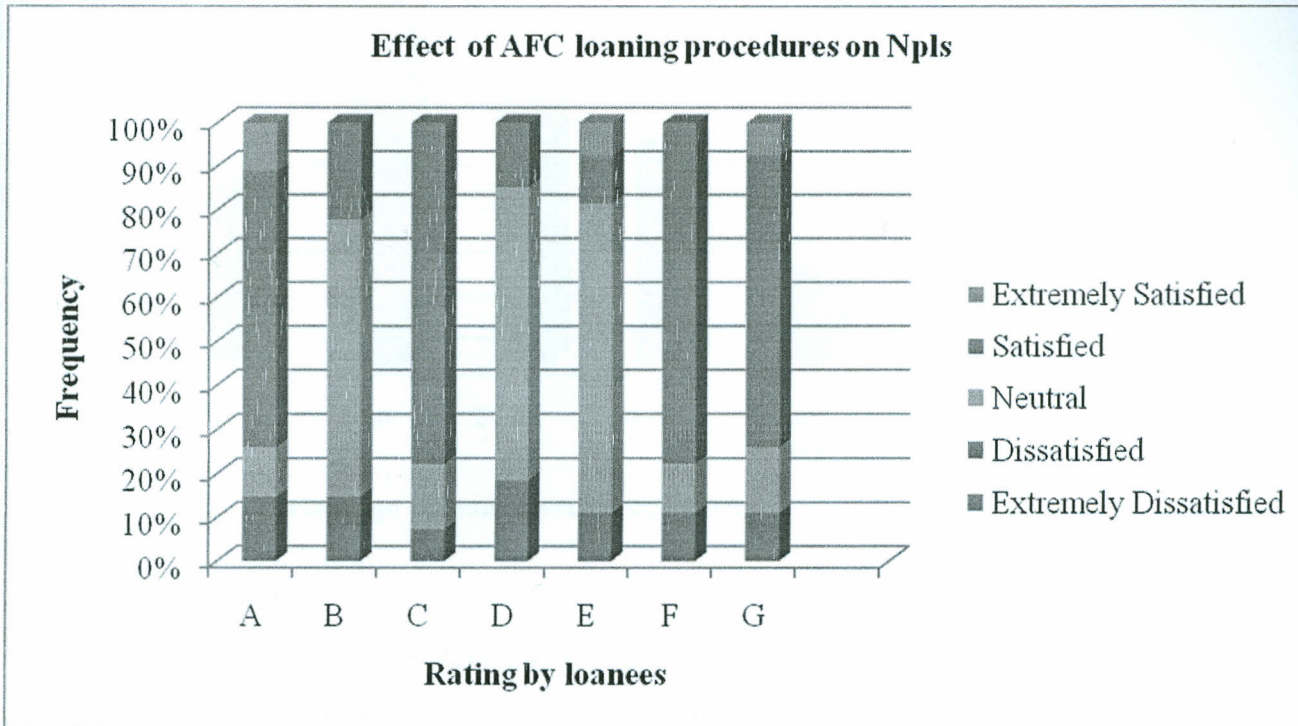


**Source:** Author (2011)

As shown in figure 4.10 above, it is imperative that the most challenging credit loan policy at AFC was attaching loanee's collateral securities and clearance of existing loans first. 40% of the respondents felt that loanee's collateral securities were the most challenging credit loan policy at AFC. Likewise, 40% felt that clearance of outstanding loan was also a challenging credit loan policy. 20% of the respondents argued that a personal contribution was another credit loan policy that was challenging at AFC. From the findings the respondents did not consider guarantors requirements as challenging policy and did not have an effect on NPLs.

### 4.3.1 Response by loanees on effect of AFC loaning procedures

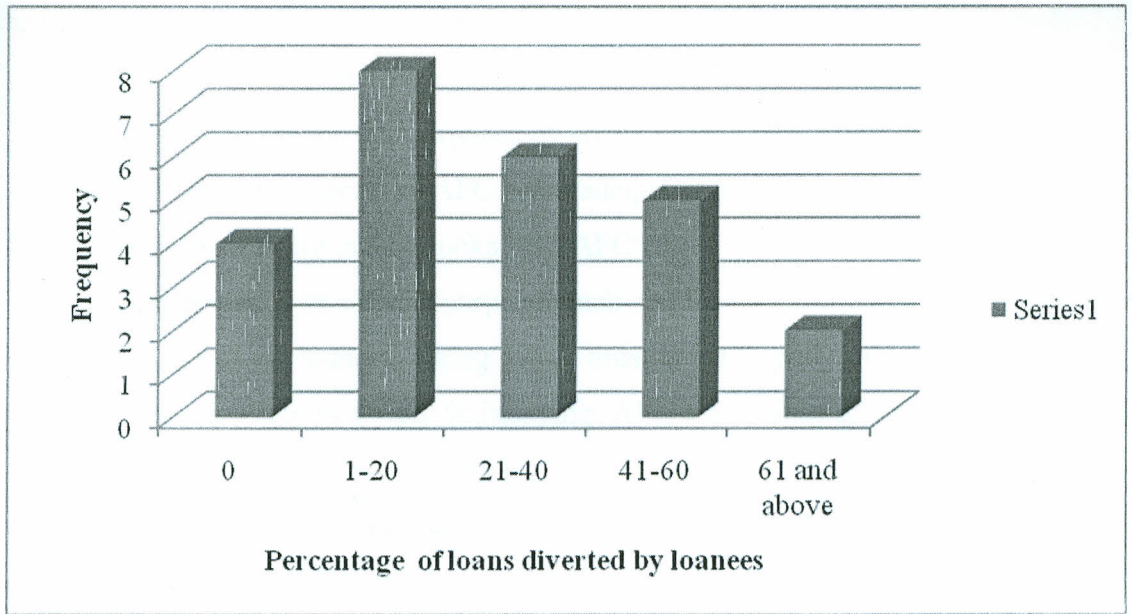
Figure 4.11: AFC loaning procedures



Source: Author (2011)

From the figure 4.11 above, loanees were asked about their level of satisfaction on AFCs loaning procedures, the findings indicate that 70% of the loanees were satisfied with the time taken to process a loan, the nature of collateral securities required and boosting of personal contributions for loan advancement. Also, the same percentages of farmers were neutral with getting guarantors to fill loan forms and involvement of committees in loan approval. However, loanees were dissatisfied below 15% on boosting of personal contributions for loans application and clearance of previous loans. Extremely dissatisfaction at less than 10% was also recorded at getting guarantors to fill the loan forms and the securities needed to qualify for the loan. It is expected that the loaning procedures will almost definitely have a direct bearing on the extent of recovery of loans by AFC. This was because ordinarily loaning procedures that are not water tight enough are most likely to lead to high levels of NPLs.

**Figure 4.12: Loans expensed for non-intended AFC purposes**

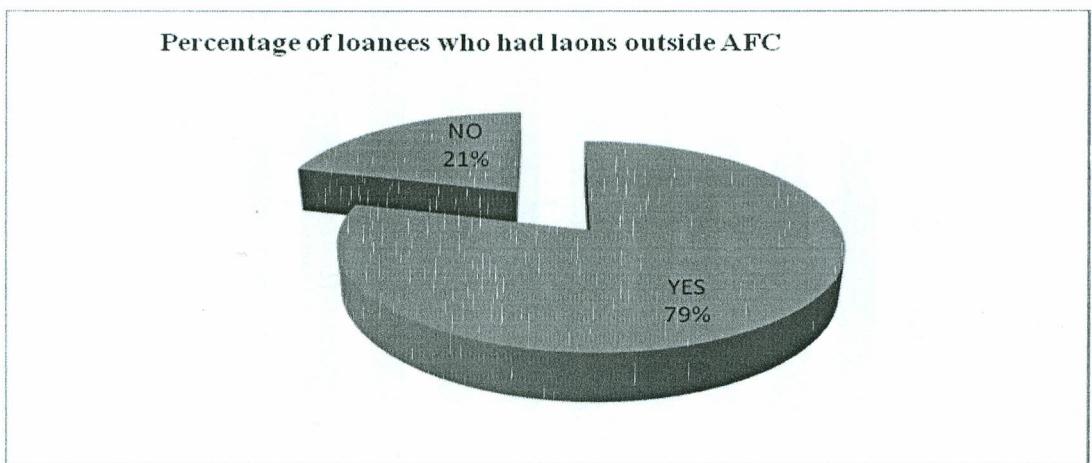


**Source:** Author (2011)

As shown in the figure 4.12 above, majority of the loanees diverted between 1%-20% of their borrowed funds for non-intended purposes. At the same time, 21%-40% of the same loans are also expensed which is closely followed by 41%-60% and the rest.

#### 4.4 Response by loanees on borrowing from other financial institutions

**Figure 4.13: Percentage of loanees with loans outside AFC**



**Source:** Author (2011)

The findings from the figure 4.13 above indicate that 19 out of 25 or 79% of the loanees had loans from other financial institutions other AFC for several of reasons namely:

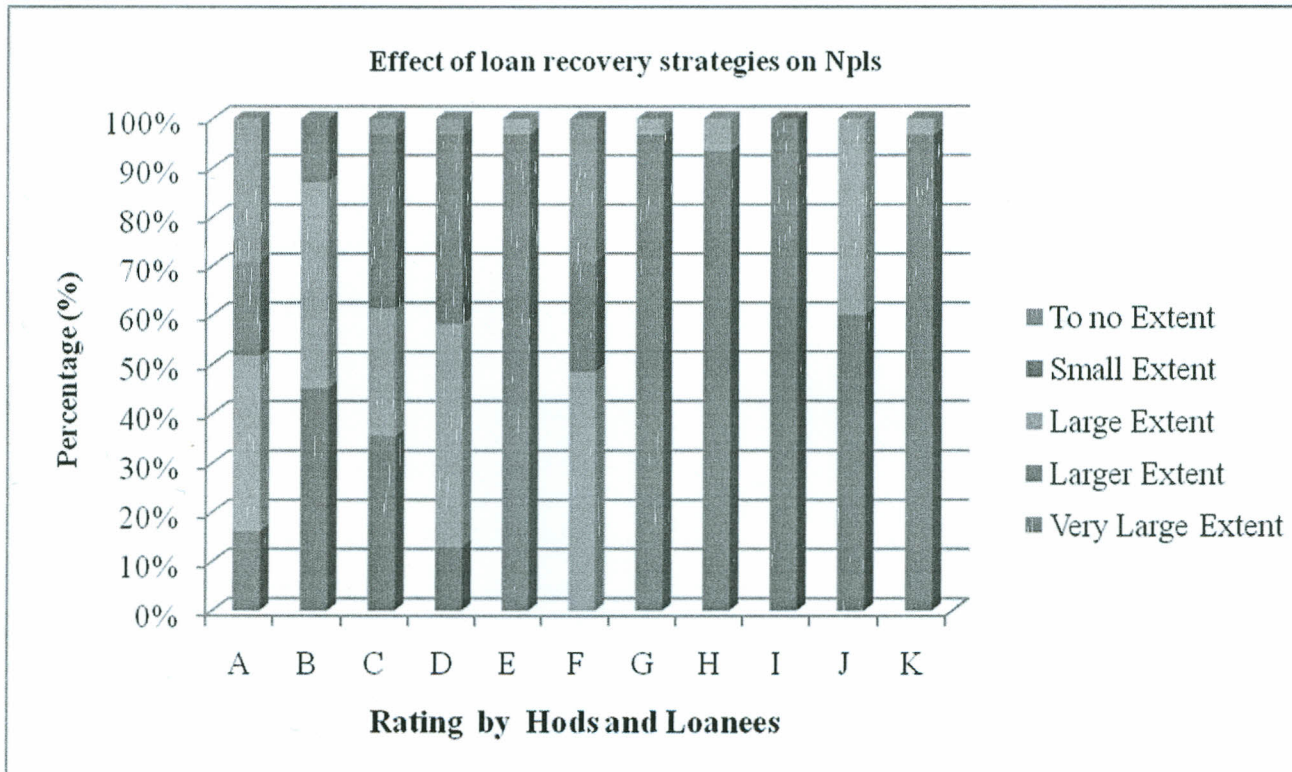
- Inability to meet the terms and conditions of AFC
- No collateral security is required by banks instead they offer unsecured loans
- If the amount offered by AFC is not adequate to sustain their projects
- Some loanees are in bad books with AFC due to default in the previous years
- For emergency or salvage purposes such medical and funeral expenses

Higher incidences of loanees taking loans outside AFC will imply that such kind of loanees are more likely to default in repaying AFC loans since the outside loans provide an additional repayment burden on them.

#### 4.5 Response on effect of loan recovery strategies employed by AFC on reduction or elimination of NPLs

The correct loan recovery strategies are very important because non recovery creates an imbalance in the liquidity position of the firm. From the findings of such strategies are illustrated in figure 4.14

**Figure 4.14: AFC Loan recovery strategies**



Source: Author (2011)

As illustrated in the figure 4.14 above, outsourcing loan recovery agents, concession offer bid, defaulters issued with a demand notice of 90 days and board approval for write offs did not impact much on reduction of NPLs which stood at 25% of the time. To a small extent finding indicate that use of internal loan recovery officers, offering of a concession bid and defaulter's issuance of demand notice in addition to loan restructuring enhance loan recovery to a small extent. To a large extent loan recovery is affected by dialogue with loanees' asset refinancing, sale of forceful property in possession (PIP) and attaching loanees' collaterals has an effect of possible recovery at 95% level. To a larger extent loan recovery at 65% is affected by loan restructuring and dialogue with loanees among others. This implies, therefore, that more emphasis should be put on those strategies which have higher probability of ensuring higher loans recovery at AFC. This includes attaching loanee's collaterals, loans re-structuring, sale of PIP and asset refinancing amongst others.

## CHAPTER FIVE

### SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

#### 5.1 Introduction

This chapter presents the summary of the finding and discussions of the study. It also covers the recommendations for further studies on related issues on the study not well covered as well as recommendations on matters of policy which need to be addressed especially by the AFC management on the research topic. The study finally addresses the limitations of the conclusions of this study.

#### 5.2 Summary of findings

This study was about the factors contributing to non performance of loans at the Agricultural Finance Co-operation (AFC), a farmer's co-operation which despite having highly educated and skilled management staff has been riddled with a huge portfolio debt of NPLs to the tune of 5-7 billion for the period 2005 – 2010. The findings indicated that 80% of the top management at the AFC in the period under study were graduates. It is instructive to note that it would have been expected that with such kind of higher education and professional skills and experience of not less than five years, the recovery of NPLs would have been easier and forthcoming. The issues of academic qualifications gender, and age of the top management team and even the loanees while contributing to non-performance of loans could not on their own make the huge desired difference in NPLs. It required additional inputs from other factors. These other key factors affecting NPLs included the initial loan appraisals, loanees level of financial management skills, AFC credit policies on NPLs and loan recovery strategies used by AFC.

It is assumed that higher educational and professional qualification empower people with the desired skills to make professional decisions that add value to management and leadership from the findings. The 25% and 75% of the HODs had masters and undergraduate degrees respectively. However, 40% of these qualifications despite their higher rankings were outside the key areas of agriculture and loan recovery management, a point of weakness on their applicability in the recovery of NPLs at AFC. Despite this, the large number of highly educated management team of 60% HODs at AFC was found to have contributed greatly in improved average cumulative recovery of loans from 10%

in the previous strategic plan period of 2002-2007 and to average of cumulative loan recovery of 30% in part of the financial years of the following strategic plan of 2008 – 2011 of the period under study. The higher qualifications of the top management are equally backed by the higher experience of the same team spurring more than 5 years for all the heads of department. The finding also points out that the level initial loan appraisals did have an impact on the NPLs at AFC. The AFC loan appraisals are almost water tight at the initial stages for example, projects which do not meet the AFC threshold for funding do not qualify for loans. This is in addition to those which do not have securities and those with previous records of default. Previous projects with poor costing and poor project planning records also fail to qualify for loans. This is addition to projects not supported by relevant securities required by AFC.

From these findings therefore, it is quite apparent that top management financial skills and experience to some extent affect the NPLs at AFC. It is expected that if higher management skills are backed by higher loanee's financial skills, then more recovery would be achieved. The findings indicate that more than 50% of the loanees had secondary school education and above and a business experience of not less than 2 years. 81% of these farmers had basic financial skills especially in book keeping and kept financial records. 60% of the loanees indicated that they kept financial records mainly for adequate to planning and control of business for cost control and turnover from business for cost control and assess the turnover from business activities and to ensure the borrowed funds were expensed for the intended purposes. However, at least 40% of loanees indicated that on paper the financial records are kept as part of AFC basic financial requirement so as to acquire more loans, for tax assessment and as basis for negotiating loans from other financial institutions other than AFC. The other acquired financial loans outside AFC places financial burden on the farmers whose source of loan repayment or collateral security may turn out to be the expected farm produce which must also be sold to offset any other non-AFC loans too.

From the findings even when most projects meet the AFC minimum requirements at the initial appraisal stage for loans and indeed are advanced the loans, the percentage rate of

The study findings also looked at the effect of AFC credit policies. From the findings, AFC policy requirements for the need for a guarantor did not have any significant impact on the in awarding the loans. This is because most of the time the guarantors turned out to be fellow loanees or farmers who could equally fail to repay the loans perhaps due to crop failure, political interferences, or related reasons shared by the defaulters. However, the collateral securities required were found to have significant impact on initial loan appraisal and recovery of loans. More than 50% of the respondents felt that the requirement of collateral securities worked positively in elimination of NPLs at AFC. This is because the farmers are prohibited to secure additional funds using the same securities already charged on the first loans. What this means in effect was that such farmers could not use the same collaterals for the next loan facility as long as the first loans are still outstanding hence elimination of NPLs.

The need to clear outstanding loans before being advanced a new loan was the most stringent conditions for farmers' reluctance to continue repayment loans. 60% of the loanees argued that instead of having to repay 100% of the loans so as to be advanced a new loan, it would be easier for them to go to banks such as Equity to be given refinancing money and get even higher loans than those offered by AFC since the banks currently offer unsecured loans up to a certain limits. Hence, loanees developed a tendency of non-repayment attitude to AFC loans leading to an increase in the non-performance of loans.

### **5.3 Conclusion**

From the analysis of the findings, it can be generally concluded that first, initial loan appraisal did not have greater impact on NPLs. This is because even with the stringent controls applied on loans appraisal by AFC, there still existed a huge portfolio of non-performance of loans. On the other hand, it is imperative that while 60% of the educated loanees purport to keep financial records for their core purposes of financial planning, cost control and effective utilization of funds, this assertion is more of theoretical practice to please the AFC management and perhaps secure more loans having satisfied the key loaning requirements. Practically, the higher skills by the educated loanee's category apparently worked against loan recovery strategies by AFC. Once the loans are acquired,

default stands at more than 30%. Therefore, this clearly becomes apparent from the study finding that the initial loan appraisal while contributing to NPLs to some extent, fails to shield AFC from the NPLs recovery perse. This is perhaps because the initial appraisals lay a lot of emphasis on the existing projects or projects with the potential of existing resources such as those farmers with land and title deeds. A time for example when succession issues are long and tedious process, it is imperative to note that many young and energetic men who may have the drive and vision and energy to take up farming are left out by AFC on this basis. A lack of competitive strategic thinking and business development thinking by AFC top management may therefore not be working well for their loan appraisal aspect. Business development may be incorporated in the new initial loan appraisal requirement to take into account tenets such as the level of education, their certificates as collateral security and their levels of entrepreneurial and visionary agricultural skills, potential or practical business proposals as basis for advancing loans to the potential applicants. This is in addition to the requirements to apply new technology in farming shall go a long way in ensuring that potential loanees who have the talent , ambition and drive to do business with AFC, but lack the traditional basics of titles and some farming background are not left out by AFC loaning policies. In any event, the amount of savings required, the repayment duration, the application of in-duplum rule and set minimum value of security seemed to favour the old farmer's school of thought with the resultant large portfolio of non-performing debt.

The findings of the study also analysed the effects of loan recovery strategies on NPLs. The strategies such as loan re-structuring and dialogue or continuous education with loanees were found to have the greatest impact on NPLs. This stood at 65%. Asset refinancing strategy, sale of forceful property in possession, attachment of loanees collaterals contributed to the largest recovery of non-performing loan portfolio fetching 25% of the total loans recovered in the period (Ksh.1.3 Million) .The findings however, revealed that demand notices and concession offer bids and outsourcing loan recovery agents have the least impact in reducing NPLs contributing only 3% of the total loans recovered during the period under review.

more than half of these loans are diverted for other uses other than the intended business purposes such as school fees and offsetting loans acquired from outside AFC thereby overburdening them and making repayment almost impossible. Thus, the level of financial management skills of loanees was found to affect the NPLs to a greater extent.

Thirdly, AFC credit policy affects NPLs to a great extent. The collateral securities required were found to have significant impact on recovery of loans. More than 50% of the respondents felt that the requirement of collateral securities worked positively in elimination of NPLs at AFC. This was because the farmers are prohibited to secure additional funds using the same securities already charged on the first loans. What this means in effect was that such farmers could not use the same collaterals for the next loan facility as long as the first loans are still outstanding hence elimination of NPLs. Finally, the loan recovery strategies employed by AFC contributed to greatest extent to NPLs. The strategies such as loan re-structuring and dialogue or continuous education with loanees were found to have the greatest impact on NPLs. This stood at 65%. Asset refinancing strategy, sale of forceful property in possession, attachment of loanees collaterals contributed to the largest percentage of non-performing loan portfolio fetching 25% of the total loans recovered in the period (Ksh.1.3 Million). The findings however, revealed that demand notices and concession offer bids and outsourcing loan recovery agents have the least impact in reducing NPLs contributing only 3% of the total loans recovered during the period under review

A Comparative of the extent of the impact of all these variables on non-performance of loans indicated that the loan recovery strategies employed by AFC had the greatest impact at 40% or ranked 1. The second most important factor affecting NPLs was the loanee's financial management skills, age and business experience. This had greater impact at 30% or ranked second. The effect of AFC credit policies on NPLs was ranked third at 20% while initial loan appraisal was ranked last at 10% with lesser extent. This is best illustrated in the table 5.1 below:

**Table 5.1: The Rating of Factors contributing to NPLs at AFC**

<b>Variables</b>	<b>% Effect on NPLs</b>	<b>Extent</b>	<b>Rank</b>
Loan Recovery Strategies	40	Greatest Extent	1
Level of Loanee's Financial management Skills	30	Greater Extent	2
Credit Policies on NPLs	20	Great Extent	3
Initial Loan Appraisals	10	Lesser Extent	4

**Source: Author (2011)**

Besides these factors mentioned in the table above as affecting the NPLs at AFC, the study findings also pointed out other reasons contributing to NPLs. These included, among others low market prices offered for farm produce for high cost of production leaving barely nothing for repayment of loans. At the same time, poor harvest due to unprecedented weather conditions also led to non-recovery of NPLs. Equally, too much dependence on farm and livestock produce for cash flows which is marred by uncertainties as well as political interferences such as political skirmishes and land disputes led to NPLs. The high economic inflation coupled with high cost of living causes financial distress among the loanees thus impaired repayment of loans. The lack of adequate financial management skills by some loanees not only lead to diversion and mismanagement of funds but also poor financial planning. Some over ambitious loanees end up in over borrowing of funds which eventually cannot be accommodated by the cash inflows generated by overtraded projects. This in essence leads to non-repayment of loans as a result of overtrading. Other factors contributing to NPLs at AFC include farmer's reluctance and dishonest pretences and practices to pay and their diversion of AFC loans for non-intended purposes.

In general, the recovery of NPLs by AFC will require sustainable strategic leadership, team work, business diplomat and entrepreneurial spirit and tenable AFC-farmer relationship.

## 5.4 Recommendations

From the findings, it is recommended that:-

- (i) AFC top Management creates a working relationship with other lending institutions to ensure that the farmers do not abuse the well kept farming financial records to acquire more loans from the other financial institutions whose recovery would create huge NPLs on the part of AFC loans advanced to farmers.
- (ii) The Government through the relevant ministry sets out less bureaucratic processes for “grant of permission to carry out research” in state parastatals.
- (iii) AFC management should improve her loan appraisal policies; or rather outsource partially the services of recovery of non-performing loans specifically. AFC must embrace business development and new technology requirements as a basis for improved productivity by loanees.
- (iv) In view of the importance of NPLs (Non-Performance of loans) to financial institutions, to a supervision authority, and to analysts, it is necessary for international organizations to develop a single definition of NPLs for the World. Now China’s financial institutions all adopt the five-grade classification: standard, watch, substandard, doubtful, and loss, which is suggested by the Institute of International Finance for external reporting.

## 5.5: Recommendations for Further Research

- (i) The impact of bureaucratic government procedures related to a permission to carry out research on post university academic researches.
- (ii) A comparative study on the quality of finance research studies undertaken by full time and part time masters students in Kenya on NPLs in banking industry.
- (iii) The impact of non- recovery of loans on agriculture-based financial parastatals in Kenya.
- (iv) The relationship between corporate performance and recovery of NPLs at AFC

## REFERENCES

- Alexander et al (1996) “*Adopting Indirect Instruments’ of Monetary Policy*” IMF Occasional Paper No.126, June
- Atingi-Ego, M (2004) “*Monetary Policy Objectives, Targets and Formulation*” Workshop Notes on Monetary Policy Implementation
- Bahati, K (2010), Responses by the Government Printing Press to the External Operating Environment; Unpublished MBA Research Project, University of Nairobi.
- Banking Act Amendment (2006): Legal Notice No.52 of 2007: came into operation on 1<sup>st</sup> May, 2007
- Bloem, etal (2001 ‘*The Macroeconomic Statistical Treatment of Non-performing Loans*’, Department of Statistics of the International Monetary Fund, December 1, 2001
- Basu.A. (1998). Banking systems reforms in Sub-Saharan Africa: Status and Challenges, IMF Report, Washington, U.S.A
- Beatty, J. (Eds), Colossus: How the Corporation Changed America,, Broadway Books,
- Berle, A.A., Means, G.C. (2001), "*The Modern Corporation and private property*",
- Bhasa, P. M. (2004). "*Understanding the corporate governance quadrilateral*". Journal
- Bies, & Susan S, (2002), "*Bank Performance and Corporate Governance*", Bank of
- Caprio G. (1997). Safe and Sound Banking in developing Countries: We are not in Kansas anymore. World Bank Policy Research Working Paper No.1739
- Caprio.G and Klingebiel .D (2002). Episodes of Systematic of systematic and financial crisis the World Bank.

- rural finance paper.
- Fofack (2005). "Non-performing loans in sub-Saharan Africa: Causal Analysis and Macroeconomic Implications." World Bank Policy Research Working Paper No.3769
- Garman.E.T& Forgue. E. R (1997), Personal finance, Fifth edition-Haughton Mifflin Co.
- Garrison R. W. (1997). "Austrian Theory of Business Cycles," in D. Glasner and T. F. Cooley (Eds), *Business Cycles and Depressions: An Encyclopedia*, Garland Pub., New York. 23–27
- Gill, J. & Johnson, P. (1997), *Research methods for managers*, London; PAUL Chapman Publishing Ltd
- Government of Kenya (GOK, 2002) *Economic Survey, Nairobi*-Ministry of Finance and Planning, Central Bureau of Statistics. *International Settlements Review*, 55
- Jeremiah & Joseph (2007) ,Impact of Commercial Banks on Business. KUSCCO Report
- Jimenez, G. and J. Saurina (2003) 'Collateral, Type of Lender and Relationship Banking as Determinants of Credit Risk, Bank of Spain'.
- Kabianga .M (2003) *The development of Co-operatives in Kenya*. Oscan Print
- Keynes (1936) "The General Theory of Employment, Interest and Money"
- Kimango, L (2002), The Study of Banks Credit Policies in Nairobi, Unpublished MBA, Dissertation, University of Nairobi
- Kothari C.R (2004) *Research Methodology Methods and Techniques*, New Age International Ltd Publishers. New Delhi
- KUSSCO (2005), Family Union newspaper February Issue No. 52

rural finance paper.

Fofack (2005). "Non-performing loans in sub-Saharan Africa: Causal Analysis and Macroeconomic Implications." World Bank Policy Research Working Paper No.3769

Garman.E.T& Forgue. E. R (1997), Personal finance, Fifth edition-Haughton Mifflin Co.

Garrison R. W. (1997). "Austrian Theory of Business Cycles," in D. Glasner and T. F. Cooley (Eds), *Business Cycles and Depressions: An Encyclopedia*, Garland Pub., New York. 23–27

Gill, J. & Johnson, P. (1997), *Research methods for managers*, London; PAUL Chapman Publishing Ltd

Government of Kenya (GOK, 2002) *Economic Survey, Nairobi*-Ministry of Finance and Planning, Central Bureau of Statistics. *International Settlements Review*, 55

Jeremiah & Joseph (2007) ,Impact of Commercial Banks on Business. KUSCCO Report

Jimenez, G. and J. Saurina (2003) 'Collateral, Type of Lender and Relationship Banking as Determinants of Credit Risk, Bank of Spain'.

Kabianga .M (2003) *The development of Co-operatives in Kenya*. Oscan Print

Keynes (1936) "The General Theory of Employment, Interest and Money"

Kimango, L (2002), The Study of Banks Credit Policies in Nairobi, Unpublished MBA, Dissertation, University of Nairobi

Kothari C.R (2004) *Research Methodology Methods and Techniques*, New Age International Ltd Publishers. New Delhi

KUSSCO (2005), Family Union newspaper February Issue No. 52

KUSSCO (2007), New look magazine July – September Issue No. 2

Lapin, L. (1987), *Statistics for Modern Business Decisions*, San Diego: Harcourt brace Jovanovich publishers.

Markowitz (1999). *The early history of portfolio theory: 1600-1960*, *Financial Analysts Journal*, Vol. 55, No. 4

Mogeni, K (2008) *Competitive responses by Kisii Bottlers Ltd*, Unpublished MBA, Dissertation, University of Nairobi

Mugenda O.M & Mugenda A.G (1999) *Research Methods Quantitative Qualitative Approaches*, Acts Press, Nairobi

Muturi N. S (2006), *Management of Strategic Change at Plan International Kenya*, Unpublished MBA Project, University Of Nairobi

Njagi M. (2003): *Corporate Social Responsibility*, Rout ledge, London of corporate governance, Volume 4. Number 4, pp. 7-15. No.19 of South Africa Reserve Ban

Rose (2002) , *Focus on management for Credit Union*. USA CUNA

Sharpe etal (1964). *Capital asset prices: A theory of market equilibrium under conditions of risk*, *Journal of Finance*, 19 (3), 425-442

Saurina Etal (2000). “Credit growth, Problem loans and Credit risk provisioning in Spain Working Paper No. 0018, Banco de Espana, October.

Strategic Plan 2005-2010, Agricultural Finance Corporation.

Taschereau, S. (1997, *Evaluating the impact of Training and institutional development Programs: A Collaborative Approach*, Washington, D.C, the World Bank

**APPENDICES**  
**APPENDIX I**  
**INTRODUCTORY LETTER**

Kenyatta University,  
School of Business and Economics,  
P.O. Box 43844-00100,  
Nairobi.

Masters of Business Administration  
Department of Accounting and Finance

Date:.....

Dear Sir/Madam,

**RE: REQUEST FOR YOUR PARTICIPATION IN MY RESEARCH WORK**

I am a post graduate student at Kenyatta University and currently undertaking research project whose theme is Factors contributing to non-performance of loans (NPLs) in Agricultural Finance Corporation of Kenya.

This request is to assist me collect and gather important information and data by filling in the attached questionnaire.

All data and information given will be used exclusively for academic purposes only and shall be treated with utmost confidentiality

A copy of the final paper will be availed to you upon your request

For any clarification on this matter, I can be reached on 0725-518897

Your assistance and co-operation shall be highly appreciated.  
Thank you.

Yours faithfully,

**Kipkirui Soo Selote**

**Student**

**APPENDIX II**

**QUESTIONNAIRE TO HEADS OF DEPARTMENT**

**PART A: PERSONAL DETAILS**

1. Department. ....

**Please tick where appropriate (√)**

2. Gender      Male            Female
3. Age (bracket) below 25  between 26-35  between 36- 45  above 45
4. Duration of service in years  
Less than 2  between 2-5  between 5-10  Above 10
5. Highest academic qualification attained  
Diploma  Degree  Masters and Above

**PART B: EFFECT OF CREDIT LOAN POLICY ON NPLs**

6. Identify the most challenging and mandatory term of loan policy to be fulfilled in order to acquire

AFC loan among the following:-

- Guarantors' requirement  Collaterals securities   
Savings requirement  Clearing of outstanding loan

7. On a scale of 1-5, what is your response to AFC loan policy in the following terms?

**1. Extremely dissatisfied 2.Dissatisfied 3. Neutral 4. Satisfied 5. Extremely satisfied**

**TERMS OF LOAN**

**RESPONSE**

- a). Amount of loan granted not exceeding 2 or 3 times loanee's value of security [ ]
- b). Savings required for at least 6 months. [ ]
- c). Guarantors requirements [ ]
- d).The set minimum value of security for normal loans granted. [ ]
- e). Waiting for two months after loan clearance by cash. [ ]
- f). Repayment period of 36 months for normal loans [ ]
- g). Exclusion of penalties or accrued interest in determining amount of loan granted [ ]
- h).Repayment of loans on Pro- rata basis [ ]

I).Application of in-duplum rule in recovery of loans from loanees

{ }

8(a) Do you currently have a loan with the AFC?

No  Yes

(b)(i).What is the highest amount of loan that a member has been advanced?

Below 150, 000  300,000-500,000  150,000-300,000  Above 500,000

(ii) Has the member cleared the outstanding loan?

Yes  No

(iii)If No, what are the reasons for default?

.....  
.....

9 (a) Do you have any member(s) with loans from other financial institutions?

No  Yes

(b)If Yes, what are their main reasons for borrowing outside AFC?

.....  
.....  
.....

**PART C: INITIAL LOAN APPRAISALS**

10 (a)(i) How often is loan application forms rejected for not meeting certain AFC terms?

Never  Rarely  Occasionally  Often

(ii) Under which AFC terms and conditions has this happened?

.....  
.....

(b) How long do applicants take to receive normal loans after application?

Within 2 weeks  Within a month  Within 2 months  More than 2 months

11 Using the following criterion comment on the AFC loaning procedure

1. **Extremely Dissatisfied.** 2. **Dissatisfied.** 3. **Neutral** 4. **Satisfied** 5. **Extremely satisfied**

<u>STATEMENT</u>	<u>RESPONSE</u>
a). Time taken to process a loan.	[ ]
b). Getting guarantors to fill loan forms.	[ ]
c). Involvement of various committees in loan approval.	[ ]
d). Boosting of shares or loan clearance by cash not considered immediately for loan advancement.	[ ]
e). Normal capital loans being processed monthly.	[ ]
f). Clearance of a previous loan of a similar type first before qualifying for another	[ ]
g).The nature of collateral securities required	[ ]

12(a) What are the other initial loan appraisal requirements by AFC?

.....

.....

.....

(b)What some of the reasons why some of these appraisal requirements lead to non-performance of loans?

.....

.....

.....

13(a) Interest on AFC loans have remained constant at 12% p.a. since inception while for bank loans fluctuate with changes in the economy but are always higher ranging from 12.18% to 25.50% currently. What percentage of your loan applicants are aware of this fact while making a choice of obtaining a loan facility?

1-20  21-40  41-60  61 and above

(b) What is the effect this awareness in terms of loan repayment?

.....  
.....  
.....

(c) Do majority of your customers fully understand that there are other additional fees charged on loans apart from interest in other lending institutions apart from AFC?

No  Yes

(d) If Yes, why do they go for bank loans instead of AFC loans?

.....  
.....  
.....

(e) What percentage of loanees usually divert more than 60% of loans from the intended purpose?

1-20  21-40  41-60  61 and above

(f) What is the percentage basic financial management skills level of majority of the loanees?

1-20  21-40  41-60  61 and above

**PART E: LOAN RECOVERY STRATEGIES**

14. To what extent do you think the following loan recovery strategies reduce or eliminate performance of loans at AFC.

<b>Loan Recovery Strategies at AFC</b>	<b>Very Large Extent (1)</b>	<b>Larger Extent (2)</b>	<b>large Extent (3)</b>	<b>Small Extent (4)</b>	<b>To no Extent (5)</b>
Outsourcing loan recovery agents					
Use of internal loan recovery officers -Used 100%					
Taking legal action on defaulters -Offer concession bids					
Using ultimatums and threats on loan defaulters					
Attaching loanees collateral -Mandatory 100%					
Outstanding loan portfolio write offs -Upon board approval					
Forceful property in possession					
Sale of property in possession					
Loan restructuring					
Dialogue with loanees					
Asset refinancing-50%					
Others specify					

17). Any other comment

.....

**Thank you for your time and cooperation**

**APPENDIX III**

**QUESTIONNAIRE FOR FARMERS**

**PART A: PERSONAL DETAILS**

Please tick where appropriate ( √ )

- 1. Gender      Male       Female
- 2. Age. Below 25  between 26-35       between 36- 45  Above 45
- 3. Highest academic qualification attained  
Primary  Secondary  University   
Other (specify) \_\_\_\_\_
- 4. The nature of business undertaken  
Farming  Non-farming  Others
- 5. If farming business, how many acreage of lands are farmed annually  
Between 1-50       between 50-100       Over 100
- 6. Experience in farming business in years  
Less than 2  between 2-5       between 5-10  Above 10

**PART B: FINANCIAL MANAGEMENT SKILLS**

7 a) Do you keep accurate accounting records for your incomes and expenditures from farming activities?

Yes       No

b).If Yes, how do the records assist you in farm management?

.....  
.....

c).How often do you prepare the income and expenditure and balance sheet of the farm?

.....  
.....

8.(a).What is the highest amount of loan that you have been advanced?

600,000-800,000  800,001-1,000,000  1,000,001- 1,200,000   
1,200,001-1,400,000  1,400,001-1,600,000  1,600,001-1,800,000   
1,800,001-2,000,000  2,000,001 and above

(b).Have you cleared your outstanding amount of loan?

Yes  No

(c).If No, what are the reasons for default?

.....  
.....

9. (a). Do you have any loans from other financial institutions?

No  Yes

(b). If Yes, what are the main reasons for borrowing outside AFC?

.....  
.....

**PART C: INITIAL LOAN APPRAISALS**

10.(a).How often is your loan application forms rejected for not meeting certain AFC terms?

Never  Rarely  Occasionally  Often

(b). Under which AFC terms and conditions has this happened?

.....

(c).How long do you take to receive normal loans after application?

Within 2 weeks  Within a month  Within 2 months  More than 2 months

11. Using the following criterion comment on the AFC loaning procedures

1. **Extremely Dissatisfied.** 2. **Dissatisfied.** 3. **Neutral** 4. **Satisfied** 5. **Extremely satisfied**

<u>STATEMENT</u>	<u>RESPONSE</u>
a). Time taken to process a loan.	[ ]
b). Getting guarantors to fill loan forms.	[ ]
c). Involvement of various committees in loan approval.	[ ]
d). Boosting of shares or loan clearance by cash not considered immediately for loan advancement.	[ ]
e). Normal capital loans being processed monthly.	[ ]
f). Clearance of a previous loan of a similar type first before qualifying for another	[ ]
g).The nature of collateral securities required	[ ]

13(a) Interest on AFC loans have remained constant at 12% p.a. since inception while for bank loans fluctuate with changes in the economy but are always higher ranging from 12.18% to 25.50% currently. Are you aware of this fact while making a choice of obtaining a loan facility?

Yes  No

(b)What is the effect this awareness in terms of loan repayment?

.....  
.....  
.....

(c) Do you fully understand that there are other additional fees charged on loans apart from interest in other lending institutions apart from AFC?

Yes  No

(d) If Yes, why do you go for bank loans instead of AFC loans?

.....

(e)What percentage of the outstanding loans have you expensed for other purposes other than farming?

None  1-20  21-40  41-60  61 and above

**PART E: LOAN RECOVERY STRATEGIES BY AFC**

14. To what extent do you think the following loan recovery strategies by AFC reduce or eliminate non-performance of loans?

<b>Loan Recovery Strategies at AFC</b>	<b>Very Large Extent (1)</b>	<b>Larger Extent (2)</b>	<b>large Extent (3)</b>	<b>Small Extent (4)</b>	<b>To no Extent (5)</b>
Outsourcing loan recovery agents					
Use of internal loan recovery officers -Used 100%					
Taking legal action on defaulters -Offer concession bids					
Using ultimatums and threats on loan defaulters					
Attaching loanees collaterals -Mandatory 100%					
Outstanding loan portfolio write offs -Upon board approval					
Forceful property in possession					
Sale of property in possession					
Loan restructuring					
Dialogue with loanees					
Asset refinancing-50%					
Others specify					

**Thank you for your time and cooperation**