

## **EFFECT OF CREDIT RISK MANAGEMENT PRACTICES ON LOAN PERFORMANCE OF MICROFINANCE BANKS IN KENYA**

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## **ABSTRACT**

Microfinance banks Kenya are experiencing continuous increase in Non-performing loans (NPLs), despite them having embraced strategies for risk management. The general objective of the study was to establish the effect of credit risk management practices on loan performance of microfinance banks in Kenya. Specific objectives were to establish the effect of internal credit risk policy practices, credit granting process practices, credit monitoring practices and credit controls practices on loan performance of Micro Finance banks in Kenya. The study adopted a descriptive cross-sectional survey. The study population composed of the 12 microfinance banks in Kenya, with 183 members of staff at currently working at the head office of microfinance banks in Kenya. The researcher used purposive sampling to reduce standard error by proving some control over variance. Using Slovin's Formula, the sample size was 126 respondents. The questionnaire was selected tool for data collection. Quantitative data collected was analyzed by the use of descriptive statistics. Content analysis was used to test data that is qualitative in nature or aspect of the data collected from the open ended questions.

The study conducted a correlation analysis to establish the strength of the relationship between the independent and the dependent variables. Multiple regressions were done to establish the effect of credit risk management practices on loan performance of microfinance banks in Kenya. The study found that the variables internal credit risk policy practices, credit granting process practices, credit monitoring practices and credit control practices positively and significantly influence loan performance of microfinance banks in Kenya. The study therefore recommends financial institutions to embrace a system for managing credit risk so as to guide them in enhancing and improving profitability. Also, Microfinance banks should charge interest rates that are affordable that will draw more creditors and therefore increase the revenue from earned interests. Microfinance Banks should enhance their credit scoring and administration practices to ensure that their financial performance improves. In addition, financial institutions should focus more on the credit policies of the regulatory authority.

**Key Word:** Internal credit risk policy, credit granting process, credit monitoring, credit control and loan performance

## **INTRODUCTION**

### **Background of the Study**

The idea of micro financing involves lending money to individuals and small-scale enterprises that either cannot afford or cannot access bank loans or other forms of financing in the market. This kind of lending activity exposes these institutions to credit risks. Credit risk is the probability that loss will be incurred due to credit default of an individual or an

enterprise to repay the loan granted. These losses directly affect loan and financial performance of these Microfinance Banks (MFBs) adversely. In order to mitigate the losses arising from lending activities, the MFBs must ensure that lending risks are not excessive. The most common form of risk that faces financial institutions is that of credit risk. MFBs can incur a huge loss just from few creditors defaulting to pay their loans (Bessis, 2013).

Defaulting can occur because of many reasons the most common one being creditors being under financial stress and as a result are being faced with bankruptcy or in cases of legal dispute or fraud. Elimination of credit risk has posed to be a great challenge; but it is possible for it to be diversified since default risk can arise due to systematic risk. Additionally, some portions of these losses are peculiar in nature and this becomes a challenge for creditors; this is despite the benefits of diversification on overall uncertainty. This is common especially for MFBs who lend in the local market and those that are less liquid. In such situations it becomes a challenge to transfer credit and make accurate estimations of losses (Ekka, Chaundry & Sinha, 2011). Considering the significance of credit risk management practice among microfinance Banks, it is expected that processes, techniques, methods, incentives and activities will have a significant effect on performance of loans (Harker & Satvros, 2018). This study sought to establish the effect of credit risk management practices on loan performance of microfinance banks in Kenya.

### **Statement of the Problem**

Microfinance institutions in Kenya, especially microfinance banks are experiencing continuous increase in NPLs (CBK, 2019). In the recent past, financial institutions have tried to develop strategies for credit risk management with the aim of lowering risk that arise from lending, growing the market share of the organization and increase in streams of revenue. Over the years, financial reports by microfinance banks have shown a rising trend in rates of NPLs. In 2019, the yearly report by CBK showed a rise in the level of microfinance banks non-performing loans over recent years. The years 2018, 2017, 2016, 2015, 2014 saw NPL ratio change from 7.5, 5.4, 4.11, 3.44 and 3.42 respectively (CBK, 2019).

There is still increase in the amount of NPLs recorded by these financial institutions despite them having embraced strategies for risk management. Failure of controlling NPLs can result in erosion of asset books and the result is that it affects banks overall performance as well as its profitability (Tetteh, 2016). As asserted by Hennie (2013) credit risk still remains to be a major challenge facing financial institution this is despite innovations made; It is also the reason why approximately 80% of balance sheets of financial institutions relate with aspects of managing risks. Kithinji (2017) conducted a research study that sought to determine how banks profitability and survival is affected by management of credit risk. It is rare to have a research study focusing on aspects of credit risk management and their effects on loan performance and consequently its effects on profitability of microfinance banks in Kenya.

Empirical studies done have also focused more on the banking industry and in relation to performance and not giving attention to loan performance in microfinance banks, thus

creating a need for further research. This research therefore sought to fill the existing research gap by conducting a study to establish the effect of credit risk management on loan performance of microfinance banks in Kenya.

### **Research Objectives**

1. To establish the effect of internal credit risk policy practices on loan performance of Micro Finance banks in Kenya
2. To evaluate the effect of credit granting process practices on loan performance of Micro Finance banks in Kenya
3. To evaluate the effect of credit monitoring practices on loan performance of Micro Finance banks in Kenya
4. To investigate the effect of credit controls practices on loan performance of Micro Finance banks in Kenya

## **LITERATURE REVIEW**

### **Theoretical Review**

#### **The Adverse Selection Theory**

The adverse selection theory of credit markets was developed by Stiglitz and Weiss (1981). The theory relies on two assumptions, that creditors are not able to differentiate between riskier debtors and that loan agreements are subject matter to limited liability. The adverse selection theory describes a situation of a lending institution where it cannot differentiate the safe borrowers from the risky borrowers and don not have all the information on the risks posed by the borrowers.

The adverse selection theory was used to explain the importance of internal credit policy practices describing the procedure of credit risk among borrowers and how microfinance banks reduce the risk of giving loans to risky borrowers. This study used the adverse selection theory to establish the effect of internal credit risk policy practices on loan performance of Micro Finance Banks in Kenya.

#### **Loanable Funds Theory**

This theory was developed by Wicksell in (1926). According to this theory, the loan demands and its supply will affect the rate of interest and interest rates and loanable funds are inversely related. In instances where demand and supply of credit changes, then the movement in credit demand and supply will determine the interest rate. It is also explained that credit demand arises from local savings and from money earned from customers, the government and local and foreign borrowers. On the other hand, supply arises from domestic savings and earnings from foreign lending and the banking industry. The study will make use of this

theory to establish how the credit granting process practices affect performance of loans among Microfinance banks in Kenya.

### **Information Asymmetry Theory**

This theory was developed by Spence, Stiglitz and Akerlof (1970), who were the winners of the Nobel Prize because of their immense contribution in the theory of economy. According to Akerlof (1970) there was possibility market failure under conditions where both the seller and the buyer possess unequal valuation information. This is as shown by the 'lemons' problem. On the other hand, Vickrey and Mirrlees, also Nobel laureates, established that prevalent transactions in the economy, whereby players lack equal information concerning benefits and costs about a transaction.

This study used the information asymmetry theory as it indicates how credit valuation in organizations can be applied by use of information that will be relevant during the process of credit appraisal. Further, it indicates how credit monitoring is carried out by the firms using information, since resources required for monitoring is a lot and not all companies can have free access to. Asymmetric information theory was applied in evaluating the impact of credit monitoring practices on loan performance of Micro Finance banks in Kenya.

### **The Agency Theory**

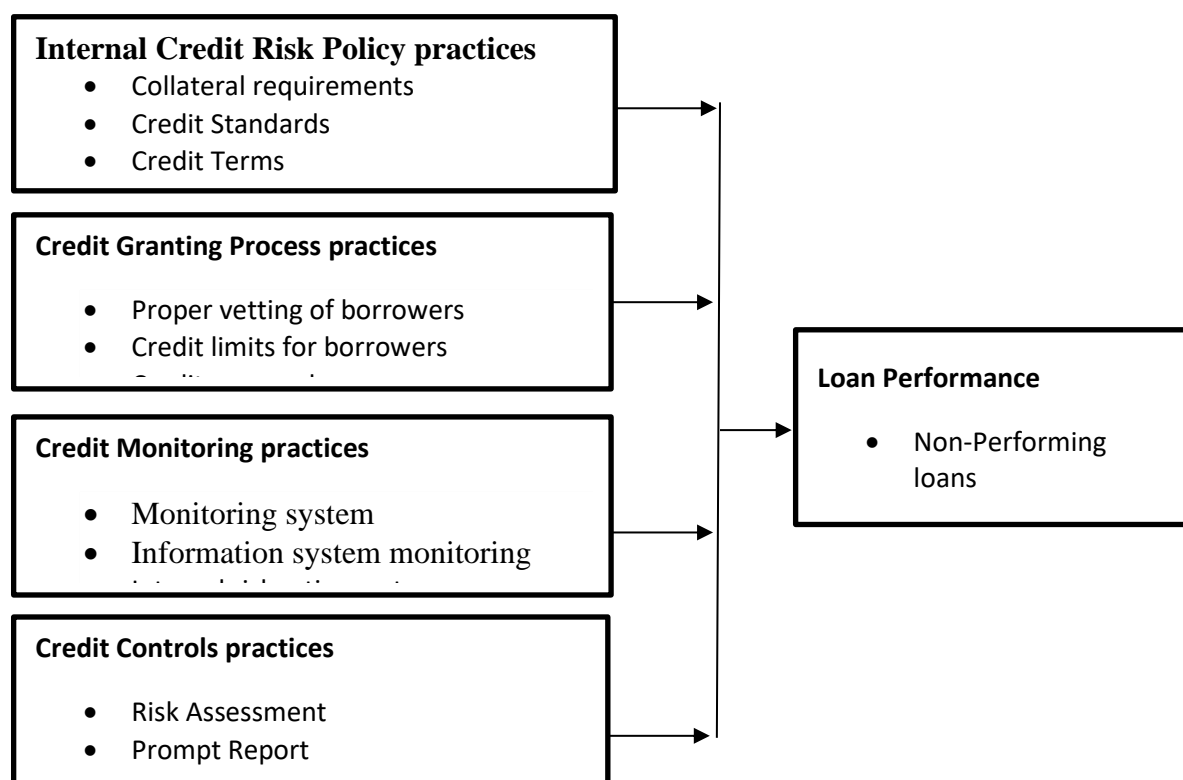
This theory was developed by Jensen and Meckling (1976). This theory studies the agency relationship and other issues relating with this relationship. Specifically, the theory explains the dilemma that agents and principals working towards achieving a particular goal might be having different interests. The main focus of this theory is techniques, systems and challenges arising when interests of agents and principals aligned (Delves & Patrick, 2000). A relationship whereby one or more persons (principals) engages another (agent) to carry out some activities on their behalf is termed as agency relationship; it is a relationship where principals delegate the authority to make decisions to agents. Lending and borrowing is an example of an agency relationship with the lender being the principal and borrow being the agent. This theory asserts that a company is a nexus of contracts between principals and managers and the owners of economic resources whereby agents are the ones who use and control the resources (Jensen & Meckling, 1976).

Through internal controls, provision of additional information to principals and shareholders regarding agents' behavior is enhanced, therefore lowering information asymmetry and reduces risk of investors and low revenue. In this study the agency theory was applied in investigating the impact of credit control practices on loan performance of Micro banks in Kenya.

### **Conceptual Framework**

Kombo and Tromp (2009) explained a concept to be a general idea obtained from specific

instances. A broad set of ideas and principals obtained from relevant areas of enquiry and applied in structuring subsequent presentations is referred as a conceptual framework. The figure below represents the variables the study investigated and their assumed relationship.



**Figure: 1 Conceptual Framework**

## **Empirical Review**

### **Internal Credit Risk Policy Practices and Loan Performance**

In a study conducted by Wachira (2015) in Kenya among deposit taking SACCOs sought to determine how organization’s financial performance was affected by credit policy. This study was a census approach among six Kenya’s DTS and from which data was collected. Results obtained showed that policies of regulatory authorities positively and significantly affected organizations financial performance. Regression model showed that the predictor variables independently affected performance an also jointly they had significant influence on performance. Further, the predictor and response variables were found to be correlated. Policies n credit standards were also found to have significant influence on financial performance. All the independent variables had significant effect on performance. Results led to the recommendation that DTS should focus more on policies of the regulatory authority aside from other factors because policies are the key factors affecting performance of DTS.

Agola (2014) carried out a research study on credit policies and how they affect MFIs financial performance. Survey design was adopted and data collected and analyzed using SPSS and presentation of findings done in tables and figures. Branch coverage, credit terms,

financial performance, credit approach, organization membership and challenges faced in practicing credit policy were analyzed. The findings revealed that credit policy, credit risk controls, credit appraisal and collection policy were positively related with financial wellbeing of the organization. Credit policy was a significant predictor showing that when credit appraisal and credit policy procedures on risk management are competent, they can influence achievement of enhance performance. Recommendations made were for MFIs to use strengthen policies rather than lenient ones when recovering debt to ensure the process is more effective.

Philip (2015) researched on credit policy and loan portfolio performance in MFIs in Uganda Finance Trust central Branch, Kampala. This study was carried out with the purpose of determining the link between performance of portfolio and credit policies in these institutions. The researcher used a combination of descriptive and analytical, cross-sectional survey. The findings indicated that Uganda Finance Trust Limited uses customer particulars for tracking purposes as some of it credit controls when issuing its loans to customers. The findings indicated that the organization has a variety of loan products such as, business loans, individual loans, school fees loans and salary loans. Analyzed data showed that policies on credit affected loan performance positively and significantly.

### **Credit Granting Process Practices and Loan Performance**

Arko (2012) researched on factors causing NPLs among Ghana's MFIs and their effect on organizations operations. It was evident that it is important for lenders to ensure decisions made are good before they grant any loan to make sure credit risk is maintained at its minimum. This simply means that it is the responsibility of the lender to assess the level of risk associated with any lending and ensure that factors that could compromise loan repayment are minimized. It is also important that the lender collects information on prospective borrower, information that can guide decision on whether to advance credit or not. Also, the organizations were found to have embraced standard requirements and procedures for loan request to mitigate non-performing loans resulting from failure of repayment; they have been integrated in credit policy manuals to guide both the customer and the loan officer.

Kisaka and Simiyu (2014) conducted a research study among MFIs in Kenya and sought to establish how the practice of managing credit risk was applied within the organization. It was established that majority of the MFIs applied the 6C technique in managing credit risk. It was also evident that comprehension of credit exposure in organizations is considered very important especially with MFIs. Follow ups were applied by institutions to avoid loan losses. It was evident that analysis of loan review was considered to be a very important aspect in process of managing risks; this was enhanced by proper documentation and analysis. Also MFBs are faced with the challenge of strict regulations by CBK, it was evident that majority of the institutions face the challenge of loan recovery.

### **Credit Monitoring Practices and Loan Performance**

Instefjord and Hiroyuki (2015) did a study on credit monitoring and bank risk. The study sought to determine the link that existed between the practice of monitoring and credit risk and how bank regulations affect incentives of banks on systems for monitoring of credit. Loan dynamic monitoring was explained in the study to be the practice whereby the bank stops monitoring of loans once they has established that the loan is good and not risky. By doing so, the incentive for holding risky loans is increased and therefore increasing regulatory compliance cost when the regulator is trying to limit banks risk. The chances that monitoring will be enhanced must balance with the increase in regulation cost and there is always a negative tradeoff.

Coleman, Esho and Sharpe (2016) conducted a research study that seeks to establish whether terms for loan contracts were affected by banks practice of monitoring. Monitoring practice in the bank was determined using the new proxy which focuses on monitoring of labor input. Analyzed information showed that the proxy had statistical and economic significance in determining the quality of future loans. There was statistically significant relationship between loan maturity and the monitoring ability also was the practice of observation clustering and control of borrowers' characteristics as well as loan maturity. The link existing between the study variables was even found to be much stronger for working loan capital.

### **Credit Controls Practices and Loan Performance**

Fung, Ho and Zhu (2016) conducted a research study risk control and regulations on interest rates and its effect on the long-run transformation of the Chinese economy. Two main institutional aspects evident in Chinese economy were identified; co-existence of state owned organizations and private companies as well as strict controls by the government over financial institution, the features were incorporated into the model of endogenous growth model investigating long term effects of credit controls and policies on interest rates on performance. Analyzed information showed that a rise in interest rate on government loans lowered the rate of inflation and the rate of output grew and increased nominal rate of interest on deposits which caused stag effect on inflation and increased the rate of inflation but lowered the rate of output growth and the change in nominal interest rate of bank loan had insignificant effect.

Akinola (2018) conducted a research study on the effects of credit control on NPLs among deposit taking financial institutions in Nigeria. The researcher's focus was on how credit controls affect credit facilities among the institutions selected. Secondary data were obtained from Central Bank of Nigeria's statistical bulletin and Nigerian Deposit Insurance Company and National Bureau of Statistics on the selected banks. These were analyzed using Econometric View Version 7. The result of regression analysis established the fact that there is significant relationship between non-performing loan and credit control. In addition, adherence to drawn down conditionality would significantly affect nonperforming loan.



## **Critique of Literature Review**

Philip (2015) conducted a research study among MFIs in Uganda on how performance of their loan portfolio was affected by their credit policies. Despite the study having been conducted on credit policy and performance of loan portfolio the study did not show how policies on credit risk affect performance of loans among MFIs in Kenya. Chepkoech (2016) researched on loan policies and how they affect financial performance of financial institutions; this study was conducted among commercial banks while our current study was conducted among Microfinance banks in Kenya. Orua (2013) carried out a research study among MFIs in Kenya and sought to determine how appraisals of loan applicants related with loan performance. This study focused on loan applicant appraisal and loan performance while the current study focus was on credit granting process on loan performance. Instefjord and Hiroyuki (2015) did a study on credit monitoring and bank risk. This study focused on credit monitoring in banks while the current study focus was on credit monitoring practices in Microfinance banks in Kenya.

Coleman, Esho and Sharpe (2016) researched on whether bank monitoring influence loan contract terms. This study focused on credit monitoring in banks while the current study focus was on credit monitoring in Microfinance Banks in Kenya. Fung, Ho and Zhu (2016) conducted a research study risk control and regulations on interest rates and its effect on the long-run transformation of the Chinese economy. This study focus was on credit control effects on Chinese economy while the current study focus was on credit control practices on loan performance of Micro Finance Banks in Kenya. Akinola (2018) studied the influence of credit control on non-performing loan in deposit money banks in Nigeria. This study focused on credit control in banks while the current study focused on credit controls practices in Microfinance banks in Kenya.

## **Research Gaps**

Several empirical studies have been reviewed by different researchers. Philip (2015) researched on credit policy and loan portfolio performance in MFIs in Uganda Finance Trust central Branch, Kampala. Chepkoech (2016) assessed policies on loan and how it affects commercial banks financial performance. In a study conducted by Arko (2012) on the causes and effects of NPLs on MFIs' operations in Ghana. Orua (2013) carried out a research study among MFIs in Kenya and sought to determine how appraisals of loan applicants related with loan performance. Instefjord and Hiroyuki (2015) did a study on credit monitoring and bank risk. Coleman, Esho and Sharpe (2016) researched on whether bank monitoring influence loan contract terms. Fung, Ho and Zhu (2016) s conducted a research study risk control and regulations on interest rates and its effect on the long-run transformation of the Chinese economy. Akinola (2018) studied the influence of credit control on non-performing loan in deposit money banks in Nigeria. Nguyen (2016) researched on credit risk control for loan products in commercial banks. Majority of the studies reviewed were on management of credit risk by commercial banks, the studies also focused on various concepts and the context in which they were conducted is different from that of our current study. The focus of the

current study was to establish the effect of credit risk management practices on loan performance of microfinance banks in Kenya.

## **RESEARCH METHODOLOGY**

Descriptive cross-sectional survey research design was adopted. The target population of this study comprised of 12 microfinance banks in Kenya. This study targeted employees working in 12 microfinance banks at their head offices. The study population composed of 183 members of staff in currently working at head office of licensed microfinance banks in Kenya. Employees at the head office were selected as they have relevant information on the effect of credit risk management on loan performance of microfinance banks in Kenya.

Questionnaire was the selected instrument or tool for data collection for the study. The questionnaire was semi-structured comprising of both open and closed ended questions. This study targeted employees working in 12 microfinance banks at their head offices. The study population composed of 183 members of staff in currently working at head office of licensed microfinance banks in Kenya. Employees at the head office were selected as they have relevant information on the effect of credit risk management on loan performance of microfinance banks in Kenya.

### **Data Processing and Analysis**

Qualitative and quantitative data was collected. Descriptive statistics were used to analyze primary quantitative data (version 23) and likert scales, presentation done in tables and figures. To achieve this, responses obtained were first tallied, percentages of variations computed and then described and interpreted based on the assumptions and the objective of the study. Secondary data was analyzed using content analysis method.

Multiple regressions were done to establish the effect of credit risk management on loan performance of Microfinance banks in Kenya. Data was presented using tables, and pie charts to make them reader friendly. In addition, a multiple regression was used to measure the quantitative data and was analyzed using SPSS too. The regression equation was:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon$$

Where

Y is the loan performance,  $\beta_0$  is the regression constant,  $\beta_1$ ,  $\beta_2$ ,  $\beta_3$  and  $\beta_4$  are the coefficients of independent variables,  $X_1$  is Internal credit risk policy practices,  $X_2$  is credit granting process practices,  $X_3$  is credit monitoring practices and  $X_4$  is credit controls practices. ANOVA was used to establish the level of significance of the established model.

Quantitative data was presented through statistical tools such as frequency distribution tables, pie-charts, bar-graphs and in prose form for easy understanding. The study interpreted the research findings from the evidence presented by the data collected. Conclusions were based on the findings.

## RESEARCH FINDINGS AND DISCUSSION

Descriptive and inferential statistics have been used to discuss the findings of the study.

### Correlation Analysis

Correlation analysis was computed to analyze the level of relationship existing between the dependent and the independent variables. Correlation value of  $\pm 0.1$  to  $\pm 0.29$  were interpreted as small correlation,  $\pm 0.3$  to  $\pm 0.49$  suggested medium correlation, and  $\pm 0.5$  and above suggested that the two variables under consideration were strongly related

Table 1: Correlations

		Loan Performance	Internal Credit Risk Policy practices	Credit Granting Process practices	Credit Monitoring practices	Credit Controls practices
	Pearson Correlation	1				
Loan Performance	Sig. (2-tailed)					
	N	103				
	Pearson Correlation	.738**	1			
Internal Credit Risk Policy	Sig. (2-tailed)	.000				
	N	103	103			
	Pearson Correlation	.826**	.364	1		
Credit Granting Process	Sig. (2-tailed)	.000	.000			
	N	103	103	103		
	Pearson Correlation	.727**	.446	.397	1	
Credit Monitoring	Sig. (2-tailed)	.000	.000	.000		
	N	103	103	103	103	
	Pearson Correlation	.723**	.437	.354	.454	1
Credit Controls	Sig. (2-tailed)	.000	.000	.000	.000	
	N	103	103	103	103	103

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

From the findings, internal credit risk policy practices was seen to have a strong, positive and significant relationship with loan performance ( $r=0.738$ ,  $p\text{-value}=0.000$ ); credit granting

process practices was seen to have a strong positive and significant relationship with loan performance ( $r=0.826$ ,  $p\text{-value}=0.000$ ); credit monitoring practices was also seen to have strong, positive and significant relationship with loan performance ( $r=0.727$ ,  $p\text{-value}=0.000$ ); and finally, credit controls practices had strong positive and significant relationship with loan performance ( $r=0.723$ ,  $p\text{-value}=0.000$ ). These findings suggest that the variables internal credit controls practices, credit granting process practices, credit risk policy practices, and credit monitoring practices have significant relationship with loan performance.

## Multiple regression Analysis

### Model Summary

Model summary was used to show the amount of variation in dependent variable as a result of changes in the independent variable. In this study, the amount of variation in loan performance as a result of changes in credit controls practices, credit granting process practices, internal credit risk policy practices, and credit monitoring practices was sought.

*Table 2: Model Summary*

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.848 <sup>a</sup>	.719	.705	.05930

a. Predictors: (Constant), Credit Controls practices, Credit Granting Process practices, Internal Credit Risk Policy practices, Credit Monitoring practices

From the findings in Table 2, the value of adjusted  $R^2$  was 0.705 suggesting that 70.5% variations in loan performance could be explained by changes in credit controls practices, credit granting process practices, internal credit risk policy practices, and credit monitoring practices. The remaining 29.5% suggest that there are other factors that can be attributed to variations in loan performance of microfinance banks in Kenya that were not included in the model. The findings further show that the variables being investigated in the study were strongly and positively related as indicated by correlation coefficient (R) value of 0.848.

### Analysis of Variance

ANOVA was used to test the significance of the regression model developed. The significance of the model was tested at 95% confidence interval and 5% level of significance. Results are as shown in Table 3.

**Table 3: ANOVA**

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	3.073	4	.768	218.458	.000 <sup>b</sup>
1 Residual	.345	98	.004		
Total	3.418	102			

a. Dependent Variable: Loan Performance

b. Predictors: (Constant), Credit Controls practices, Credit Granting Process practices, Internal Credit Risk Policy practices, Credit Monitoring practices

From the findings presented in Table 3, the significance level of the modelled equation was 0.000 which is less than the selected level of significance (0.05). This suggests that the model was significant. The findings also show that the F-calculated value (218.458), from the ANOVA table, was greater than the F-critical value ( $F_{4,98}=2.465$ ), from the f-distributions table. These suggest that the model was significant and that the variables credit controls practices, credit granting process practices, internal credit risk policy practices, and credit monitoring practices can be used to predict loan performance of microfinance banks in Kenya.

### Beta Coefficients of the Study Variables

*Table 4: Coefficients*

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	0.997	0.160		6.234	0.000
Internal Credit Risk Policy practices	0.367	0.076	0.354	4.824	0.001
1 Credit Granting Process practices	0.155	0.039	0.164	3.982	0.024
Credit Monitoring practices	0.485	0.111	0.377	4.367	0.017
Credit Controls practices	0.440	0.092	0.431	4.785	0.003

a. Dependent Variable: Loan Performance

From the findings in Table 4, the following regression equation was fitted;

Loan Performance = 0.997 + 0.367 Internal credit risk policy practices + 0.155 Credit granting process practices + 0.485 Credit monitoring practices + 0.440 Credit control practices

From the regression equation above, it can be observed that while all the other variables (credit controls practices, credit granting process practices, internal credit risk policy practices, and credit monitoring practices) are held to a constant zero, loan performance will be at a constant value of 0.997.

The findings also show that internal credit risk policy practices have a positive effect on loan performance as shown by a regression coefficient of 0.367. The p-value (0.001) was less than the selected significance level (0.05), hence the relationship was significant. These findings suggest that internal credit risk policy practices positively and significantly influence loan performance of microfinance banks in Kenya. Therefore, a unit increase in credit risk policy will result to an increase in loan performance by 0.367 units.

The findings also show that credit granting process practices is statistically significant to loan performance ( $\beta = 0.155$ ,  $P = 0.024$ ). This implies that at 95% confidence level, credit granting process had significant positive relationship with loan performance of microfinance banks in Kenya. This implies that a unit increase in credit granting process will result to increase loan performance by 0.155 units.

Regarding credit monitoring practices, the findings showed that credit monitoring has a positive effect on loan performance as shown by a regression coefficient of 0.485. The p-value (0.017) was less than the selected significance level (0.05), hence the relationship was significant. These findings suggest that credit monitoring positively and significantly influences loan performance of licensed microfinance banks in Kenya. Therefore, a unit increase in credit monitoring will result to an increase in loan performance by 0.485 units.

On credit controls practices, the findings showed that credit controls is statistically significant to loan performance ( $\beta = 0.440$ ,  $P = 0.003$ ). This implies that at 95% confidence level, credit controls practices had significant positive relationship with loan performance of licensed microfinance banks in Kenya. This implies that a unit increase in credit controls will result to increase loan performance by 0.440 units.

## **CONCLUSIONS AND RECOMMENDATIONS**

### **Conclusions**

The study found that internal credit risk policy practices has a positive effect on loan performance. The study further established that the relationship between the two variables was significant. Those findings suggested that internal credit risk policy practices positively and significantly influences loan performance of microfinance banks in Kenya. Based on these findings, the study concluded that a unit increase in credit risk policy practices will result to an increase in loan performance.

The study found that credit granting process practices is statistically significant to loan performance. The study also found that credit granting process practices had significant positive relationship with loan performance of microfinance banks in Kenya. From these findings, the study concluded that a unit increase in credit granting process practices will result to increase in loan performance.

Regarding credit monitoring practices, the study established that credit monitoring has a positive effect on loan performance. The study also established that the relationship between the two variables was significant. These findings suggested that credit monitoring positively and significantly influences loan performance of microfinance banks in Kenya. Therefore, from those study findings, the study concluded that a unit increase in credit monitoring will result to an increase in loan performance.

On credit controls practices, the study found that credit controls is statistically significant to loan performance. The study also found that credit controls practices had significant positive relationship with loan performance of microfinance banks in Kenya. From these study findings, the study concluded that a unit increase in credit controls will result to increase loan performance.

### **Recommendations**

Increasing internal credit risk policies were found to positively enhance loan performance. The study therefore recommends for Microfinance banks to use strengthened policies rather than lenient ones to ensure that the rate of loan defaulting is reduced; this is also applicable for loan recovery process.

Improving credit granting process practices will result to improved loan performance. The study recommends Microfinance banks to have well developed procedures for granting loans and ensure that the set procedures are followed to the later; this includes conducting client appraisals and checking on their past credit history.

The study also recommends financial institutions to embrace a system for managing credit risk so as to guide them in enhancing and improving profitability. Also, microfinance banks should charge interest rates that are affordable that will draw more creditors and therefore increase the revenue from earned interests.

The study also recommends for Microfinance banks to enhance their credit scoring and administration practices to ensure that their financial performance improves. Also, financial institutions should focus more on policies of the regulatory authority aside from other factors because policies are the key factors affecting loan performance.

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