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DEBT RECOVERY PRACTICES AND LOAN PERFORMANCE OF DEPOSIT-TAKING MICROFINANCE BANKS IN KENYA

[1] Kamanda Cynicah Nyaboke, [2] Ondabu Ibrahim Tirimba, [3]Teimet Paul, [4] Matanda Joshua

[1]Masters Student, Jomo Kenyatta University of Agriculture and Technology

[2,3,4] Lecturer, Jomo Kenyatta University of Agriculture and Technology

ABSTRACT

This study explored the relationship between debt recovery practices and loan performance for deposit-taking microfinance banks in Kenya. The study is guided by agency theory and risk shifting theory. The objectives of this study include determine the effect of third-party credit and analyze the effect of collection agencies on loan performance. This research adopted a descriptive approach, the research meticulously captured numerical data for rigorous statistical analysis, aligning with the study's objective. This study used census servay, all 14 microfinance banks licensed and operational by the Central Bank of Kenya were included. This study used self-administered questionnaires. In this study diagnostic tests were performed to validated the robustness of statistical analysis using SPSS. Validity and reliability were ensured through content validity guidelines and expert assessments where reliability has shown an average Cronbach alpha of 0.7 for all the variables. The study conducted a detailed analysis of the relationships between various elements related to loan performance surveyed microfinance banks. In this study the correlation matrix revealed strong positive correlations between third-party credit guarantees, and collection agencies. Regression analysis showed a significant impact of these factors on loan performance, with an R Square of 0.416. The study's hypotheses regarding the influence of third-party credit guarantees, and collection agencies on loan performance were tested and supported. This study concluded that effective debt recovery practices significantly enhance loan performance in MFBs. Recommendations included reassessing debt policies, focusing on equity policies, and streamlining policy implementation concerning loan defaulters. The study also identified areas for further research to deepen understanding of loan performance dynamics in the microfinance sector. The study highlighted the importance of proactive debt recovery strategies and risk mitigation measures in enhancing the financial sustainability of MFBs in Kenya.

Key Words: Debt Recovery Practices, Loan Performance, Deposit-Taking Microfinance Banks, Third-Party Credit, Collection Agencies

Background of the Study

Deposit-taking microfinance Institutions (DTMFIs) play important roles in providing financial services to diverse segments of the population mostly in developing economies (Monyi, 2017). However, the issue of loan performance has emerged as a critical challenge within this sector, casting a shadow on its overall effectiveness. Loan performance refers to the timely and complete repayment of loans by borrowers and the timely repayment has become a pressing concern for DTMFIs in Kenya (Kingu et al., 2018). The consequences of poor loan performance cut across the financial health of these institutions, impacting their sustainability and ability to fulfill their mandate and this brings the concept of Non-Performing Loans (NPL).

DTMFIs recognize the urgent need to address the challenges associated with loan performance, and in this context coming up with debt recovery practices emerge as a strategic solution. The effectiveness of debt recovery practices can play a decisive role in mitigating the adverse effects of loan defaults. Establishing robust debt recovery mechanisms, these DTMFIs aim to recover outstanding amounts, thereby safeguarding their financial stability and ensuring the continuity of their operations (Nguyen, 2020).

Several theories explain the linkage between these strategies which formed part of the variables and loan performance. The moral hazard theory emphasizes that borrowers may take excessive risks if they perceive minimal consequences for default (Annan, 2022). Adverse selection theory posits that without proper screening, lenders may attract higher-risk borrowers (Moyi, 2019). These theories provide a theoretical framework to comprehend the relationship between debt recovery practices, the identified practices, and the overarching issue of loan performance in DTMFIs. This research endeavors to provide a thorough exploration of these elements aims to shed light on effective strategies for enhancing loan performance and fortifying the resilience of Deposit-Taking Microfinance Banks in Kenya.

Statement of the Problem

Loan performance in Kenya's microfinance Banks represents a formidable challenge that requires immediate attention and in-depth (Kitonyi, 2017). The microfinance banks faces a persistent challenge characterized by significant fluctuations in loan performance. Recent data gathered marked disparities in NPL ratios across all these Banks. As of 2018, non-performing loans escalated, with the ratio of gross non-performing loans to gross loans rising from 11.81% to 11.97%. However, in 2019, there was a slight decrease to 9.75%, followed by a small increase to 11.88% in 2020, attributed to a slowdown in business activities (CBK, 2022).

According to the CBK Reports (2022), this surge in non-performing loans mirrors the broader banking industry's struggle, culminating in a staggering total of Ksh. 540.8 billion in bad loans by March 2022 which increased further to 11.11% higher than the previous year. The NPL ratios in 2021 stood at 10.89%, signifying the ongoing challenges within microfinance Banks concerning loan performance and recovery practices. This escalation has led to an increased prevalence of subprime loans, adversely impacting the sector's growth trajectory (CBK, 2022). By March 2022, the ratio of gross loan performance to gross loans had deteriorated from 13.3% to 14.0 percent in December 2022 driven by a 4.8 percent increase in gross loans. According to Bhattarai (2020), these high NPL percentages have significant effects to the performance of MFIs.

Non-performing loans severely limit MFBs' ability to lend money, put strain on their capital reserves, and prevent them from offering low-income people and small businesses access to affordable financial services. In consequence, this compromises their chances for growth and sustainability, which ultimately jeopardizes the effort to promote financial inclusion in Nairobi, an issue raised by Mombo (2013). However, the current state of understanding regarding debt recovery practices within Nairobi's deposit-taking MFBs is insufficient (Bhattarai, 2020). To better understand the complex effects of debt recovery strategies on loan performance, this research study covers elements including fines, lending restrictions, and collection agency involvement. The main goal is to create a database of policies and tactics that are evidence-based and specifically designed to improve loan performance in the microfinance industry while also improving debt collection processes.

This research, in addressing the issue of PLs in Kenya's MFBs, seeks to bridge several critical gaps. Conceptually, it aims to provide a comprehensive analysis of the determinants, mechanisms, and drivers of elevated LP ratios (Kitonyi, 2017). Contextually, it explored the unique contextual factors specific to this geographical region to decipher the root causes of the challenge. Methodologically, the research employed a well-defined research design, data collection methods, and analytical techniques (Bhattarai, 2020). Theoretically, it integrated pertinent existing theories or frameworks to elucidate the multifaceted NPL challenge (Bhattarai, 2020).

Research Objectives

The main objective of the study was to analyze the effect of debt recovery practices on loan performance of deposit-taking Microfinance Banks in Kenya.

Specific Objectives

i. To evaluate the effect of third-party credit guarantee on loan performance of deposit-taking Microfinance Banks in Kenya.
ii. To analyze the effect of collection agencies on loan performance of deposit-taking Microfinance Banks in Kenya.

LITERATURE REVIEW

Theoretical Review

Risk-Shifting Theory

Risk-shifting theory, also known as Risk Transfer Theory, is a financial concept that outlines how risk is transferred from one party to another using a variety of financial instruments or methods. The term "Risk-Shifting Theory" was coined by economists Stewart Myers and Nicholas Majluf in their seminal paper titled "Corporate Financing and Investment Decisions When Firms Have Information That Investors Do Not Have," published in the Journal of Financial Economics in 1984. Myers and Majluf introduced the theory to explain how asymmetric information between managers and investors influences corporate financing decisions, leading to the issuance of securities to shift risk. According to the hypothesis, people or organizations attempt to transfer the weight of risk onto other parties to lessen their exposure and possible losses (Andreu et al., 2019). This concept has significant implications for financial markets, particularly in the context of lending and risk management (Elliott et al., 2021).

The theory posits that when firms possess private information that investors do not have, such as the true value of their assets or future earnings prospects, they may exploit this information asymmetry to their advantage. One way they can do this is by issuing securities, such as debt or equity, to external investors. By selling securities, firms effectively transfer some of the risk associated with their operations to investors who purchase these securities. This risk-shifting behavior allows firms to mitigate their risk exposure while potentially benefiting from the capital raised through security issuance. However, Risk-Shifting Theory has faced criticism from several quarters. One major criticism is related to the potential for moral hazard, where parties that bear less risk may engage in riskier behavior due to the presence of risk-sharing mechanisms (Uluc & Wieladek, 2018).

In the context of the study on debt recovery practices and loan performance of deposit-taking Microfinance Banks in Kenya, the Risk-Shifting Theory provides a relevant framework for understanding the role of third-party credit guarantees. Third-party credit guarantees entail the employment of external institutions, such as insurance firms or government agencies, to give lenders with assurance that loans would be repaid in the case of borrower default. This approach essentially transfers some credit risk from the lender to a third party. The paper investigates the usage of third-party credit guarantees by Kenyan microfinance banks, utilizing Risk-Shifting Theory to better understand their strategic approach to controlling credit risk. By shifting some credit risk to guarantors, banks can reduce risk exposure and enhance loan performance. However, the analysis recognizes several limits and concerns, such as moral hazard incentives and the influence of guarantor financial stability.

Agency Theory

Pioneered by Michael Jensen and Meckling in 1976 and originating from their seminal paper titled Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure, this theory looks into the complexities of the principal-agent relationship that emerges when delegating debt recovery tasks to specialized agencies (Cuervo-Cazurra et al., 2019). Within the theoretical construct, the engagement of third-party agencies in the microfinance sector is conceptualized as the delegation of debt recovery responsibilities from the principal (MFB) to specialized agencies, creating a principal-agent relationship.

The conclusions drawn from this theory provide light on the possible advantages and difficulties of this kind of delegation. It delves deeper into the motivations and actions that arise in the principal-agent relationship, offering insightful viewpoints on the complexities of debt collection procedures. Agency Theory was developed within a larger economic framework, but its application to debt recovery in the microfinance industry deepens our understanding of the complex interactions between principals and agents. It also provides a fundamental framework for evaluating and improving debt recovery procedures (Stanescu, 2023).

In the microfinance sector, the involvement of collection agencies can be perceived as the delegation of debt recovery tasks from MFBs (principals) to specialized agencies (agents). Agency Theory provides insights into the potential benefits and challenges of such delegation, as well as the incentives and behaviors emanating from this principal-agent relationship (Stănescu, 2023). According to Agency Theory, the principal-agent relationship is characterized by information asymmetry, conflicting interests, and moral hazard. The lender aims to recover outstanding debts, while the collection agency seeks to maximize its profit. This misalignment of interests can create agency problems, where the collection agency might not exert optimal effort in pursuing debtors or could engage in opportunistic behavior.

However, it is essential to acknowledge certain critiques that have been raised against Agency Theory (Maestrini et al., 2018). Some critics argue that the theory could oversimplify the complexities of real-world principal-agent relationships and might neglect the influence of factors beyond incentives. Furthermore, the application of Agency Theory in contexts like microfinance should take into account the unique features of the sector, such as its social mission and emphasis on financial inclusion (Zalina & Yusof, 2016).

In this study the theory explains the benefits and drawbacks of employing collection agencies for debt recovery in MFBs, capturing issues affecting the principal-agent relationship. The theory examines how contractual, monitoring, and selection processes might influence the efficacy of collection agency activities, aligning with the study's focus on collection agencies' impact on loan performance in microfinance. Agency Theory suggests that careful selection, monitoring, and contracting of collection agencies play a pivotal role in debt recovery. Principals like MFBs must choose agencies with expertise and a proven track record. Furthermore, performance-based contracts, tying compensation to successful debt recovery, could incentivize agencies to exert effort and achieve desired outcomes. The different views on the nature of Agency Theory enhance comprehension of the dynamics between lenders and collection agencies within the microfinance sector. While acknowledging the theory's critiques, its application in this study provides valuable insights into the strategic selection and management of collection agencies, contributing to the broader discourse on optimizing debt recovery practices in microfinance.

Conceptual Framework

The conceptual framework provides a visual representation of the key concepts and variables under investigation in a research study. It outlines the relationships and interconnections between these variables, guiding the research process and helping to generate hypotheses (Varpio et al., 2020).

Independent Variables **Dependent Variable**

(Debt Recovery Practices)

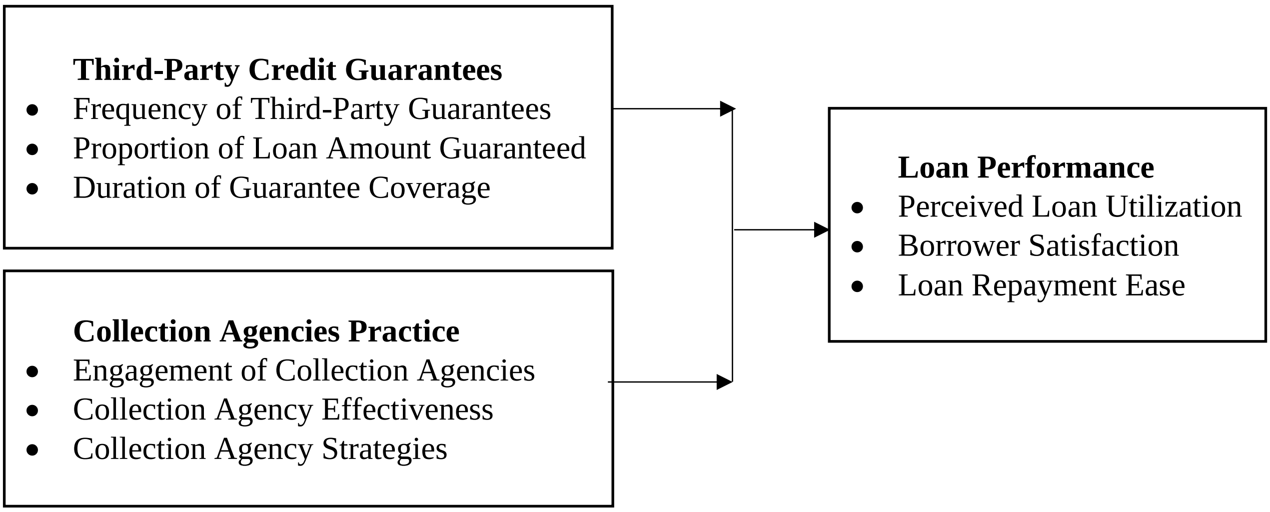

Figure 2. 1 Conceptual Framework

Third-Party Credit Guarantee Practices

Third-party credit guarantees involve securing loans with the backing of a third-party entity, which can significantly influence loan performance. This variable is included because third-party guarantees mitigate the risk of default by providing additional security to lenders. Such guarantees can enhance the creditworthiness of borrowers who may otherwise be deemed high-risk, thereby increasing the likelihood of loan approval and successful repayment. The presence of a third-party guarantee can also facilitate access to larger loan amounts or more favorable terms for borrowers. By incorporating third-party credit guarantees into the study, we recognize the importance of external assurances in improving loan performance and reducing default rates. This practice ensures that there is an additional layer of financial protection, which can contribute to the stability and reliability of loan portfolios. Thus, third-party guarantees play a critical role in enhancing the overall performance and risk management of loans.

Collection Agencies Practices

The involvement of collection agencies in the debt recovery process is a vital aspect of managing loan performance. Collection agencies specialize in recovering overdue debts and have established methodologies for pursuing delinquent accounts. Including this variable is justified by the significant impact collection agencies can have on improving loan recovery rates and overall performance. Their expertise in negotiating with borrowers, managing repayment plans, and handling collections can directly influence the effectiveness of debt recovery efforts. By leveraging the services of collection agencies, MFIs can enhance their ability to recover outstanding loans and reduce the incidence of non-performing loans. This practice is particularly relevant for MFIs with large volumes of loans or high levels of delinquency. The efficiency and effectiveness of collection agencies in managing and recovering debts make this variable essential for understanding and improving loan performance in the microfinance sector.

Loan Performance

Loan performance is a key outcome variable that reflects the effectiveness of lending practices and management strategies. It encompasses various aspects such as perceived loan utilization, borrower satisfaction and loan repayment ease. This variable is crucial for assessing the success of microfinance and the impact of different practices on financial outcomes. Including loan performance as a variable allows for a comprehensive evaluation of how various factors, such as guarantees, and collection practices, influence the success and sustainability of lending activities. By focusing on loan performance, we can gauge the effectiveness of implemented strategies and identify areas for improvement. This variable provides a clear measure of the impact of different credit management practices on the financial stability and operational success of microfinance institutions.

Empirical Review

Third-Party Credit Guarantee and Loan Performance

Beyhaghi's (2022) study on provided valuable insights into the impact of third-party credit guarantees on loan dynamics, which was highly relevant to our exploration of the effect of third-party credit guarantees on loan performance within Microfinance Banks in Kenya. The research drawn from a comprehensive dataset compiled by the Federal Reserve, revealed a notable trend where a substantial portion of corporate loans in the US benefited from third-party credit guarantees provided by separate legal entities. Through rigorous empirical analysis, the study demonstrated that the presence of such guarantees correlated with reduced loan risk, lower loan interest rates, and decreased instances of loan delinquency. These findings suggested that third-party credit guarantees played a pivotal role in mitigating credit risk and enhancing the overall performance of loans. The study highlights the role of third-party credit guarantees in easing collateral constraints in credit markets, especially for smaller firms, underscoring the need to understand their influence on loan performance.

According to Bertoni et al. (2023), who explored the impact of credit guarantee policies on the survival and performance of small and medium-sized enterprises (SMEs) in the Republic of Korea, their findings offer valuable insights relevant to the analysis of third-party credit guarantees on loan performance. The study evaluated how credit guarantee frequency and amounts influenced the survival and productive performance of guaranteed firms. Results suggested that the frequency of credit guarantees contributed to improved performance among guaranteed firms. While credit guarantees partially fulfilled their objectives of easing SMEs' financial constraints and stabilizing employment, the nuanced findings underscore the complexity of the relationship between credit guarantee policies and SME performance. Applying these insights to the analysis of third-party credit guarantees on MFB loan performance can provide a broader understanding of the mechanisms through which such guarantees impact financial institutions.

The study conducted by Wilcox and Yasuda (2019) delved into the effects of government guarantees on loans extended by banks to small and medium-sized enterprises (SMEs), focusing specifically on the Japanese context. By examining the dynamics of loan guarantees and their impact on banks' risk-taking behavior in terms of giving loans and non-guaranteed lending activities, the research shed light on important aspects relevant to the analysis of third-party credit guarantees on loan performance. The findings indicated that loan guarantees provided by the government increased banks' propensity for risk-taking to give more loans. Moreover, the study revealed that the presence of loan guarantees stimulated an expansion in guaranteed lending. This finding implied that loan guarantees acted as "high-powered" incentives, amplifying the overall lending capacity of banks. These insights offered valuable implications for understanding the dynamics of third-party credit guarantees on loan performance in the context of MFBs in Kenya, providing a nuanced perspective on the interplay between guarantee mechanisms, risk-taking behavior, and lending practices within financial institutions.

The study conducted by Muigai and Maina (2018) addressed the persistent challenge of credit default risk in Kenyan commercial banks, which historically led to numerous bank failures between 1984 and 1991. Despite a reversal of this trend, credit default risks remain a significant concern among banks in the country. Specifically, the study examined the influence of credit guarantees alongside loan appraisal, lending requirements, credit management tools, and loan recovery processes on the financial performance of these banks. Adopting a descriptive research design, the study targeted all licensed commercial banks operating in Kenya as of 2017. Both primary and secondary data were utilized, with findings indicating a positive and significant relationship between credit guarantees and the financial performance of commercial banks in Kenya. As a recommendation, the study emphasized the need for commercial banks to strengthen their credit guarantee mechanisms, including establishing comprehensive credit limits for individual borrowers and implementing clear processes for credit approval and monitoring.

Collection Agencies and Loan Performance

The study conducted by Sikira (2021) aimed to investigate the loan recovery procedures employed by Microfinance Institutions (MFIs) in Tanzania, with a specific focus on NFBS, SMF, and AML in Dar-Es-Salaam. Recognizing the challenges associated with loan recovery in the financial sector, especially for microfinance institutions, the researcher employed a mixed-case study design, involving 50 credit officer respondents selected through purposive sampling. Primary data were collected using semi-structured questionnaires, complemented by secondary data from documents available at the mentioned institutions. Data analysis utilized simple descriptive statistics for quantitative data and thematic analysis for qualitative data. The findings revealed that the institutions utilized various loan recovery procedures, including direct contact, friendly reminders, issuance of final demand notices and engaging debt collection agencies. Notably, the study highlighted the significance of debt collection agencies for loan recovery to enhance effectiveness. The study implied the need for Microfinance Institutions to adopt and prioritize formal procedures, promoting a structured and conflict-free environment for loan recovery. The research recommended the establishment of clear guidelines to ensure a systematic and efficient approach to loan recovery, ultimately contributing to the financial sustainability of microfinance institutions in Tanzania.

In another study by Gatimu (2022) the focus was on the Deposit Taking SACCO sector in Kenya, which played significant roles in the financial industry and contributes to the country's GDP. The rising trend of Non-Performing Loans (NPLs) in these SACCOs posed challenges to internal growth, liquidity, and overall operational efficiency. The research aimed to explore the impact of management practices, specifically restructuring, guarantee policies, monitoring practices, and loan recovery, on NPLs in these cooperatives. Anchored in Stakeholder Theory, Shareholder Theory, and Acceleration Theory, the study employed descriptive analysis and structured questionnaires for data collection. Statistical tools like Excel, SPSS, and AMOS, along with Regression Analysis, facilitated hypothesis testing. Results revealed that efficient management practices positively influenced NPL outcomes, reducing both the number and total amount of non-performing loans. Moderated Multiple Regression analysis further indicates that SACCO size enhances the relationship between management practices and NPLs. The study concluded that recovery practices including use of collection agencies and other variables are critical determinants of NPLs in SACCOs, emphasizing the importance of sustaining low NPL levels for robust asset quality. The findings suggested a need for SACCOs to continually enhanced their efficiency in managing NPLs, fostering sustainable development in these institutions.

The research conducted by Habamenshi and Gasana (2023) focused on assessing the impact of credit risk management on loan performance within microfinance banks, using Réseau Interdiocésain De Microfinance (RIM Ltd) Kibuye Branch as a case study over the past five years (2015-2019). A population of 97 respondents, randomly selected from a total population of 4,334 RIM Ltd clients, including 2,777 men and 1,557 women, along with 9 staff members, was involved in the study. The research employed a quantitative approach with a Likert scale questionnaire and was analyzed. Key findings indicated that client appraisal, credit risk control, collection policy including use of debt collection agencies or auctioneers, and terms of credit significantly influenced the loan performance of RIM Ltd. Challenges identified in effective credit risk management included project deviation, business climate fluctuations, client resistance to working in solidarity, concurrent loans in SACCOs and RIM Ltd, and poor entrepreneurship skills. Recommendations encompassed different approaches, improvement of RIM policy on solidary groups, introduction of clearance for loan applicants. Additionally, the research recommended incorporating debt collection agencies as part of credit risk management practices to enhance the effectiveness of loan recovery strategies and mitigate non-performing loans within microfinance institutions.

Additionally, the operationalization of collection agencies has varied across studies. While some studies have focused on the proportion of loans assigned to collection agencies, others have considered the success rates of collection efforts or borrower satisfaction with the collection process. Future research should aim for standardized measures of collection agency involvement and effectiveness to facilitate comparisons and meta-analyses across studies.

There exists divergence in the operationalization of collection agencies across different studies. Some investigations have concentrated on the percentage of loans designated for collection agencies, whereas others have focused on the efficacy of collection endeavors or the contentment of borrowers with the collection procedures. To address this variability, this research endeavors strive for standardized metrics when gauging the engagement and impact of collection agencies. This standardization through operationalization is essential for fostering consistency, enabling more robust comparisons, and facilitating meta-analyses across diverse studies in the field.

RESEARCH METHODOLOGY

The research design for this study employed a descriptive approach to investigate the relationship between debt recovery practices and loan performance of deposit-taking microfinance Banks. The study employed a census approach, targeting 14 microfinance Banks (MFBs) operational and supervised by the Central Bank of Kenya as at 31st Dec 2022 (CBK, 2022) in Kenya. The distribution of respondents to each MFB was proportionate to the number of MFBs to reach a final population goal of 45 respondents. To ensure that each institution is fairly represented in the study, it was specifically assign five respondents to each MFB. This strategy ensures thorough and representative data collection across the microfinance industry, enabling a thorough investigation of loan performance and debt recovery practices inside each MFB (Lelis, 2022). The study looks to provide a comprehensive overview of the microfinance landscape in Kenya by including all MFBs in the study.

Data collection involved the use of primary data was collected by questionnaires. Secondary data was collected from published CBK reports, financial statements, and records of microfinance Banks from 2016 to 2022, including historical non-performing loans for the specified period. This secondary data provided additional insights into the loan performance of the Banks (Ruggiano & Perry, 2019). The study used descriptive statistics to summarize key features of the data, enabling a clear understanding of central tendencies, variability, and distribution. Correlation analysis examined the relationships between credit management practices and loan performance indicators, while regression analysis explored the combined influence of various credit management factors on loan performance variations. To establish a regression equation for the relationship between dependent and independent variables, a multiple regression analysis was be employed.

RESEARCH FINDINGS AND DISCUSSION

out of the 45 questionnaires distributed to the 14, an impressive response rate was achieved, with 41 questionnaires being filled and returned. This translates to a robust response rate of 91.11%. The high participation level demonstrates the engagement and willingness of the respondents to contribute to the research study, enhancing the reliability and validity of the gathered data.

Descriptive Statistics

The study focused on understanding the influence of debt recovery practices on loan performance within deposit-taking Microfinance Banks (MFBs) in Kenya. To provide a comprehensive examination of this relationship, descriptive statistics were employed to assess various dimensions of debt recovery practices. The study compared its findings with existing literature, allowing for a nuanced understanding of similarities and differences in the impact of debt recovery practices on loan performance.

Third-Party Credit Guarantees

The Table 4. presents descriptive statistics for six Likert-scale questionnaire items related to third-party credit guarantees in a Microfinance Bank. Each item assesses different aspects of third-party credit guarantees, including frequency, proportion of loan amounts guaranteed, and duration of guarantee coverage.

Table 4.1 Third-Party Credit Guarantees

	N	Min	Max	Mean		Std. Deviation
	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic
The frequency of third-party credit guarantees in our Microfinance Bank is sufficient to meet the needs of our clients.	41	1.00	5.00	3.4878	.17848	1.14285
Our Microfinance Bank frequently utilizes third-party credit guarantees to secure loans for clients in need of financial assistance.	41	1.00	5.00	3.4878	.19482	1.24744
The proportion of loan amounts guaranteed by third parties adequately mitigates the risk associated with default on loans.	41	1.00	5.00	3.3659	.16659	1.06668
The percentage of loan amounts guaranteed by third parties significantly contributes to the overall stability of our loan portfolio.	41	1.00	5.00	3.1707	.16712	1.07010
The duration of guarantee coverage provided by third parties aligns well with the typical repayment period of our loans.	41	1.00	5.00	3.7073	.17195	1.10100

The duration of guarantee coverage offered by third parties sufficiently protects our Microfinance Bank from potential losses in the event of default.	41	1.00	5.00	3.0732	.17247	1.10432
Valid N (listwise)	41					

(Source: Research Findings, 2024)

The mean scores for each item range from approximately 3.07 to 3.71, indicating a moderate to high level of agreement with the statements regarding third-party credit guarantees. This suggests that, on average, respondents perceive third-party credit guarantees positively and believe that they play a significant role in mitigating loan default risk and enhancing the stability of the loan portfolio. However, it's essential to consider the standard deviations alongside the mean scores. The standard deviations range from approximately 0.17 to 0.19, indicating some variability in responses across respondents. This variability suggests that while there is a general trend of positive perceptions toward third-party credit guarantees, there are also differences in opinion among respondents.

The significance of these findings lies in the implications for the Microfinance Bank's operations and risk management strategies. The relatively high mean scores suggest that third-party credit guarantees are perceived as valuable tools for managing loan default risk and ensuring the stability of the loan portfolio. This suggests that the Microfinance Bank's current use of third-party credit guarantees aligns well with the needs and expectations of its clients. However, the variability in responses indicates that there may be room for improvement or refinement in the utilization of third-party credit guarantees. For example, the Microfinance Bank could explore ways to enhance the frequency or coverage of third-party guarantees to further strengthen its risk management practices. The findings indicate that Microfinance Bank's operations are significantly influenced by third-party credit guarantees, enabling informed decision-making to optimize risk management strategies.

Collection Agencies

The findings on engagement of collection agencies for debt recovery within their Microfinance Banks (MFBs), majority of respondents, comprising 95.12%, affirm that their MFIs utilize the services of collection agencies for debt recovery. Similarly, a small percentage of 4.88% report that their MFIs do not engage collection agencies for this purpose. Notably, there are no respondents expressing uncertainty regarding the involvement of collection agencies. These findings underscore the prevalence of use of collection agencies on debt recovery, highlighting the significance of exploring the effectiveness and implications of such practices in the context of loan performance.

Table 4.2 Collection Agencies

	N	Min	Max	Mean		Std. Deviation
	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic
The Penalty Structure in our institution is clear and well-defined	41	1.00	5.00	3.6098	.14347	.91864
The Penalty Enforcement Policy is consistently implemented in our institution	41	1.00	5.00	3.5366	.18837	1.20618
Penalties effectively discourage late loan repayments in our institution	41	2.00	5.00	3.6829	.13270	.84968
The Penalty Structure is fair and proportional to the offense	41	2.00	5.00	3.6829	.15397	.98588

The Penalty Enforcement Policy is communicated clearly to borrowers	41	1.00	5.00	3.0488	.18790	1.20315
Penalties have a positive impact on borrower behavior, encouraging timely repayments	41	1.00	5.00	3.3902	.16703	1.06953
Valid N (listwise)	41					

(Source: Research Findings, 2024)

Table 4.2 looks into the different perceptions of the respondents regarding collection agencies in the context of surveyed Microfinance Institutions. Commencing with the clarity of penalty structures, respondents indicated an average rating of 3.61, with a standard deviation of 0.92. This suggests a moderate level of consensus on the clarity of penalty structures. Moving forward, the consistent implementation of penalty enforcement policies received an average rating of 3.54, with a standard deviation of 1.21. This indicates a spectrum of opinions regarding the effectiveness and uniformity of policy implementation.

Moreover, the efficacy of penalties in discouraging late loan repayments garnered an average rating of 3.68, with a standard deviation of 0.85. While there is a general agreement on the effectiveness of penalties, the variation suggests how different respondents perceive the impact of penalties on borrower behavior. Examining the fairness and proportionality of penalty structures, respondents provided an average rating of 3.68, with a standard deviation of 0.99. This indicates a moderate level of consensus, albeit with varied perspectives on the fairness of penalties relative to the perceived offenses.

Furthermore, the clarity in communicating penalty enforcement policies received an average rating of 3.05, with a standard deviation of 1.20. This suggests diverse viewpoints on the adequacy and transparency of communication, emphasizing the need to enhance clarity in conveying penalty-related information to borrowers. The perceived positive impact of penalties on borrower behavior, encouraging timely repayments, earned an average rating of 3.39, with a standard deviation of 1.07. This indicates a varied spectrum of opinions on the extent to which penalties contribute positively to borrower behavior.

Loan Performance

The survey responses in Table 4. 3 provide valuable insights into the perceptions of respondents regarding the loan performance in their microfinance institutions (MFIs). These findings offer a nuanced understanding of how borrowers and staff perceive the effectiveness, satisfaction, and manageability of loans provided by the microfinance institutions.

Table 4. 3 Loan Performance

	N	Min	Max	Mean		Std. Deviation
	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic
The loans provided by our microfinance institution are effectively utilized by borrowers.	41	1.00	5.00	3.1220	.14896	.95381
Borrowers make the best use of the loan amount received to achieve their intended goals.	41	1.00	5.00	3.3415	.16234	1.03947
I am satisfied with the range of loan products offered by our microfinance institution.	41	1.00	5.00	3.2683	.17469	1.11858
The loan application process meets my expectations and is user-friendly.	41	1.00	5.00	3.1463	.14634	.93704

The repayment terms for our loans are manageable and reasonable for borrowers.	41	2.00	5.00	3.2439	.19375	1.24057
Borrowers find the loan repayment process straightforward and convenient.	41	1.00	5.00	3.4146	.16371	1.04823
Valid N (listwise)	41					

(Source: Research Findings, 2024)

Table 4. 3 breaks down perceptions on effects of loan performance within the surveyed Microfinance Banks. The statement on the effective utilization of loans provided by microfinance institutions received an average rating of 3.12, with a standard deviation of 0.95. This indicates a moderate level of agreement among respondents that borrowers are effectively utilizing the loans they receive. However, the standard deviation suggests some variability in opinions, indicating differing views on the effectiveness of loan utilization across different borrowers or situations. Regarding the best use of loan amounts to achieve intended goals, the average rating was 3.34, with a standard deviation of 1.04. This suggests a stronger, though still moderate, agreement that borrowers are making the best use of their loans to achieve their goals. The higher standard deviation points to a wider range of opinions, indicating that while some respondents believe borrowers are effectively using their loans, others may have reservations.

On satisfaction with the range of loan products offered by the microfinance institution, respondents provided an average rating of 3.27, with a standard deviation of 1.12. This reflects a moderate level of satisfaction with the variety of loan products available. The relatively high standard deviation indicates considerable diversity in opinions, suggesting that while some respondents are satisfied, others may find the product range lacking or not well-suited to their needs. The statement on the loan application process being user-friendly received an average rating of 3.15, with a standard deviation of 0.94. This reflects a moderate agreement with the ease and accessibility of the loan application process, though the standard deviation indicates that some respondents may find the process more challenging than others.

Regarding the manageability of loan repayment terms, the average rating was 3.24, with a standard deviation of 1.24. The higher standard deviation suggests significant variation in how respondents perceive the repayment terms, with some finding them reasonable and others potentially struggling with the terms. Lastly, the statement on the loan repayment process being straightforward and convenient received the highest average rating of 3.41, with a standard deviation of 1.05. This indicates a relatively stronger agreement that the repayment process is perceived as straightforward and convenient by borrowers, although the standard deviation still points to varying experiences and opinions among respondents..

Correlations

The correlation matrix on Table 4.4 highlights on the relationships between various elements related to loan performance within the surveyed Microfinance Banks (MFBs). The Pearson correlation coefficients, ranging from -1 to 1, provide insights into the strength and direction of these associations.

Table 4.4 Correlations Analysis

		Third-Party Credit Guarantees	Collection Agencies	Performance
Third-Party Credit Guarantees	Pearson Correlation			
	Sig. (2-tailed)			
	N	41		

Collection Agencies	Pearson Correlation	.807**		
	Sig. (2-tailed)	.000		
	N	41	41	
Performance	Pearson Correlation	.785**	.833**	
	Sig. (2-tailed)	.000	.000	
	N	41	41	41

(Source: Research Findings, 2024)

Collection agencies show a strong positive correlation with third-party credit guarantees (0.807). These correlations suggest that collection agencies are often employed alongside other credit management practices. Finally, the direct correlation between loan performance and each debt recovery practices reveals strong positive associations. The findings from the correlation analysis highlight the significant impact of credit management practices on loan performance in microfinance institutions. The strong positive correlations indicate that as these practices are effectively enforced and integrated, they play a critical role in enhancing loan performance, ultimately contributing to the financial sustainability and success of microfinance institutions. These insights emphasize the importance of robust credit management strategies, including third-party credit guarantees, and the use of collection agencies, in driving positive loan outcomes.

Regression Analysis

Coefficients

The coefficients of regression as shown in Table 4. , provide insights into the relationship between the dependent variable and the independent variables.

Table 4. 5 Coefficients of Regression

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.613	.293		2.091	.044
	Third-Party Credit Guarantees	.279	.130	.325	2.148	.039
	Collection Agencies	.554	.159	.628	3.493	.001
a. Dependent Variable: Performance						

(Source: Research Findings, 2024)

Third-Party Credit Guarantees show a positive coefficient ($\beta = 0.279$, $p = 0.039$), demonstrating a substantial positive effect on loan performance. This significant relationship highlights that effective third-party guarantees enhance loan performance, making them a crucial factor in the microfinance sector. The coefficient for Collection Agencies is notably positive ($\beta = 0.554$, $p = 0.001$), indicating a strong positive impact on loan performance. Collection agencies significantly improve loan performance, crucial for effective debt recovery. The regression equation based on the findings can be expressed as follows:

Loan Performance = 0.613 + 0.279(Third-Party Credit Guarantees) + 0.554(Collection Agencies)

Holding other variables constant, the constant value 0.613 represents the estimated value of the dependent variable when all independent variables are set to zero. For Third-Party Credit Guarantees, a unit increase in Third-Party Credit Guarantees is associated with a substantial 0.279 increase in Performance. Lastly a unit increase in Collection Agencies is associated with a significant 0.554 increase in Performance.

Hypothesis

From the findings above of the hypothesis were as the following:

Table 4. 6 Hypothesis

Variable	Null Hypothesis	P value	certik	Conclusion
Third-Party Credit Guarantees	H03,Third-Party Credit Guarantees does not significantly affect loan performance of deposit-taking Microfinance Banks in Kenya.	$p < 0.05$	Reject H03,	Third-party credit guarantees have influence statistically significant influence on loan performance.
Collection agencies	H04,Collection agencies do not significantly affect loan performance of deposit-taking Microfinance Banks in Kenya.	$p < 0.05$	Reject H04,	Collection agencies have a statistically significant influence on loan performance.

(Source: Research Findings, 2024)

Conclusion

This study provides significant insights into the factors influencing loan performance in Kenyan microfinance banks. Contrary to expectations third-party credit guarantees emerged as significant determinants of loan performance, highlighting the importance of effective debt recovery strategies and risk mitigation measures. However, the involvement of collection agencies did not yield statistically significant effects on loan performance. These findings underscore the need for tailored approaches to managing credit risk and enhancing the financial sustainability of microfinance institutions. The study highlights the complex interplay between various factors such as leverage, company size, liquidity, and capital adequacy in shaping loan performance. Moving forward, practitioners and policymakers should consider these findings to develop targeted interventions aimed at improving loan portfolio quality and promoting financial stability in the microfinance sector.

Recommendations

Recommendations derived from this study encompass several key areas for action. Firstly, microfinance bank management should reassess debt policies to mitigate overreliance on debt financing. This involves implementing measures to diversify funding sources and reduce leverage levels, ultimately enhancing financial stability.

Secondly, management should focus on bolstering equity policies to lower leverage ratios, thereby reducing the vulnerability to economic fluctuations. Thirdly, strategic plans should be devised to augment the asset base, with a particular emphasis on prudent asset allocation strategies to maximize returns.

Additionally, policymakers, notably the Central Bank of Kenya, should streamline policy implementation concerning loan defaulters to expedite debt recovery processes and minimize non-performing loans. Lastly, it is recommended that academicians and researchers leverage the empirical findings of this study to inform and enrich future research endeavors in the field of microfinance and loan performance analysis.

Areas for Further Research

This study examined the influence of specific firm characteristics on non-performing loans (NPLs) within Kenyan microfinance institutions, focusing on debt recovery practices. While our analysis of debt recovery practices, such as third-party credit guarantees, and collection agencies, provided valuable insights, there are avenues for further exploration. Future research could investigate additional aspects of debt recovery strategies, such as the effectiveness of loan restructuring programs or the impact of borrower credit histories on NPLs. Additionally, extending the research scope to include comparative analyses with other financial sub-sectors like commercial banks and SACCOs could offer insights into unique debt recovery dynamics within microfinance institutions. Such comparative studies would enhance our understanding of debt recovery practices' effectiveness and inform tailored strategies for improving loan performance in microfinance banks.

Limitations of the Study

The limitations of this study must be acknowledged to provide a balanced understanding of its scope and implications. The study's findings are based on a specific population of Kenyan microfinance banks within a particular timeframe. As such, the generalizability of the results to other regions or periods may be limited. Future research with larger and more diverse populations could enhance the generalizability of the findings.

The study relied on available data from the surveyed microfinance banks, which may have varied in terms of completeness and accuracy. Limited access to comprehensive data on certain variables, such as borrower characteristics or specific debt recovery strategies, may have constrained the depth of analysis. Utilizing more robust and comprehensive datasets could mitigate these limitations in future studies.

The study's analysis is based on data collected within a specific period, which may not capture longer-term trends or fluctuations in loan performance. Economic or regulatory changes occurring outside the study period could have influenced the results. Longitudinal studies spanning multiple years could provide a more nuanced understanding of the dynamics affecting loan performance over time.

The study's reliance on published literature and available datasets may introduce publication bias, as studies with significant findings are more likely to be published. This bias could affect the comprehensiveness of the literature review and potentially influence the study's conclusions. By acknowledging these limitations, future research can build upon this study's findings and address these constraints to advance understanding in the field of microfinance and loan performance analysis.

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