

Effect of Credit Risk Management Practices on Loan Performance of Women Enterprise Fund in Kenya: Survey of Women Groups in Nakuru Town Sub-County, Kenya

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Abstract

Original Research Article

Credit is the probability of loss because of a borrower's inability or failure to pay back on his debt whereas credit risk management is the process of understanding how adequate a bank's loan loss reserves and capital are at any given time in order to mitigate these losses. Women Enterprise Fund is a semi-independent agency of the government established to advance low cost credit to Kenyan Women. Women Enterprise Fund as any other credit business is exposed to credit risks. Credit advanced to women by WEF come along with credit risk challenges. How the fund has handled these risks challenges among women is not adequately researched compared to other enterprises or corporations. To the researcher knowledge, there is little documented study done on effect of credit risk management on loan performance of government revolving fund in Kenya, much of the work done relating to credit risk management practices on financial performance of commercial banks and microfinance institutions creating a research gap. The main objective of this study is to analyze effect of credit risk management practices on loan performance of Women Enterprise Fund in Kenya. More specifically, the study is to analyze loan appraisal procedure, loan recovery procedure, savings rate and interest rate on loan performance of Women Enterprise Fund in Kenya. The study will adopt the following theories for the analysis of the objectives; financial economic theory, credit risk theory, adverse selection theory of credit, credit default theory and capital asset pricing theory. The study will adopt a quantitative longitudinal research design taking Women Enterprise Fund as the target population. The study will collect primary data 99 women groups. Regression analysis will be used to analyze the relationship between independent and dependent variables. The findings from the study will inform the policies of the Women Enterprise Fund as government revolving funds on effect of credit risk management practices on loan performance and also broaden scholarship knowledge in the fields like Micro Finance, Developmental Finance and Economics.

Keywords: Loan Appraisal Procedure, Loan Recovery Procedure, Saving Rate, Lending Interest Rate.

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INTRODUCTION

The strategies for credit risk management include transferring to another party, avoiding the risk, reducing the negative effects of the risk, and accepting some or all of the consequences of a particular risk. The very nature of the banking business is so sensitive because more than 85% of their liability is deposits from depositors [1]. Most studies on credit risk management posit that there is a positive relationship between effective credit risk management and banks' profitability while some of these studies support the notion that there is a negative relationship between them [2].

Some studies that found a positive relationship between credit risk management and bank performance include those of Hosna, Manzura and Juanjuan [3] who found Non-performing loans indicator affects (ROE), Aruwa and Musa [4] who found a strong positive relationship between risk components and the banks' loan performance, although the direction of the effect is not specified, and Boahene, Dasah and Agyei [5] who also found a positive relationship between credit risk and bank profitability. On the other hand Musyoki and Kadubo [6], assessing various parameters pertinent to credit risk management as it relates to banks' loan performance, found an inverse impact of the parameters under study on banks' loan performance. This result is duplicated by Kaaya and Pastory [7] who showed that credit risk indicators negatively affected on the bank performance.

Credit risk is the probability of loss because of a borrower's inability or failure to pay back on his debt. Yegon [8] defined credit risk management as an approach (structured) to managing uncertainties through risk assessment, developing strategies to manage it and mitigation of risk through the utilization of resources available to management. Meanwhile, credit risk management is the process of understanding how adequate a bank's loan loss reserves and capital are at any given time in order to mitigate these losses. According to Nzube [9], Credit risk management models include the systems, procedures and control which a company has in place to ensure the efficient collection of customer payments and the risk of non-payment.

According to Asiedu-Mante [10] credit management involves establishing formal legitimate policies and procedures that will ensure that proper authorities grant credit, the credit goes to the right people, the credit is granted for the productive activities or for businesses which are economically and technically viable, the appropriate size of credit is granted, the credit is recoverable and there is adequate flow of management information within the organization to monitor the credit activity. Credit management is the process for controlling and collection of payments from customers. This is the function within financial services to control credit policies that will improve revenues and reduce financial risks [1]. Credit risk should be taken seriously as it has a potential of preventing lending institutions from meeting their optimum levels of loan performance. Credit risk occurs as a result of a borrower's inability to settle his financial obligations, leading to losses for the financial institutions [11]. The financial institutions are therefore advised to design and implement practices of credit risk management that is capable of identifying risks already existing and risks that may arise in each environment and implement strategies to counter them.

Globally, Ogboi and Unuafé [12] conducted a study on how credit risk management and capital adequacy impacted loan performances of Nigerian commercial banks. The study aimed to establish the extent to which huge scarce resources invested in credit risk management by commercial banks was affecting their loan performance. Investigation into the extent to which credit risk, along with capital adequacy, affected loan performance of banks in Nigeria was conducted using regression analysis. Six out of the twenty-one commercial banks operating as at 2009 were the sample for this study. The evidence provided in this study, revealed that a comprehensive credit management procedure, and adequate capital are recipes for profitability. This study goes to the core of the area of study, as these SACCOs are also financial institutions.

In Kenya, credit risk is a real threat to the microfinance industry due to the fact that loan portfolios form the largest part of the balance sheet items [13]. Credit risk encompasses both the loss of income resulting from the MFI's inability to collect anticipated interest earnings as well as the loss of principle resulting from loan defaults [14]. Janney & Lynn [15] said that, Management must continuously review the entire portfolio to assess the nature of the portfolio's delinquency, looking for geographic trends and concentrations by sector, product and branch.

In an attempt to bridge gender gap and empower women economically, Kenya government in August 2007 established Women Enterprise Fund (WEF). Women Enterprise Fund is a semi-independent agency of the government under the Ministry of Public Service, Youth and Gender Affairs established through a Gazette Notice as a rotating loan fund. The fund aims at among others, providing affordable and reachable credit for development of women enterprises, building the capacity of women who benefits from the scheme and their institutions, promoting local and international marketing, promoting linkages and infrastructure support. The fund was established to enhance poverty reduction, promote gender equality and empowerment of women through enterprise development and to be a flagship project in the Vision 2030 Development Road Map [16]. According to WEF Headquarters, so far, WEF has extended loans to women amounting to Ksh. 2.6 billion to over 645,825 women entrepreneurs. Equally, to date, the fund has trained 116,372 women on loan management and business skills.

Loan performance result mostly from ineffective management of credit risks Hippolyte, [18]. Successful financial institutions have managed to maintain high levels of loan recovery rates, generally over 95%. These remarkably high loan recovery ratios triggered the initial wave of funds from funding agencies and the subsequent inflow from a variety of social investors which they could use to expand their operations Hippolyte[18]. The Government of Kenya established Women Enterprise Fund in 2007 to provide alternative financial services to women who are excluded from the formal and informal financial sectors. The fund provides accessible and affordable credit to support women start or expand business for wealth and employment creation. Women Enterprise Fund was one of the positive steps in ensuring resources reach excluded women and it was also a Kenya government's commitment to achieve women empowerment and gender equity. In a bid to achieve its mandate, the Fund started by availing funds to the target women entrepreneurs [19].

Credit advanced to women by WEF come along with credit risk challenges. How the fund has handled these risks challenges among women is not adequately researched compared to other enterprises or corporations. To the researcher knowledge, there is little documented study done on effect of credit risk management on loan performance of

government revolving fund in Kenya, much of the work done relating to credit risk management practices on financial performance of commercial banks and microfinance institutions creating a research gap. This study therefore intend to fill this literature gap by analyzing effect of credit risk management practices on loan performance of Women Enterprise Fund in Kenya, more specifically; To establish the effect of loan appraisal procedure on loan performance of Women Enterprise Fund Nakuru Town East, Kenya; To determine the effect of loan recovery procedure on loan performance of Women Enterprise Fund Nakuru Town East, Kenya; To analyze the effect of saving rate on loan performance of Women Enterprise Fund in Kenya; To determine the effect of interest rate on loan performance of Women Enterprise Fund Nakuru Town East, Kenya.

Objectives

- To establish the effect of loan appraisal procedure on loan performance of Women Enterprise Fund Nakuru Town East, Kenya.
- To determine the effect of loan recovery procedure on loan performance of Women Enterprise Fund Nakuru Town East, Kenya.
- To analyze the effect of saving rate on loan performance of Women Enterprise Fund in Nakuru Town East, Kenya.
- To determine the effect of lending rate on loan performance of Women Enterprise Fund in Nakuru Town East, Kenya.

HYPOTHESES

HO₁: There is no significant statistical relationship between loan appraisal procedure and loan performance of Women Enterprise Fund Nakuru Town East, Kenya.

HO₂: There is no significant statistical relationship between loan recovery procedure performances of Women Enterprise Fund Nakuru Town East, Kenya.

HO₃: There is no significant statistical relationship between saving rate and loan performance of Women Enterprise Fund Nakuru Town East, Kenya.

HO₄: There is no significant statistical relationship between lending rate and loan performance of Women Enterprise Fund Nakuru Town East, Kenya.

Conceptual Framework

This is a hypothesized model identifying the concepts or variables under the study and their relationships. It is a scheme of concepts (variables), which the researcher will operationalize in order to achieve the set objectives. The purpose of the conceptual model is to help the researcher to relate the proposed relationships. The independent variables of the study include; loan appraisal practice, loan recovery practice, Savings Rate measured in terms of frequency of savings and amount saved and interest rate practice. The dependent variable is loan performance measured in terms of loan performance index. The moderating variable is macroeconomics environment measured in terms of inflation. It is hypothesized that when Women Enterprise Fund manages its credit risk well then the loan will be performing well leading to more money generated for improved loan advance cycle.

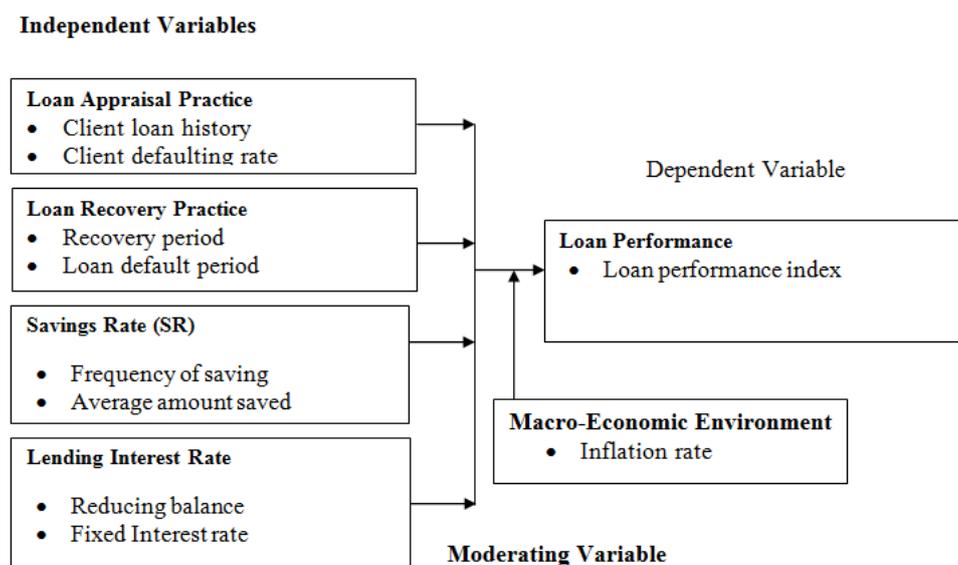


Fig-1: Conceptual framework

Source: (Own Conceptualization, 2018)

Research Design

The study adopted a quantitative longitudinal research design targeting 971 Women Groups who have taken loan with Women Enterprise Fund from Nakuru Town East Sub-County, Kenya. The researcher adopted Nassiuma [20] formula that can be used to calculate a suitable sample for the Women Groups financed by Women Enterprise Fund. Data was analyzed using regression analysis using the regression equation below;

$$y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon$$

Where;

Y = Loan performance

α = constant

β_1, \dots, β_5 = Regression Coefficients

X_1 = loan appraisal practice

X_2 = Loan recovery practice

X_3 = Saving rate practice

X_4 = Interest rate practice

ε = the error of term.

FINDINGS AND DISCUSSIONS

Table-1: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.659 ^a	.434	.408	.98883

The R value was 0.659 and R² of 0.434, which indicated a high degree of correlation. The R² value indicates how much of the dependent variable, "loan performance index", was explained by the independent variables, "loan appraisal procedure, loan recovery procedure, saving rate, lending rate". In this case, 43% was the R Squared, which was fairly large indicating that the data collected was closely fitted to the regression line.

Table-2: ANOVA of the Predictors and the Dependent variable

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	64.482	4	16.121	16.487	.000 ^b
	Residual	84.089	86	.978		
	Total	148.571	90			

Predictors: Loan appraisal procedure, loan recovery procedure, saving rate and lending rate. The Dependable variable: loan performance index. Table 4.11 indicated that the regression model predicted the outcome variable significantly with $p = 0.00$, which was less than 0.05, and indicated that; overall, the model statistically and significantly predicted the outcome variable.

Table-3: Full Regression Model

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	2.121	.694		3.056	.003
Loan appraisal	-.115	.228	-.063	-.504	.616
Loan recovery	.146	.237	.080	.619	.538
Savings rate	-.334	.166	-.217	-2.017	.047
Lending rate	.523	.070	.607	7.423	.000

The first hypothesis was stated as **HO₁**: there is no significant statistical relationship between loan appraisal procedure and loan performance of Women Enterprise Fund Nakuru Town East, Kenya, and the following regression was used;

$$Y = \alpha_1 + \beta_1 X_1$$

When loan recovery procedure, saving rate and lending rate were held constant, where Y was the loan performance index, α_1 was the constant, β_1 was the rate of change and X_1 was loan appraisal procedure. The null hypothesis that there is no significant statistical relationship between loan appraisal procedure and loan performance of Women Enterprise Fund Nakuru Town East, Kenya was accepted. Loan appraisal procedure had insignificant relationship with loan performance index, this was because loan appraisal procedure had $P=0.616 > 0.05$ indicating that

loan appraisal procedure did not contribute significantly towards loan performance index of Women Enterprise Fund Nakuru Town East.

This finding was supported by Wanjira [21] studied the relationship between non-performing loans management practices and financial performance of commercial banks in Kenya. The study concluded that there is a need for commercial banks to adopt non-performing loans management practices. Such practices include ensuring sufficient collaterals, limiting lending to various kinds of businesses, loan securitization, ensuring clear assessment framework of lending facilities and use of procedures in solving on problematic loans among others. The study further concluded that there was a positive relationship between nonperforming loans management practices and the financial performance of commercial banks in Kenya which implies that the adoption of non-performing loans management practices leads to improved financial performance of commercial banks in Kenya.

Matere [7] further supported the finding of the study by a research on credit risk management practices, but this time on how it affected loan performance of private hospitals in Kenya. The design used in this study was causal. The fifty licensed private hospitals in Nairobi were the study's population. A census approach was adopted and the respondents were the managers from these hospitals. Data used in this study were from two sources, primary and secondary. A 5-point likert scale was used to determine the impact of credit management practices on performance of private hospitals in Kenya. Descriptive statistics such as means, standard deviation and frequency distribution were used to analyze the data. Findings from this study was that credit risk management procedures can be used to influence profitability of the private hospitals and the study recommends the management of the private hospitals to oversee facilitation of credit risk management through a high level of standardization of its processes and documentations.

The second hypothesis **HO₂**: was stated as there is no significant statistical relationship between loan recovery procedure performance of Women Enterprise Fund Nakuru Town East, Kenya, and the following regression was used;

$$Y = \alpha_2 + \beta_2 X_2$$

When loan appraisal procedure, saving rate and lending rate were held constant, where Y was the loan performance index, α_1 was the constant, β_1 was the rate of change and X_1 was loan recovery procedure. The null hypothesis that there is no significant statistical relationship between loan recovery procedure performances of Women Enterprise Fund Nakuru Town East, Kenya was accepted. Loan recovery procedure had insignificant relationship with loan performance index, this was because loan recovery procedure had $P=0.538 > 0.05$ indicating that loan recovery procedure did not contribute significantly towards loan performance index of Women Enterprise Fund Nakuru Town East.

This finding is supported by Kimando, Kihoro and Njogu [16] who studied the factors influencing sustainability of MFIs in Murang'a Municipality, Kenya. The study findings indicated that the greatest challenge was non-repayment of loans borrowed as shown by 88.9 per cent of the study respondents. It was found out that credit rationing is a tool employed by many MFIs as a way of hedging the effects of default by borrowers. In this respect, it is advisable that MFIs demand for some form of collateral before giving loans. In addition, Bichanga and Aseyo [22] examined the causes of loan default within microfinance institutions in Kenya. The authors noted that there are many such firms that depend on the government for subsidy as one way of addressing financial losses incurred through loan default [24]. The study realized that the default in loan repayment was occasioned by non-supervision of borrowers on how to employ the credit advanced to them and also inadequate training of borrowers on how to put into use those funds prior to their receipt of the loan. More so, it was found out that some borrowers divert the funds borrowed to other projects which may not be financially viable and as such increasing the risk of default

The third hypothesis **HO₃**: was stated there is no significant statistical relationship between saving rate and loan performance of Women Enterprise Fund Nakuru Town East, Kenya, and the following regression was used;

$$Y = \alpha_2 + \beta_2 X_2$$

When loan appraisal procedure, loan recovery procedure and lending rate were held constant, where Y was the loan performance index, α_1 was the constant, β_1 was the rate of change and X_1 saving rate. The null hypothesis that there is no significant statistical relationship between saving rate and loan performance of Women Enterprise Fund Nakuru Town East, Kenya was rejected. Saving rate had significant relationship with loan performance index, this was because saving rate had $P=0.047 < 0.05$ indicating that contributed significantly towards loan performance index of Women Enterprise Fund Nakuru Town East.

This finding is supported by Ngugi [23] who analyzed the interest rate in Kenya when commercial banks increase the lending rates, there is a probability of increased non-performing assets. The researcher prescribed that commercial banks should apply thorough strategies on loan advances with the aim of guaranteeing that loans are disbursed to just those with the ability to reimburse and relieve moral peril, for example, insider lending and information asymmetry.

The fourth hypothesis HO_4 was stated as there is no significant statistical relationship between lending rate and loan performance of Women Enterprise Fund Nakuru Town East, Kenya, and the following regression was used;

$$Y = \alpha_3 + \beta_3 X_3$$

When loan appraisal procedure, loan recovery procedure and saving rate were held constant, where Y was the loan performance index, α_1 was the constant; β_1 was the rate of change and X_1 lending rate. The null hypothesis that there is no significant statistical relationship between saving rate and loan performance of Women Enterprise Fund Nakuru Town East, Kenya was rejected. Lending rate had significant relationship with loan performance index, this was because lending rate had $P=0.000 < 0.05$ indicating that contributed significantly towards loan performance index of Women Enterprise Fund Nakuru Town East.

The finding is supported by Globally, Ogboi and Unuafé [12] conducted a study on how credit risk management and capital adequacy impacted loan performances of Nigerian commercial banks. The study aimed to establish the extent to which huge scarce resources invested in credit risk management by commercial banks was affecting their loan performance. Investigation into the extent to which credit risk, along with capital adequacy, affected loan performance of banks in Nigeria was conducted using regression analysis. Six out of the twenty-one commercial banks operating as at 2009 were the sample for this study. The evidence provided in this study, revealed that a comprehensive credit management procedure, and adequate capital are recipes for profitability. This study goes to the core of the area of study, as these SACCOs are also financial institutions.

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