

## **Group Lending and Loans Performance in Micro-Finance Institutions in Nairobi City County, Kenya: Case of Kenya Women Microfinance Bank Limited**

**Abdirashid Ali Abdi<sup>1</sup>, Dr. Ambrose O. Jagongo<sup>2</sup>**

<sup>1</sup>Correspondent Author, School of Business, Kenyatta University, Kenya

<sup>2</sup>Lecturer, Department of Accounting and Finance, Kenyatta University, Kenya

---

### **ABSTRACT**

---

*The microfinance industry has grown over the years. However, there is a growing concern on the loan default among microfinance institutions in Kenya. This may be a pointer to increased ineffectiveness of the institutions' various lending programs. This study seeks to examine the relationship between group lending and loans performance in micro-finance institutions in Kenya, with a focus on KWFT. The study specifically sought to: determine the relationship between group self-internal regulations among group members and loans performance in KWFT microfinance; to examine the relationship between credit appraisal process of members and loans performance in KWFT microfinance; to establish the relationship between credit policy on group loans and loans performance in KWFT microfinance; and to assess the relationship between credit risk control measures on the group and loans performance in KWFT microfinance. The study was guided by theory of group lending, Asymmetric Information theory and Portfolio Theory. The study adopted a descriptive research design. The target population consisted of approximately 60 respondents in six KWFT branches within Nairobi County. The unit of observation was the credit managers and credit/ loan officers. Since the population was small, a census study was adopted whereby the entire population was considered for the study, thus all the 60 respondents formed the sample size for the study. The study collected primary data through a questionnaire. The developed questionnaire was checked for its validity and reliability through pilot testing. The collected data was analyzed using descriptive and inferential statistics with the help of SPSS software. The descriptive statistics included frequency distribution tables, means, standard deviation and measures of relative frequencies. The inferential statistics entailed a regression analysis which will establish the relationship between variables. The study findings indicate that strong correlation coefficient between loans performance at KWFT and group self-internal regulations, credit appraisal process, credit policy and credit risk control measures and they are all statistically significant. The study concludes that groups financed had put in place mechanisms to ensure that the group members repay loans in time, credit appraisal process employed to inform lending to groups were amount of credit the group qualifies, the ability of the group to repay and the nature of collateral to be imposed, rates charged on the group loans determines the effectiveness of repayment of loans by the members and the period the group is given to repay the loans determines the loan performance. The study recommends that organizations participating on group loans need to ensure that the group are promoting good governance in their leadership and administration, the study recommends that those in charge of loans need to work for stability in the macro-environment to ensure interest rates charged by MFIs remain stable and affordable and the*

*study recommends that micro-finance institutions should put in place a credit risk management team whose mandate will be to establish well defined credit control policy and guidelines.*

**Keywords:** *Group Lending, Loans Performance, Micro-Finance Institutions, Kenya Women Microfinance Bank Limited*

DOI 10.7176/ijcab.v3iIII.33, URN: :nbn:de:0000ijcab.v3iIII.331

**Cite this Article:**

Abdirashid, A., & Jagongo, A. (2019). Group Lending and Loans Performance in Micro-Finance Institutions in Nairobi City County, Kenya: Case of Kenya Women Microfinance Bank Limited. *International Journal of Current Aspects*, 3(III), 96-110. <http://journals.ijcab.org/journals/index.php/ijcab/article/view/33>

---

## 1. INTRODUCTION

Microfinance is flourishing in developing countries to provide credit to the poor micro entrepreneurs. For decades, poverty alleviation has topped the international development agenda and in this regard, microfinance has become an emerging phenomenon that opens access to capital for individuals previously shut out from financial services of these countries (Bruton, Khavul & Chavez, 2011). Microfinance refers to the provision of financial products to low-income borrowers who do not have access to loans from established formal institutions. The term microfinance embraces different forms of micro lending, the most famous institutions being the Grameenq Bank of Bangladesh, the Bancosol of Bolivia and the Bank Kredit Desa of Indonesia. These institutions have already shown success in being able to reach the poor and realizing high repayment performance (Mehreteab, 2005). The microfinance sub-sector has had to contend with numerous challenges. One of the major challenges faced especially by personal loan programs of Microfinance Institutions (MFIs), is that borrowers are highly risky since they are typically low net-worth individuals with little or no collateral that can be acquired by the MFI in the event of default (Kodongo & Kendi, 2013). A popular remedy to this problem involves requiring borrowers to apply for credit in voluntarily formed groups: since such borrowers know each other, safe borrowers will likely form their own groups, avoiding those with higher risk profiles – this mitigates the adverse selection problem (Demont, 2013). Group lending model has attracted an enormous amount of public and academic attention mainly after the success of group lending program in Grameenq Bank (Ibtissem & Bouri, 2013). In microfinance, group lending model is one of the best practices in Africa (Schreiner, 2013). It is evident from the background that there is a growing concern on the credit risk resulting from high levels of loan default (non-performing loans) among lending financial institutions. Consequently, this has negatively affected the sustainability and constrained the scope of credit available to borrowers as these firms have to compensate for loan delinquency. In addition it discourages the financial institutions from refinancing the defaulting members, which put the defaulters once again into vicious circles of low productivity (Warue, 2012).

The group lending model was first used in Bangladesh and runs two broad microcredit programs: personal lending and group lending (Maria, 2009). In Group Lending, time and effort is invested in building social networks that enable groups to select members who are creditworthy under group lending, the role of loan officers is 'to provide structure, training on loan processes and administrative support. The principle incentives for repayment of group loans is' joint liability group reputation, credit rating and future access to credit for each member, all of which are

directly contingent on each member upholding their obligations (Giné & Karlan, 2010). The microfinance sector in Kenya has largely adopted the Bangladeshi model. Credit is typically granted to finance business/entrepreneurial activities under both programs but it is believed that significant unfulfilled market demand also exists for personal loans to finance consumption and emergency needs. The two credit programs (personal and group lending) exhibit different characteristics defined by among others, the rapidity of loan approval, repayment periods (defines as weeks or months), interest rates, and other program specific terms (Kodongo & Kendi, 2013). The MFIs lends to self-help groups (SHGs) which in return lends to the group members. This suggests that group governance including self-internal regulations and screening process for members for loan qualifications, may affect loan delinquency levels of the lending MFI (Thuo & Juma, 2014). Group lending is not without setbacks. Savita (2007) argues that group lending is associated with additional costs including group formation costs, training borrowers on group procedures higher degree of supervision and a higher frequency of installment payments. These costs increase interest rates of such microcredit loans leading to enhanced repayment risk. Other researchers argue that joint liability in group lending penalizes good credit risk customers (Giné & Karlan, 2010), could hinder optimal utilization of borrowed funds by clients (Madajewicz, 2003) and might even jeopardize repayment since the incentive of future credit is no longer present in the event that one member fails to pay (Besley & Coate, 1995).

A loan is said to be delinquent when a payment is late (CGAP, 2009). A delinquent loan becomes a defaulted loan when the chance of recovery becomes minimal. Delinquency is measured because it indicates an increased risk of loss, warnings of operational problems and may help to predict how much of the portfolio will eventually be lost because it never gets repaid. According to Lawrence (2012) there are three broad types of delinquency indicators: collection rates which measures amounts actually paid against amounts that have fallen due, arrears rates measures overdue amounts against total loan amounts and portfolio at risk rates which measures the outstanding balance of loans that are not being paid on time against the outstanding balance of total loans. Default occurs when a debtor has not met his or her legal obligations according to the debt contract. According to new Basel II Capital Accord, default is defined as 90 days delinquent. For example a debtor has not made a scheduled payment, or has violated a loan covenant (condition) of the debt contract (Mwenje, 2006). A default is the failure to pay back a loan (Lawrence, 2012). Default may occur if the debtor is either unwilling or unable to pay their debt. A loan default occurs when the borrower does not make required payments or in some other way does not comply with the terms of a loan (Ledgerwood *et al.*, 2009).

According to Smirllok (2011) default is a risk threshold that describes the point in the borrower's repayment history where he or she missed at least three installments within a 24 month period. This represents a point in time and indicator of behavior, wherein there is a demonstrable increase in the risk that the borrower eventually will truly default, by ceasing all repayments. The definition is consistent with international standards and was necessary because consistent analysis required a common definition. This definition does not mean that the borrower had entirely stopped paying the loan and therefore been referred to collection or legal processes; or from an accounting perspective that the loan had been classified as bad or doubtful, or actually written-off. Loan default can be defined as the inability of a borrower to fulfill his or her loan obligation as at when due (Mwenje, 2006). Repayment performance thus serves as a positive signal for increasing the volume of credit availability to various sectors of the economy (Acquah

& Addo, 2011). However, certain factors are considered before it is availed to the beneficiary and one of such factors is the beneficiaries' ability to repay the loan which in turn is also determined by many factors. According to Ugbomeh, Achoja, Ideh and Ofuoku (2008), credit repayment performance could be influenced by a myriad of factors such as interest rate, and the social relations and responsibilities of the borrower. Kiiru (2007) found out that repayment performance is significantly affected by borrowers' characteristics, lender's characteristics and loan characteristics. The marginal effects of each set of characteristics are determined and analyzed. Repayment problems can be in the form of loan delinquency and default. Whatever the form however, the borrowers alone cannot be held responsible wherever problems arise as it is important to examine the extent to which both borrowers and lenders comply with the loan contract as well as the nature of the duties, responsibilities and obligations of both parties as reflected in the design of the credit program rather than heaping blames only on the borrowers.

In Kenya, microfinance started in the 1980s with the Kenya Rural Enterprise Programme (K-REP) and few other NGOs being the first players. The industry has grown very fast over the years due to high demand for microfinance services. The microfinance institutions in Kenya have been operating from different legal legislations ranging from NGOs, trusts, commercial banks among others and the industry has been unregulated (Sabana, 2003). In 2006 the Parliament, through the Central Bank, enacted a Micro-finance Act that was effected on 2nd May 2008. The enactment deepened the financial market and enhanced access of financial services and products to all Kenyans. Primarily, the Act regulates the establishment of such institutions through licensing and supervision. The Act enables taking deposits from the general public and hence promotes competition, efficiency, and access (Micro-finance Act, 2008). The MFIs in Kenya are licensed and regulated by the Central Bank of Kenya (CBK). This is under the Microfinance Act of 2006 and the Microfinance Regulations for Deposit Taking MFIs of 2008. The act saw the development of two types of licensed micro finance institutions the deposit taking and non-deposit taking institutions. Most Microfinance Institutions in Kenya double-up as Deposit Taking Institutions and in this regard, the Microfinance Act was amended in 2013 where the deposit-taking institutions were allowed to be referred to as Microfinance Banks.

The microfinance industry has grown over the years, currently with over 62 members who serve over 6.5 million clients with assets worth more than Ksh. 325 billion (Mwanthi, 2015). In order to build the capacity of the Kenyan Micro finance Industry, the Association of Microfinance Institutions (AMFI) was registered in 1999 under the Societies Act by the leading MFIs in Kenya. The main reasons for its establishment were the felt need for MFIs to have a common voice; to lobby government for favorable policies; to share information, experiences and to link up and network with both local and international actors. The membership of AMFI-K is varied but focuses on institutions which provide micro finance services to the lower pyramid of the society. Membership ranges from large, microfinance banks, commercial banks which have a focus on microfinance, credit only microfinance institutions, wholesale microfinance lenders developmental institutions, as well as savings and credit co-operatives (AMFI, 2016). Popularly known as KWFT, Kenya Women Microfinance Bank Ltd is one of the biggest Deposit Taking Microfinance Institutions in Kenya which was licensed to operate as an MFI by the CBK on 31st March, 2010. KWFT has branches all over Kenya. The MFI both savings and loans accounts that are open to all women and girls in Kenya. KWFT has over 600,000 clients and over 231 branches in all counties in Kenya. Like its name suggests, KWFT has a mission to empower women—and in the process enrich the lives of entire families, communities and the nation at large.

## 2. RESEARCH PROBLEM

There is a growing concern on the loan default among microfinance institutions in Kenya. This is caused by existence of high levels of loan delinquency problem in microfinance industry. Warue (2012) documents an increasing trend in level of loan delinquency among MFIs in Kenya. This may be a pointer to increased ineffectiveness of the institutions' various lending programs Kenya's micro-finance banking sector loss hit \$7.31q million for the period ended December 2017, from a loss of \$3.77q million over a similar period in 2016, largely attributed to reduction in financial income and non-performing loans. The non-performing loans rose to \$99.1 million for the period ended 2017, from \$73.71 million (Central Bank of Kenya Report, 2017). The report by CBK also acknowledged that some of the challenges facing micro-finance banking sector include the increased credit risk which has contributed to increasing the number of non-performing loans. A study by Kodongo and Kendi (2013) shows 75%q of microcredit issued in Kenya goes to individual borrowers while only 25%q of credit is extended to group borrowers. This shows that though there has been an increase on adoption group lending model by MFIs in Kenya with time, individual lending is still dominant. This is despite the association between group lending and lower delinquency levels in group loans as revealed by some researchers, where borrowers are required to apply for credit in voluntarily formed groups since such borrowers know each other, and those whom are believed to avoid those with higher risk profiles. This implies that groups governance including self-internal regulations and screening process for members for loan qualifications, control loan delinquency levels of the lending MFI. Moreover, studies by researchers such as Guttman (2007); Aniket (2011); and Al-Azzam *et al.* (2011) shows conflicting arguments between individual lending and group lending. This has left a gap and uncertainty as to which is the appropriate credit program, to mitigate default risk. It is against this background therefore that the study sought to examine the relationship between of group lending and loans performance in micro-finance institutions in Kenya.

## 3. OBJECTIVES OF THE STUDY

The general objective of the study was to examine the relationship between group lending and loans performance in micro-finance institutions in Nairobi County, Kenya. A case of KWFT.

The study was guided by the following specific objectives:

- i. To determine the relationship between group self-internal regulations among group members and loans performance in KWFT microfinance.
- ii. To examine the relationship between credit appraisal process of group members and loans performance in KWFT microfinance.
- iii. To establish the relationship between credit policy on group loans and loans performance in KWFT microfinance.
- iv. To assess the relationship between credit risk control measures on the group and loans performance in KWFT microfinance.

## 4. THEORETICAL REVIEW

The theoretical reviewed theories attributed by other authors and scholars and were relevant to credit scoring systems on loan performance. The study is guided by theory of group lending, Asymmetric Information theory and Portfolio Theory.

#### **4.1 Theory of Group Lending**

The theory of group lending which essentially looks into ex ante moral hazard and the role of joint responsibility was first put across by Varian (1990). This theory set out an ante moral hazard approach to group lending. Their main argument was that the group-lending contract circumvents ex ante moral hazard approach by inducing borrowers to monitor each other's choice of projects and to inflict penalties upon borrowers who have chosen excessively risky projects. Laffont and Rey (2003), input their assertion regarding this theory when they opined that, due to the fact that group members are affected by the actions and inactions of other members meant that they would take steps to punish anyone who happened to put in little effort and as such burdens the group with excessive risk. The joint liability contract relies on the group's capacity to sanction individual members who may try to shirk. Granted the contract, in principle both group members will never shirk. As such, it turns out that the sanctions are never actually affected. MFIs and SHGs operate under the influence of external factors such as macroeconomic factors which are beyond their control. Specific measures to discourage default can be incorporated in credit schemes, but viable project design and good administration are the most important safe guards (Laffont & Rey, 2003).

#### **4.2 Agency Theory**

Agency theory is the study of how actors of the economy make contractual agreements based on the asymmetric information available (Shapiro, 2005). Agency theory largely focuses on methods and systems and their consequences that arise to try to align the interests of the principal and agent (Delves & Patrick, 2010). An agency relationship is one in which one or more persons (the principal) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent (Jensen & Meckling, 1976). In adverse selection models, the characteristic of the agent is not open to the principal. Adverse selection is defined as market processes the buyers, sellers have access to asymmetric information, and undesired results occur. On the other hand, in moral hazard model, access to information is granted to the principals and the principals verify the agents' actions (Jussi & Petri, 2004). The relationship between agency theory and the chances of a borrower failing to make loan repayment is so important for this research study to overlook. The information available on both the microfinance institution and the borrowers created opportunities for some borrowers when their loan creditworthiness is close to zero. This study recognizes the relationship between agency theory and the likelihood of borrowers to default their loan obligations. Information asymmetry between the Microfinance Institutions and their borrowers leads to some borrowers to acquire loan even when the probability of repayment is low.

In normal situations, borrowers are expected to choose actions that result into additional cost when there is additional program management. Normally, it is expected that the borrower will choose actions such that the additional benefit of each action equals its additional cost. This is not the same when there is no perfect information about the borrower. In addition, the borrower does not take full responsibility of loan defaults if there is no collateral. The lender is not also in a position to specify perfectly how their borrowers should run their business. This is because some of the borrowers' actions are costly to obtain. In this research study, MFIs are the principals while borrowers are the agents who have been given the loan and are expected to repay the loan according to the rules and requirements of the respective MFI. The inability to of the MFIs to extract borrowers' information about socioeconomic life, experience and general business as a whole may result in loan repayment default. Moreover, the study proposes that in

some instances, the loan supervisors who become Agents of MFIs, fail to meet the interest of MFIs to ensure that borrowers are well scouted and signals the principal for any sign of default for immediate measures. MFIs as the principal has to effectively carry out credit appraisal process, set credit policies for the borrowers and put in place credit risk control measures to reduce credit risks that may lead to non-performing loans.

### **4.3 Asymmetric Information Theory**

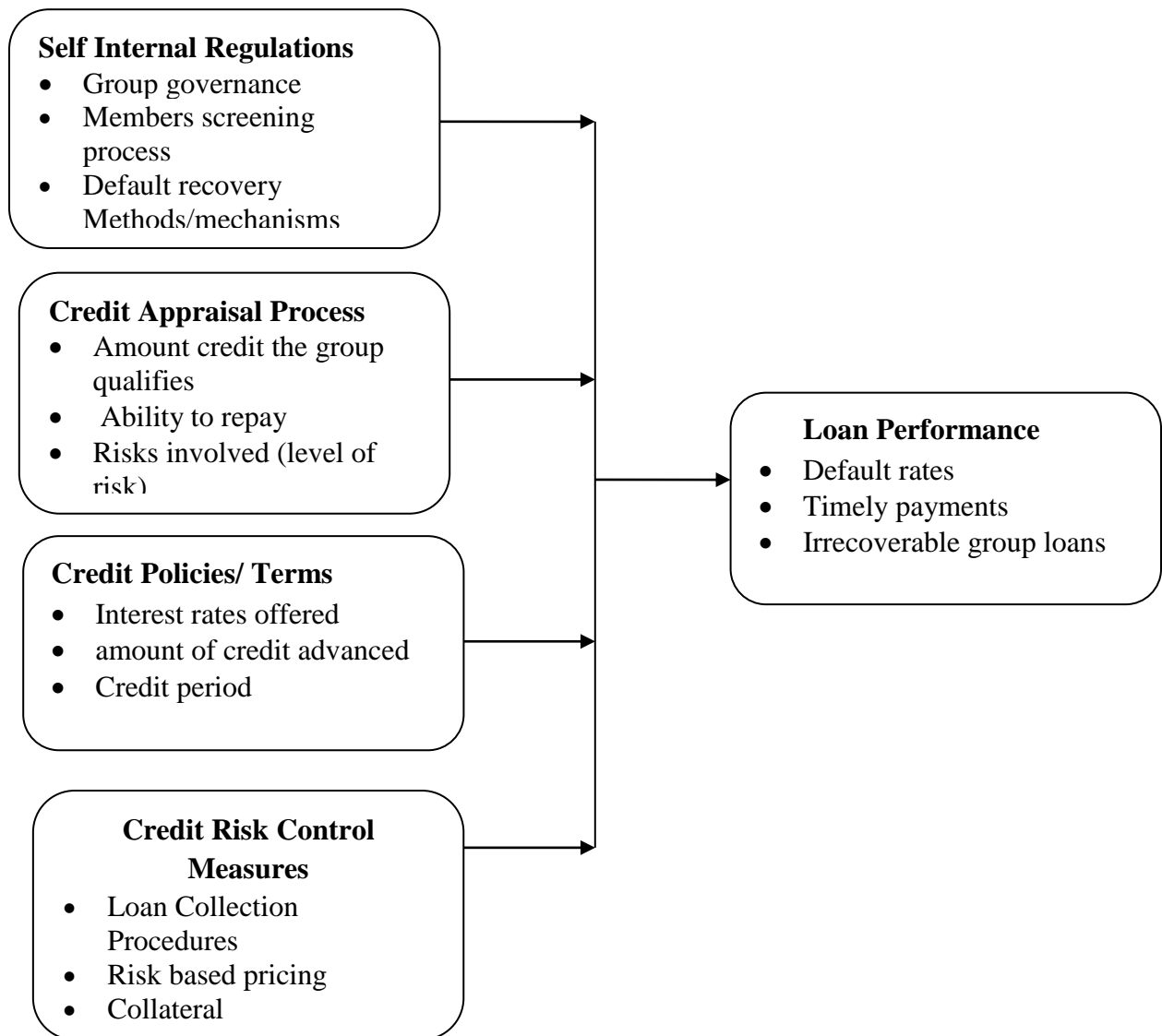
The asymmetric information theory was first introduced by Akerlof's 1970 which shows that there exists information asymmetry in assessing bank lending applications (Binks & Ennew, 1997). Information asymmetry theory describes the condition in which relevant information is not known to all parties involved in an undertaking (Ekumah & Essel, 2003). Eppy (2005) describes a condition in which all parties involved in an undertaking do not know relevant information. The theory point out that perceived information asymmetry poses two problems for the financial institution, moral hazard, monitoring entrepreneurial behavior and adverse selection that is making errors in lending decisions. Theory emphasizes on the importance of private information in explaining credit-market failures. Information asymmetries and the resulting credit constraints have been used to explain anomalous behavior in consumption, borrowing and labor supply. Credit scoring and information coordination can help mitigate selection problems, while incentive problems are better addressed by improved collection or repayment schemes (Dobbie & Skiba, 2012). The theory explains that in the market, the party that possesses more information on a specific items to be transacted (in this case the borrower) is in a position to negotiate optimal terms for the transaction than the other party (in this case the lender). The party that knows less about the same specific items to be transacted is therefore in a position of making either right or wrong decision concerning the transaction. Adverse selection and moral hazards have led to significant accumulation of non-performing loans in banks. In the presence of asymmetric information a well-capitalized bank is less risky but profits are lower since they are perceived as safer (Auronen, 2003). Pagano and Jappelli (1993) show that information sharing reduces adverse selection by improving banks information on credits applicants. Credit Reference Bureaus (CRB) complement the fundamental role played by banks and other financial institutions in extending financial services within an economy. In Kenya, CRBs assist lenders to make faster and more accurate credits decisions. They collect, manage and disseminate customer information to lenders in the form of credits reports. These credits reports help lenders to decide whether to extend an applicant's loan, credits card overdraft facility or extend any other product, which is reliant on customer's ability to repay at a determined cost. The theory is critical in informing this study as emphasizes on coordination between credit scoring and information of the borrowers which can help mitigate problems of non-repayment or default.

### **4.4 Portfolio Theory**

Portfolio Theory is a theory on how risk-averse investors can construct portfolios to optimize or maximize expected return based on a given level of market risk, emphasizing that risk is an inherent part of higher reward. Portfolio theory of investment which tries to maximize portfolio expected return for a given amount of portfolio risk or equivalently minimize risk for a given level of expected return, by carefully choosing the proportions of various assets. Portfolio theory was developed in 1950's through the early 1970's and was considered an important advance in the mathematical modeling of finance. Since then, many theoretical and practical criticisms have been developed against it. This includes the fact that financial returns do not follow a Gaussian distribution or indeed any symmetric distribution and those correlations between

asset classes (Opiokello, 2010). In standard portfolio theory developed by Markowitz (1952) the optimal portfolio is selected solely based on financial returns. The most common method to include a social dimension in investment choice is screening. The idea is simple: From all available assets, investors choose the subset of assets they want to invest in. Positive screening selects the assets to invest in, whereas negative screening excludes assets which the investor does not want to fund under any circumstances. This theory also informs the study as it shows that an investor (in this case the commercial banks) can construct a portfolio of multiple assets that will maximize returns for a given level of risk. Likewise, given a desired level of expected return, an investor can construct a portfolio with the lowest possible risk. The use of automated credit scoring systems is perceived to guide the commercial banks in establishing the extent of the risk or the risks involved. In reference to such information, the commercial banks are able to set the terms of credit offered to a particular borrower to maximize returns for a given level of risk. The commercial banks are also informed of the credit risk control measures to take in order to minimize the risks.

## 5. CONCEPTUAL FRAMEWORK



*Figure 1: Conceptual Framework*

The conceptual framework shows the hypothesized relationship between independent variables and the dependent variable in the study. As shown in Figure 1, the independent variables of the study were: self internal regulations, screening process, credit terms and credit risk control measures while the dependent variable was loan performance.

## **6. RESEARCH METHODOLOGY**

This study adopted the qualitative and quantitative research methodology. This study adopted a descriptive survey research design. This design was the most appropriate for this particular research since it aims at getting precise information. This research design was further justified since it presents the researcher with the opportunity to fuse both qualitative and quantitative data a means to enable the reconstruction of the topic under review. A population is defined as a complete set of individuals, case or objects with some common observable characteristic (Mugenda, 2008). There were a total of six KWFT branches in Nairobi. The target population consisted of 60 employee in credit department in the six KWFT branches within Nairobi County. The unit of observation was the management and credit officers in credit department. Since the population was small, a census study was adopted whereby the entire population was considered for the study. The study collected primary data through a questionnaire. The questionnaire had both closed and open ended questions which facilitated collection of quantitative and qualitative data. The data was collected from the credit/loan officers in KWFT, Nairobi County. The researcher first sought permission and consent to collect data from the management of the sampled organizations. Consents was sought through use of a letter for data collection which was obtained from Kenyatta University. After permission was granted, appointments were made with the respective respondents. The researcher administered the questionnaire through drop and pick later method. Personal administration of the questionnaire gave the researcher a chance to interpret and clarify questions in the questionnaire to the respondents. This ensured that the respondents fully understand the questions before answering hence ensuring high response rate. A deadline was set by which the completed questionnaires must be ready for data analysis. The data collected through the questionnaire was edited, coded, entered into SPSS which also aided in the data analysis. The data was analyzed using descriptive and inferential statistics. The descriptive statistics included frequency distribution tables and measures of central tendency (the mean), measures of variability (standard deviation) and measures of relative frequencies. The inferential statistics included a regression model which established the relationship between variables. The analyzed quantitative data was presented using tables, charts and graphs. The study used inferential statistics to allow the researcher make generalizations about the populations from the study samples were drawn. This was necessary owing to the fact that sampling naturally has a sampling error which affects perfect representation of the population.

## **7. STUDY FINDINGS**

The study used correlation analysis to measure the degree of relationship between the variables. Correlation analysis was used to help the researcher understand the direction and the degree of relationship that existed among the variables of the study.

**Table 1: Relationship between group self-internal regulations and loans performance**

Variable		Loans performance at KWFT	Group self-internal regulations
Loans performance at KWFT	Pearson Correlation	1	.598
	Sig. (1-tailed)		.046
	N	180	180
Group self-internal regulations	Pearson Correlation	.598	1
	Sig. (1-tailed)	.046	
	N	180	180

The results of correlation test analysis between the independent variable group self-internal regulations and the dependent variable loans performance at KWFT are as shown in Table 1. The results show that there is a strong correlation coefficient between loans performance at KWFT and group self-internal regulations as shown by correlation factor of 0.598 and was statistically significant at a value which was 0.046 which is less than 0.05.

**Table 2: Relationship between credit appraisal process and loans performance**

Variable		Loans performance at KWFT	Credit appraisal process
Loans performance at KWFT	Pearson Correlation	1	.843
	Sig. (2-tailed)		.016
	N	180	180
Credit appraisal process	Pearson Correlation	.843	1
	Sig. (2-tailed)	.016	

The findings of the correlation test analysis between the independent variable (credit appraisal process) and the dependent variable (loans performance at KWFT) are as shown in Table 2. The study established that there was a strong positive correlation between credit appraisal process and loans performance at KWFT represented by a factor of 0.843 which was also statistically significant at 0.016 which is less than 0.05.

**Table 3: Relationship between credit policy and loans performance**

Variable		Loans performance at KWFT	Credit policy
Loans performance at KWFT	Pearson Correlation	1	.802
	Sig. (1-tailed)		.001
	N	180	180
Credit policy	Pearson Correlation	.802	1
	Sig. (1-tailed)	.001	
	N	180	180

The findings of the correlation test analysis between the independent variable (credit policy) and the dependent variable (loans performance at KWFT) are as shown in Table 3. The study established that there was a strong positive correlation between credit policy and loans performance at KWFT represented by a factor of 0.802 which was also statistically significant at 0.001 which is less than 0.05.

**Table 4: Relationship between credit risk control measures and loans performance**

Variable		Loans performance at KWFT	Credit risk control measures
Loans performance at KWFT	Pearson Correlation	1	.722
	Sig. (2-tailed)		.008
	N	180	180
Credit risk control measures	Pearson Correlation	.722	1
	Sig. (2-tailed)	.008	
	N	180	180

The findings of the correlation test analysis between the independent variable (Credit risk control measures) and the dependent variable (loans performance at KWFT) are as shown in Table 4.9. The study established that there was a strong positive correlation between credit risk control measures and loans performance at KWFT represented by a factor of 0.722 which was also statistically significant at 0.008 which is less than 0.05.

The study conducted a multiple regression analysis to test the influence among the study predictor variables made possible through the use of statistical package for social sciences by

coding, entering and computing the measurements of the multiple regressions. The model summary is as shown in Table 5.

**Table 5: Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.818 <sup>a</sup>	.669	.652	.37290

The model fit in this study was evaluated by the coefficient of determination. The adjusted R<sup>2</sup> also called the coefficient of multiple determinations, is the percent of the variance in the dependent explained uniquely or jointly by the independent variables. The model had an average adjusted coefficient of determination (R<sup>2</sup>) of 0.652 and which implied that 65.2% of the variations on loans performance at KWFT are explained by the independent variables focused on this study thus; group self-internal regulations, credit appraisal process, credit policy and credit risk control measures.

The study further tested the significance of the model using the ANOVA technique. The study results are as tabulated in Table 6.

**Table 6: ANOVA Results**

Model		Sum of Squares	df	Mean Square	F	Sig.
	Regression	8.552	4	2.138	5.717	.000 <sup>b</sup>
1	Residual	65.45	175	0.374		
	Total	74.002	179			

As shown in the ANOVA statistics, the regression model from the study findings was established to be valid at (F = 5.717, P < 0.05). The implication of this is that the independent variables of group self-internal regulations, credit appraisal process, credit policy and credit risk control measures are good predictors of loans performance at KWFT.

Additionally, the study used the coefficient table to determine the study model among the independent and dependent variables. The study results are as shown in Table 7.

**Table 7: Coefficients**

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
	(Constant)	0.176	0.067		2.627	.0121
1	Group regulations self-internal	0.571	0.166	0.532	3.442	.0013

---

Credit appraisal process	0.817	0.238	0.767	3.431	.0014
Credit policy	0.782	0.301	0.694	2.590	.0132
Credit risk control measures	0.674	0.202	0.613	3.337	.0018

---

The generated output as per the SPSS is as presented in Table 7 above, thus the equation is as shown below:  $Y = 0.176 + 0.571X_1 + 0.817X_2 + 0.782X_3 + 0.674X_4$ . As shown from the regression model found above, a change in group self-internal regulations holding all the other factors constant would positively change loans performance at KWFT by a factor of 0.571; a change in credit appraisal process while holding all the other factors constant would positively affect loans performance at KWFT by a factor of 0.817, a change in credit policy while holding all the other factors constant would positively affect loans performance at KWFT by a factor of 0.782 while a change in credit risk control measures while holding all the other factors constant would affect loans performance at KWFT by a factor of 0.674. The study findings agree with those of Kiiru (2007) who found out that repayment performance is significantly affected by borrowers' characteristics, lender's characteristics and loan characteristics among other factors. The marginal effects of each set of characteristics are determined and analyzed. Repayment problems can be in the form of loan delinquency and default.

## 8. CONCLUSIONS

The study concludes that groups financed had put in place mechanisms to ensure that the group members repay loans in time. There was no highly subsidized interest rate or cheap credit and they were of the assumption that it was possible to channel credit to specified activities that they considered most productive and beneficial to development purposes thus they made sure that there was sufficient commitment and arrangement to ensure that loans were used for purposes they were meant for. There are other complimentary tools since the effectiveness and the impact of credit schemes are significantly enhanced by this. The study concludes that credit appraisal process employed to inform lending to groups were amount of credit the group qualifies, the ability of the group to repay and the nature of collateral to be imposed. This is in addition to credit appraisal process employed to inform lending to groups. The study concludes that rates charged on the group loans determines the effectiveness of repayment of loans by the members, the period the group is given to repay the loans determines the loan performance, the amount of credit advanced on the group loans may affect loan performance and that interest rates charged on the group loans are favourable as compared to individual loans. The organization uses risk based pricing to determine the loan terms (e.g. interest rate) for the group loans, the MFI uses risk-based pricing based on the borrowers' credit score and credit history before advancing the loan to the groups, the MFI attaches collateral to group loans to reduce risks exposure or cases of loan defaults and that the MFI factors in the loan collection measures (incase of default) when advancing group loans.

## 9. RECOMMENDATIONS


The study recommends that organizations participating on group loans need to ensure that the group are promoting good governance in their leadership and administration since this will enhance management of loan default rates amongst their members. The study recommends that those in charge of loans need to work for stability in the macro-environment to ensure interest rates charged by MFIs remain stable and affordable. This is in addition to having in place scales

to review individual repayment. The study recommends group lending since this alleviates the problem of moral hazard and this can be done by ensuring that the group can coordinate its members' decisions and achieves higher repayment rates. The study recommends that micro-finance institutions should put in place a credit risk management team whose mandate will be to establish well defined credit control policy and guidelines that are within the corporation's range of implementation.

## REFERENCES

- Al-Azzam, M., Hil, R.C., Sarangi, S., 2011. Repayment performance in group lending: evidence from Jordan. *Journal of Development Economics*, 97(1), 404–414.
- Aniket, K. (2011). *Queuing for Credit: Increasing the Reach of Micro finance through Sequential Group Lending*. [http://www.editorialexpress.com/cgi-bin/conference/download.cgi?db\\_name=NASM2011&paper\\_id=762](http://www.editorialexpress.com/cgi-bin/conference/download.cgi?db_name=NASM2011&paper_id=762) (accessed 21.01.15.).
- Auronen, L. (2003). Asymmetric Information: Theory and Applications. *Paper presented in the Seminar of Strategy and International Business as Helsinki University of Technology*, May 21st 2003.
- Besley, T., & Coate, S. (1995). Group lending, repayment incentives and social collateral. *Journal of Development Economics*, 46, 1–18.
- Bruton, G., Khavul, S. & Chavez, H. (2011). Micro-lending in emerging economies: Building a new line of inquiry from the ground up. *Journal of International Business Studies*, 42 (5), 718–739.
- CGAP, (2009). *Measuring microcredit delinquency: Occasional paper no. 3* CGAP secretariat 1818 h street. Government printer
- Delves, D. and Patrick, B. (2010), “Agency theory summary”, available at: [http://www.delvesgroup.com/wpcontent/uploads/2010/08/AgencyTheorySummary\\_DelvesPatrick.pdf](http://www.delvesgroup.com/wpcontent/uploads/2010/08/AgencyTheorySummary_DelvesPatrick.pdf) (Accessed 2<sup>nd</sup> September 2018)
- Demont, T. (2013). *Microfinance Spillovers: A model of competition in informal credit markets with an application to Indian villages*. CRED WP, University of Namur.
- Dobbie, W., & Skiba, P. (2012). Information asymmetries in consumer credit markets: Evidence from payday lending. *Working paper, National Bureau of Economic Research*.
- Giné, X. & Karlan, D.S., (2010). *Group versus Individual Liability: Long Term Evidence from Philippine Microcredit Lending Groups*. Working Paper No. 61. Economics Department, Yale University.
- Guttman, J. (2007). Repayment Performance in Microcredit Programs: Theory and Evidence. NFI Working Paper WP-11, p. 13. Available at <http://ssrn.com/abstract=985890>
- Ibtissem, B., and Bouri, A. (2013). Credit Risk Management in Microfinance: The conceptual Framework. *ACRN Journal of Finance and Risk Perspectives*. 2 (1), 9-24.
- Jensen, M. C., & Meckling, W. H. (1976). Theory of the firm: Managerial behavior, agency costs and ownership structure. *Journal of Financial Economics*, 3(4), 305–360.
- Jussi, N. & Petri, S. (2004). Does Agency Theory Provide a General Framework for Audit Pricing? *International Journal of Auditing*, 8 (2), 253-262.
- Kodongo, O., & Kendi, L. G. (2013). Individual lending versus group lending: An evaluation with Kenya's microfinance data. *Review of Development Finance*, 3, 99–108.

- Laffont, J. & Rey, P. (2003), *Collusion and group lending with moral hazard*, IDEI Toulouse and University of Southern California.
- Madajewicz, M., (2003). *Capital for the Poor: The Effect of Wealth on the Optimal Credit Contract*. Unpublished Master's Thesis, Columbia University.
- Maria, L. (2009). *Group Lending Versus Individual Lending in Microfinance*. Discussion Paper No. 299. University of Munich.
- Mugenda, A.G. (2008). *Social Science Research: Theory and Principles*. Acts Press, Nairobi.
- Pagano, M. & Jappelli, T. (1993). Information Sharing in Credit Markets. *The Journal of Finance* 43(5), 1693-1718.
- Savita, S. (2007). Transaction costs in group microcredit in India. *Management Decisions* 45, 1331–1342.
- Schreiner, M. (2013). *A Cost-Effectiveness Analysis of the Grameen Bank of Bangladesh*. St. Louis Publishers.
- Thuo, N. S. & Juma, W. A. (2014). Effect of Group Lending on Management of Loan Default Rates among Microfinance Institutions in Nakuru Town, Kenya. *International Journal of Science and Research (IJSR)*, 3 (3), 606- 609.
- Varian, H. (1990). Monitoring agents with other agents. *Journal of Institutional and Theoretical Economics*, 146(1), 153- 174.
- Warue, B. N. (2012). Factors affecting loan delinquency in microfinance institutions in Kenya. *International Journal of Management Sciences and Business Research*, 1 (12).

**This is an open-access article published and distributed under the terms and conditions of the  [Creative Commons Attribution 4.0 International License](https://creativecommons.org/licenses/by/4.0/) of United States unless otherwise stated. Access, citation and distribution of this article is allowed with full recognition of the authors and the source.**

**Authors seeking to publish with an International Peer Reviewed Journal should consider [www.ijcab.org](http://www.ijcab.org) by writing to the Editor at [editor@ijcab.org](mailto:editor@ijcab.org).**