FINANCIAL INSTITUTION FACTORS INFLUENCING LOAN DEFAULT BY SMEs IN KITUI CENTRAL SUB-COUNTY

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A RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION OF SOUTHEASTERN KENYA UNIVERSITY

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DECLARATION

I understand that plagiarism is an offence and I therefore declare that this research-project report is my original work and has not been presented in any other institution for any award.

Signature…………………………………….. Date………………………………..

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This research-report has been-submitted for examination with our approval as University supervisor.

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DEDICATION

This study work is dedicated to my parents Mr. Augustine Syomane Muthui and Ruth Syomane, my brothers Caxton Muema, Lewis Muimi and Amos Katana for their support and back-up during my studies.
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ABBREVIATION AND ACRONYMS

ANOVA: Analysis Of Variance
CBK: Central Bank of Kenya
GDP: Gross Domestic Product
MFIs: Micro Finance Institutions
NGOs: Non-Governmental Organizations
NPLs: Non Performing Loans
SACCOs: Savings and Credit Cooperatives Societies
SMEs: Small and Medium Enterprises
SPSS: Statistics Package for Social Sciences
TEKUN: The Economic Fund for National Entrepreneurs
YUM: Yayasan Usaha Maju
ABSTRACT

The Small and Medium Sized Enterprises (SMEs) are considered as the power driving many countries’ economies. Elsewhere, it's been argued that SMEs are the lifeblood of most economies round the world and any government cannot afford to ignore this sector. Access to money capital is an important issue for the success of SMEs significantly in their early years. Industrial banks represent the anchor of the expansion of different sectors by providing them access to credit facilities within the style of loans. A recent survey by CBK has established that these SMEs flat-topped the list of biggest loan_defaulters within the half-Year of 2015. The most objective of this study was to ascertain the financial factors influencing loan_defaulting by the SMEs operative in Kitui Central Sub-County. The study’s target population consisted of all the registered SMEs operative in Kitui Central Sub-County. This study used just one sampling technique: straightforward sampling methodology, in choosing the SMEs to represent the target population. This study collected primary information by use of a structured form. The info assortment tool was administered to the chief government officers of every specific SMEs designated to make the sample size. The collected information was processed with the assistance of the applied math Package for Social Sciences (SPSS version 21). The study conducted multiple correlations and multivariate analysis to search out the connection between the variables that were studied. Multiple regressions were used to work out the results of the money factors on loan default by the SMEs in Kitui Central Sub-County. The study findings established that there was a medium positive and a significant positive relationship at 99% confidence level between the mode of loan payment and loan_default (r=0.644, p=0.000). There was also a strong and a significant relationship 99% confidence level between the structure of rate of interest and loan_default (r=0.774, p=0.000). The findings also showed that there was also a weak but a significant positive relationship at 99% confidence level between the size of loan and loan_default (r=0.335, p=0.003). There was also a weak positive correlation between the loan_repayment interval and loan_default (r=0.240, p=0.033). The relationship between loan_repayment interval and loan_default was significant at 95% confidence level. There was medium correlation and a significant relationship at 99% confidence level between the type of financial institution and loan_default (r=0.605, p=0.000). This study concluded that the mode of loan repayment, the structure of rate of interest and the type of financial institution highly influenced loan_default. Therefore, the study recommends that the financial_institutions ought to contemplate revising their loaning policies thus to reduce loan compensation issues emanating from the lenders, loans and therefore the characteristics of the credit establishments.
CHAPTER ONE

1.0. INTRODUCTION

2.0. This chapter discusses the background data, statement of the matter, purpose, objectives, analysis queries, significance, scope, the constraints and delimitations of this study.

1.1 Background to the Study

The established customary role of an ad bank is disposal. Compared to different bank business assets, loans comprise the majority of banks’ assets (Njanike, 2009). Nevertheless, giving out loans isn't a straightforward task for money establishments as a result of it creates an enormous drawback that is termed non-performing loans (Boahene, 2012) as cited in (Hosna, 2009). in keeping with Achou (2008), non-performing loans (NPL) are those loans that are ninety days or a lot of due on their payment or now not accruing interest. Given the character of their operations, business banks place themselves at the danger of borrowers failing to repay their loans (Waweru, 2009).

In the method of giving loans, business banks ought to observe caution thus on avoid cases of potential customers failing to repay their loans. Variety of things of default in an exceedingly establishment will simply and apace cause a breakdown of the whole industry. In Associate in Nursing investigation that was conducted by Guy (2011) on factors related to non playing loans, he over that the loans that don't seem to be playing ought to be investigated closely as a result of they need light-emitting diode to the enhanced disorder within the money markets over the years.

This study is anchored on Moral_hazard_theory and the Information asymmetry theory. The moral-hazard-theory argues that, a risk can arise once one party to an agreement decides to change his/her behavior to the disadvantage of the opposite party once the contract has been completed. Financial loss can emerge in an exceedingly state of affairs whereby people, United Nations agency have non-public data. The asymmetric information theory argues that those who participate in the market habitually keep this
information asymmetrically (Messai, 2013). According to Akerlof (1970), there are ways in which we can attain adverse selection in the markets whenever there are asymmetries in informational. Murumba (2013) illustrated that the economic agents who are informed in this type of markets might have access to incentives so as to get discernible actions which are costly to convincingly signal their private information to agents who are not informed to improve the outcome of their markets.

According to Sinkey (2007), Small And Medium sized Enterprises (SMEs) are delineate as enterprises which have an annual turnover that ranges between five hundred thousand and five million Kenya shillings as well as that which has between ten and fifty employees (Sinkey, 2007). The SMEs are considered as the driving force of economies of many countries. Consequently, there is no government which can afford to ignore this sector (Ayyagari, 2007). The SMEs themselves access their credit from other financial institutions, especially commercial banks.

Nene (2014) argued that the most important reason for SMEs in African nation failing to repay their credit is as a result of disposal is finished barren of any kind of security to shoppers and lack of a policy structure to assist in correct projection of your time and allocation of what proportion cash ought to be paid over such amount of your time. The high rates of default by the disposal SMEs ar purported to be a main worry to people who build policies significantly within the developing countries. This can be because of its accidental negative effects on the funding of SMEs (Ntiamoah, 2014). However, there's lack of proof for individual corporations particularly within the rising markets additionally because the new member states of EU on the loans’ default pattern (Beck, 2013). Owing to this missing data, this analysis geared toward establishing the factors at the institutional level that influence the default of loans by SMEs within the Kenyan perspective.

1.1.1 Financial Institution factors
Financial institutions are organizations that process monetary transactions, including business and private loans, customer deposits, and investments. Institutional factors
entail the entirety of factors with real or potential effect on the loan performance which interact within the financial institution. These factors are dependent on the type of the Institution and they include staff, policy and systems (Collins, 2011). Some research publications on research findings have indicated that poor management is the main cause of non-performing (Karim, 2010). Previous studies have argued that lack of proper practice of adequate loan underwriting, monitoring and control by the managers in most commercial banks or MFIs is the other major problem of non-performing loans in SMEs.

According to a policy research working paper by the World Bank on non-performing loans in Sub-Saharan Africa, it has been established that adverse economic shocks in addition to high cost of capital and low interest margins are the main cause of NPLs (Fofack, 2005). According to Guy (2011), the accumulation of non-performing loans is mostly associated with several factors which include macroeconomic volatility, economic downturn, high rate of interest, terms of trade deterioration, and excessive reliance on overly high-priced inter-bank borrowings, insider borrowing and moral hazard. Nawai and Shariff (2013) have also suggested that the underlying repayment factors can be classified further into three categories which include lender, institutional, and loan attributes which affect the repayment performance Atsmegiorgis (2013).

The institutional factors consist of time lag between the application and the disbursement of the loan, rate of interest structure, collection procedures, and access to business information and penalty for late coming to group meetings. The lender characteristics are described as the factors within the financial institution which might affect the loan repayment. (Nawai & Shariff, 2012). A study by Kibosia (2012) established that low credit analysis and rate of interest structure and loan collection procedures also contributed to loan defaults by SMEs.

Loan characteristics consist of the loan size, repayment period, collateral value, number
of installments, and application costs among others. Past studies by Nawai & Shariff (2012), have established the influence of loan factors on default. Atsmegiorgis (2013) revealed that the loan_default rate was significantly related with loan size, loan type, and loan repayment, purpose of loan, educational level and type of collateral offered.

Types of financial institution include bank and non-bank institutions. Banks are financial intermediaries that take funds from depositors, pool that money, and lend it to those seeking funds. They make money, in part, by paying depositors less interest than they charge borrowers and pocketing the difference. Banks often offer checking and savings accounts, certificates of deposits, personal and business loans, mortgages and credit facilities (Ochung, 2013) while a non-bank financial institution provides some banking services without meeting the legal definitions of a bank, or financial institutions operating without a license. This can cover many forms, as many types of institutions offer some form of financial services without qualifying as a bank (Collins, 2011).

1.1.2 Loan_default by SMEs
Loan_default is described as the borrower’s lack of ability to accomplish his or her-loan responsibility when it is payable (Foos, 2009). The policymakers in developing countries should be concerned with the high default rates in SMEs lending because of its involuntary negative effects on SMEs financing. According to Packer (2012), some of the effects attributed to default in loan repayment include: the lack of ability to reuse funds to other borrowers; the creation of mistrust, and the lack of willingness by other financial mediators to serve the needs of small borrowers. Makorere (2014) noted that, the costs of loan_default can be recognized by both parties; the borrowers and the lenders. The costs of the lender in loan_default circumstances include lost rate of interests, principal’s opportunity cost, legal fees and other related costs.

For the borrowers, the act to default is usually is like a trade-off whereby he/she has to compare between the penalties in lost reputation from loan_default against the opportunity cost of forgoing investments because of working out the immediate loan. Given the
circumstances of this study therefore, a debt is as a result of the SME being unable to repay its loan, leading to negative financial impact on the financial institution. Loan default on borrowed funds could also occur from unfavorable situations which might impact on the ability of the borrower to repay (J. Stiglitz, 2001). Nene (2014) argued that the main reason why SMEs in Kenya fail to repay their credit is because of loans given out without any form of collateral to clients and lack of a clear lending policy where funds are not well projected over the period of repayment and apportion money for such repayment.

In his study, Onyeagocha (2012) realized that the relationship differences between SMEs and the small lending institutions will often lead to bank default. It is assumed that the increasing problem of default in loan repayment is threatening the sustainability of microfinance institutions. The high repayment default rates in SMEs lending is therefore being considered as an issue of major concern by policy makers in the developing countries, due to its unintentional negative impacts on SMEs financing (Ntiamoah, 2014).

1.1.3 SMEs in Kitui Central Sub-County

Kitui Central Sub-County is an arid and semi-arid area and it is where the county headquarters are situated. There are many SMEs in the sub-county; actually, compared to the other sub-counties in the county, it has the highest number of SMEs in the county. The SMEs within the sub-county can be grouped into two main groups in relation to what they provide: goods or services. The study area borders Kitui West Sub-county, Kitui South Sub-county, Mwingi Central, Kitui Rural and Kitui East Sub-County. The businesses operated by the SMEs in Kitui Central Sub-County involve both goods and services. Most of the SME owners in Kitui Central Sub-County have invested mostly in both retail and wholesale businesses. The owners and the managers of these SMEs have access to credit from both banks and microfinance institutions. According to the latest statistics published in 2017, there are estimated 512 SMEs in Kitui Central Sub-County (across all-the 5 wards; Kitui Township, Kyangwithe East, Kyangwithya West,
Miambani and Mulangowards) out of which, only 407 SMEs had access to credit facilities (Ministry of Trade, Investments and Cooperatives, Kitui County).

1.2 Statement of the Problem

The small and medium enterprises have access to credit from the financial institutions i.e. Banks and MFIs. High default rates in SMEs disposal ought to be of major concern to policy manufacturers in developing countries, owing to its fortuitous negative impacts on SMEs funding (Ntiamoah, 2014). The Bank management report ready by the CBK (2011) urged that the delayed payments and provisioning of loans, and therefore the high interest rates have light-emitting diode to the downgrading of loan accounts by banks so impacting negatively on the standard of assets. From this, non-performing loans (NPLs) enhanced by thirty six per cent from Ksh. 108.3 billion in December 2014 to Ksh. 147.3 billion in December 2015.

Similarly, the magnitude relation of gross non-performing loans to gross loans enhanced by one.2% to 6.8 per cent in December 2015 from five.6 per cent in December 2014. The report conjointly indicated that non-performing loans (NPLs) enhanced by forty five.5% from KShs 147.3 billion in December 2015 to KShs 214.3 billion in December 2016. Similarly, the magnitude relation of gross NPLs to gross loans enhanced to nine.2 p.c in December 2016 from half-dozen.8 p.c in December 2015. Most of those will increase were related to reimbursement loan_default by SMEs (CBK, 2016).

Loan repayment default happens when a debtor is not able to accomplish the legal responsibility of repaying his/her debt. Bad loans are as a result of the debtors not able to repay their loan interests as well as their loans within the specified time (Warue, 2013) leading to undesirable impacts of the creditor on the financial condition. Ochung (2013) conducted an investigation to find out the factors associated with loan defaults of SMEs financed by Cooperative Bank in Kangemi and Kawangware areas in Nairobi, Kenya. His study found out that majority of SMEs were mainly inhibited by a number of factors which included poor management, irregular income and high competition from the businesses which are well established.
Kibosia (2012) also carried out a study on the causes of the high rates of loan repayment default by the youth groups funded by the constituency youth enterprise in Kitui central constituency. The study found out that a number of factors influence loan repayment. In relations to the previous studies reviewed, it was found out that there are a variety of factors which influence loan default and that some of these factors are important in relation to the study context while others were not significant on a different perspective. Moreover, majority of the previous studies have concentrated on other sectors other than the sector of SMEs and therefore their results are not generalizable to the context of SMEs. Because of this limitation, this study sought to find out the financial factors influencing loan default by SMEs in the perspective of Kenya.

1.3 Objectives of the Study
This study was guided by the following objectives:

1.3.1 General Objective
To investigate factors influencing loan default by SMEs in Kitui central Sub-county

1.3.2 Specific Objectives
The specific objectives of this study were:

i. To study the effect of Lender characteristics on loan default by SMEs in Kitui central Sub-county

ii. To investigate the effect of loan characteristics on loan default by SMEs in Kitui central Sub-county.

iii. To realize the effect of type of the institution on loan default by SMEs in Kitui central Sub-county

1.4 Research Questions

i. What is the effect of Lender characteristics on loan default by SMEs in Kitui central Sub-county?

ii. What is the effect of Loan characteristics on loan default by SMEs in Kitui central Sub-county?
iii. What is the effect of type of the institution on loan_default by SMEs in Kitui central Sub-county?

1.5 Significance of the Study

It’s been said that SMEs are the lifeblood of most economies round the world which any government cannot afford to ignore this sector. The findings of this study are going to be of nice importance as a result of it investigated the factors influencing loan_default by SMEs. The outcomes have provided several important contributions to the different players in the economy.

The government and other policy makers can an understanding of the challenges that face SMEs financing in order to formulate effective policies that can support entrepreneurs. Therefore, this study is of great value towards the achievement of the Vision 2030. The government and the other related stakeholders may use the study outcomes to formulate policies on how to improve loan repayment by SMEs. The study aimed at establishing the determinants of loan repayment and hence its findings are of benefit to the SMEs to establish the factors that influence their ability to repay their loans. In light of the findings of this study, it is expected that the financiers will review their stringent requirements to accommodate SMEs.

The study has also given some shaded some light to entrepreneurs on alternative sources of finances available to them in the form of non-banking financial institutions in Kenya. Financial institutions such as commercial banks, MFI’s, SACCOs and others will also benefit from the findings of this study since it has established the major determinants of loan repayment. This study has also added onto the already available pool of knowledge on loan repayment and SMEs. In addition, prospective scholars may use the study as part of their empirical studies.

1.6 Limitations of the Study

The study was restricted to the study region and won't be generalized to all or any
SMEs in Kenya. Some challenges which might be expected are SMEs owners might not wish to disclose the information on their enterprises or even give unreliable information. For mitigation of the above challenge, the researcher had an introduction letter which helped to notify the respondents that the research is made for academic purposes.

1.7 Scope of the Study

This study confined itself into investigating the factors influencing loan default by SMEs in Kitui Central Sub-County. The study investigated only three variables and how they impacted on the dependent variables; lender characteristics, loan characteristics, and firm characteristics on loan repayment by the SMEs in Kitui Central Sub-County. The study centered solely on the registered SMEs operative in Kitui central Sub-county.
CHAPTER TWO

2 LITERATURE REVIEW

2.1 Introduction
This chapter captures the literature review on the various theories that underpin the factors influencing loan_default by SMEs, conceptual framework and empirical review of the literature relevant to the topic studied.

2.2 Theoretical Review
This section on literature presents various theories related to loan_default specifically, the moral hazards theory, information asymmetry theory and Information sharing theory.

2.2.1 The Moral Hazard Theory
The Moral_hazard_theory was developed by Stigliz & Weiss (1981). This theorystates that lenders don't use the rate of interest as a sortingdevice as a result of amendments its change could have an effect on the danger levels of the cluster of borrowers. Themodel assumesthat riskier borrowers have access to riskier comes with lower chance of success however the next come if they succeed, whereas safeborrowers have comes with higher chance of success however a lower come. The financial loss theory suggests that, a risk arises once one party to a contract changes his behavior to the disadvantage of the opposite party once the contract has been over. the idea conjointly argues that financial loss arises once people in possession of personal data, take actions that unfavourably have an effect on the chance of dangerous outcomes (Mirrlees, 1999).

Moral_hazard_theory has relevancy during this study therein in most cases lenders don't seem to be sure that after a loan is advanced to the receiver (SMEs), it absolutely was used for its meant purpose, or that the receiver applies the expected amounts of complementary inputs, particularly effort and entrepreneurial talent that is that the basis for the agreement to supply the loan. If these inputs are not expected then the receiver could also be less ready to repay it (Fatemi, 2006). Loan diversion ends up in ethical hazards, which can successively, have an effect on loan reimbursement by little and medium enterprises since the loan was amused from its meant business purpose.
According to Agyapong (2011) the actual fact that these borrowers will use the funds for different functions aside from those stipulated within the loan agreement, it means business banks shouldn't solely investigate the credit good of the tiny business borrowers however they ought to conjointly monitor their activities once they need obtained the loans. true of ethical hazard so is caused by the failure of the loaner to observe the actions of the receiver once credit is obtained.

has been criticized as a result of it presents a slim model of human inspiration which it makes unessential negative ethical evaluations regarding individuals. that specialize in self-interested behavior makes it attainable that for the broader vary of human motives to be unheeded, together with the necessity for action, altruism, respect Associate in Nursingd intrinsic motivation towards an inherently satisfying task (Agyapong, 2011). Kuperman (2008a) argues that financial loss theory doesn't focus solely on the link between the receiver and therefore the loaner to clarify why the receiver would amendment his behavior to the harm of the loaner once the contract has been over.

2.2.2 Information Asymmetry Theory

The asymmetry information theory was developed by Akerlof (1970). This theory argues that party of an economic transaction, should have the adequate knowledge about the other party to be able to make accurate decisions. The main assumption of this theory is that the characteristics of all products transacted in the market should be equally observed by all agents or business representatives. When such assumption fails to hold, i.e. when there is asymmetry of information, prices are distorted and do not achieve optimality in the allocation of resources. The asymmetry information theory continues to argue that, the market participants often hold this information asymmetrically (Messai, 2013).

Akerlof (1970) showed however we have a tendency to might get adverse choice within the markets within the presence of informational asymmetries. Murumba (2013) incontestable that enlightened economic agents in such markets could have incentives to require evident and dear actions to probably signal their non-public data to ignorant agents, thus on improve their market outcome. This theory was relevant to the current study within the sense that SMES as borrowers and frequently they are doing not disclose all the relevant data to the loaners that successively ends up in the adverse choice by the lender establishments or organizations. Regarding the SMEs, the spatiality scientific
theory has assumed that SME managers and outsiders possess non-public data regarding the enterprise characteristics. The idea jointly assumes that the borrowers additionally have some important data on the sort of the establishment of come stream or investment opportunities that are seldom proverbial by the money organizations.

Financial institutions perceive and are aware that the credit risk breaks down among their borrowers however owing to data spatiality, they're not capable to spot individual amounts of default prices for specific borrowers because of their observance and economic systems that vary from the individual establishments. In keeping with Karim (2010), within the event of adverse choice, the loaner doesn't have data on the danger level of its borrowers whereas the opposite hand, the receiver has important data on the establishment. The borrowers, United Nations agency ar a lot of risky, ar a lot of doubtless to default than safer borrowers, and thus, they ought to be charged higher rate of interests to catch up on the enhanced risks of default.

According to Warue (2013) the check implications of the uneven scientific theory is within the term life assurance market and finds no proof of market failures. The authors have established that it's value economical for insurance establishments to prevail over data asymmetries. The insurance establishments alter someone data, all the time, each in their role as insurers and because the underwriters. {it could|it's going to|it should} be untrue that the insurance purchasers have superior information; in truth these firms may have higher estimates of a person's health risks than what the individual himself or herself has.

According to a test conducted by Chiappori (2000) in the French market for automobile insurance, the findings agreed with the conclusions made by Warue (2013). The asymmetric information theories predicted that, among observationally identical individuals, those with more coverage were more likely to have more accidents. When Chiappori (2000) carried out this test, he found no correlation between the unobserved risky states and accident frequency. On critical analysis of the two theories discussed above, it is noted that the theory of moral hazard is inadequate in because it ignores the fact that SMEs are rational investors and they always make the best investment decision.

Additionally, it's assumed that borrowers are continuously forward a risk-taker perspective however not the opposite two attitudes; a risk indisposed or a risk-neutral attitudes. According to the information asymmetry theory, the receiver maintains a lot
of data regarding the contract. But within the fashionable society sharing data exploitation databases is has been created simple. This can be as a result of the info would act as a medium from which individuals might retrieve the mandatory data for higher cognitive process processes.

2.3 Empirical Review

This section presents a brief discussion of the institutional_factors that have been investigated by the previous studies suggesting that they may influence loan_default by SMEs in one way or another. A number of scholars have investigated this area of loan_default and the factors that have determined it in the past. Different studies have established different factors which have been found to have different impacts on loan_default.

2.3.1 Lender Factors and Loan_default

Makorere (2014) carried out a study and investigated the factors affecting the loan_default conduct in Tanzania because previous studies and experiences had shown that the many financial_institutions were facing poor loan_recovery. His study used a cross-sectional research design because the study was conducted only once in point and time. The study used a sample size of one hundred respondents since it absolutely was a pilot study. The study used convenience sampling technique supported disposition and therefore the accessibility of the study respondents to participate within the study. Form was used because the primary knowledge assortment instrument. Knowledge analysis was administrated exploitation descriptive statistics like frequencies and percentages. The findings of the study un concealed that majority of the loan borrowers (32%) of the respondents interviewed had not paid their loan balances either on time or entirely. The respondents reported high rate of interest because the main reason for the failure to repay their loans. During this case, to combat this drawback of rate of interest, the money establishments ought to impose affordable and really competitive rate of interests to confirm effective reimbursement of loans. In most cases, high rate of interests haven't promoted the expansion of companies owing to most of the profit generated goes back to the establishment to service loans that were once given to the receiver.
According to another study administrated by Maina (2014) the findings of his study established some institutional_factors contributory to loan_defaulting among the MFIs in African nation.

His study collected and used primary data. The target population consisted of 59 registered microfinance institutions in Kenya. The study used a descriptive analysis study style and census technique was used on the targeted population since it absolutely was comparatively little. Knowledge was collected with the assistance of a structured form that was administered to the credit managers of MFIs for assortment of responses. The results of this study indicated that the 3 factors studied; credit policies, loan recovery procedures, and loan appraisal method had a major impact on loan_defaulting rate. The 3 were seen because the vital determinants and drivers to loan delinquency.

Another study was also carried out by Evusa (2015) on the causes of loan_default among the customers of Equity Bank, Kenya. The target population of the study consisted of 240 respondents out of that, a study sample of eighty respondents including each the bank managers and loan_defaulters at Equity Bank were designated for functions of the study. Within the method of conducting this analysis on the causes of nonperforming loans, his study place into thought the contribution of different factors like the banks’ disposal practices, the economic backgrounds and money higher cognitive process processes among the recipients of loans at Equity Bank Ltd. Knowledge was analyzed exploitation the Microsoft stand out knowledge analysis Tools to ascertain the link between the worth of loans given to a personal or business and therefore the quantity of loan_defaulted. The study unconcealed that the most important factors influencing nonpayment of borrowed loans were each internal and external. The paper suggested that banks’ credit policies be reviewed to match the extremely volatile economic trends among money markets with a powerful stress on institutional appraisals on credit worthiness.

Njeru (2011) examined the credit assignation technology of lenders and therefore the reimbursement behavior of borrowers at a rural establishment supported 504 sample observations. Loan assignation equation and loan reimbursement equations calculable using Book of Tobit model exploitation survey knowledge at Guyana Cooperative Agricultural and Industrial Development Bank unconcealed that solely thirty third of the factors utilised known credit worthy borrowers implying that the screening technology wasn't economical and required to be repaired. The results conjointly indicated that
modification the loan contract terms by reducing the grace amount on loans and rejecting applications that had long process times increased the pool of credit worthy borrowers.

2.3.2 Loan Factors and Loan_default

Makorere (2014) examined the factors touching loan_default behavior in African country as a result of experiences show that a lot of money establishments still face poor loan recovery The study utilized a cross sectional style as a result of the study was done once in purpose of your time. The study sample size was one hundred respondents as a result of the study was a pilot study. The study utilized convenience sampling technique supported the accessibility and disposition of respondents to participate within the study. form technique was employed in capturing primary knowledge, whereas descriptive datum was employed in analyzing of knowledge exploitation frequencies and percentages. The study unconcealed that a minimum of 8 May 1945 of the respondents interviewed complained regarding the inadequacy of the time given for them to create their initial installment. Most of the money establishments tend to supply a grace amount of 1 month solely, that was seen to not be decent for the tiny business homeowners to start out realizing enough revenue for them to start out paying their loans. The study found that companies get enough grace amount and have not intimate with drawback of default.

Ibeleme (2013) investigated the loan size and repayment performance of sodbuster feather palm producers and processors in Federal Republic of Nigeria mistreatment Abia State as a case study. Ninety respondents, comprising fifty four producers and thirty six processors, were indiscriminately selected and interviewed. Standard Least sq. technique was utilized in analyzing the info and drawing conclusions. The analysis of information disclosed that loan size by feather palm processors was considerably determined by process expertise, gross annual financial gain and rate. For the farmer- borrowers, the key determinants of loan size were academic level and rate all of that fell in line with a priori expectations as indicated by the signs of the coefficients of relevant variables. On loan charge per unit and credit good rating, results of information analysis showed that loan-asset magnitude relation and distance between home and supply of loan were important determinants of loan charge per unit.

Roslan (2009) did a study on microcredit loan reimbursement behavior in Asian country.
They did a study on microcredit loan borrowers from Agro-Bank Asian country. Agro-Bank may be a business establishment specializing in loans to borrowers concerned in agricultural business. Aside from giving large-scale loans, it conjointly provides small-scale loans like microcredit loans to borrowers. In their analysis, they found that male borrowers and borrowers United Nations agency had a extended period for repayments had the next chance of defaulting. Borrowers concerned in non-production minded business activities like within the service or the support sectors United Nations agency had coaching in their explicit business and United Nations agency borrowed higher loans had lower chances of defaulting.

Roslan (2009) in their study conclude that shut and informal relationship between MFIs and borrowers could facilitate in observance and early detection of issues which will arise in non-repayment of loans. Additionally, cooperation and coordination among varied agencies that give further support to borrowers could facilitate them achieve their business. The study compared the great practices and performance of designated MFIs in Asian country namely; Amanah Ikhtiar Asian country, Koperasi Kredit Rakyat and Bank Pertanian Asian country. However, Maina (2014) classified reimbursement issues into four factors: receiver connected cause, business operation connected cause, loaner connected cause, and extraneous causes. The higher than studies conducted in varied places concurred that loan factors have an effect on loan default. but a study conducted in Asian country by Roslan (2009) indicates that SMEs United Nations agency had borrowed higher loans had lower chances of defaulting.

### 2.3.3 Type of the Institution and Loan_default

Kibosia (2012) did a study that wanted to see the link between Non-performing Loans related to SME sector and its determinants among business banks in African nation. The analysis methodology used was a descriptive survey style and therefore the population of was all business banks in national capital region. The population of the study consisted of all the business banks in African nation. Data collected was by use of a form that created use of each open and closed concluded queries. Knowledge was emended for accuracy, uniformity, consistency and completeness and organized to change committal to writing
and tabulation for end. This study conjointly used multiple linear regressions to research the info.

The study pointed out that Loan_defaults by SMEs has considerably been increasing and variety of determinants affected the loan_defaults key among them rate of interests and the way long the business has been operational. The character of the someone has been found to possess a major impact on loan_defaults. Poor Credit Analysis and observance, kind of loan, reimbursement amount and economic conditions conjointly contributed to loan_defaults by SMEs. From the results, it's evident that for all the banks United Nations agencies lend to SME, the SME loan book contained a major level of Non-performing loans. The study recommends that business banks ought to place a lot of stress on Credit Risk Management, coaching of employees and adopt credit rating in vetting of SME customers loan requests.

Kamakia (2012 did a study to ascertain the factors that have an effect on the selection of a retail bank by little and Medium-sized Entrepreneurs in academic sector in African nation. The analysis used the descriptive analysis style. The target population of the study was the highest management of three hundred non-public colleges in national capital County. The study used stratified sampling to come back up with the sample of the study. The study used primary knowledge that was collected exploitation semi structured questionnaires. The study pointed out that SMEs relied on loans to fund the operation of their establishment and thus the number of rate of interests on loans borrowed and different services influenced the selection of retail bank by the SMEs. the number of rate of interests influenced the selection of retail bank to a good extent. additionally, SMEs most popular their various bank as a result of they offered rate of interest on loan and different services at competitive rates. The scientist established that through technology had created money establishments a lot of proximate to SMEs.

Mukono (2015) did a study which sought to investigate the determinants of loan repayment by (SMEs) in Nairobi County, Kenya. The study employed a descriptive research design and a sample of 160 respondents was used. The sample was 2% of the total population and the study target SME owners and managers and focused on SMEs that have obtained
a loan facility with any financial institution in Kenya. Simple random and stratified sampling methods were used to select the respondents and a questionnaire was used to collect data for the study. The data collected was classified, summarized analyzed using the descriptive statistical tools and inferential statistics using Gretel.

The study used the logit regression to model the determinants of loan repayment by SMEs in Nairobi County. The study findings established that loan, institutional and lender characteristics are major determinants of loan repayment by small and medium enterprises in Nairobi County, Kenya. The study concluded that loan, borrower, firm and lender characteristics influence loan repayment by SMEs. The study recommended that financial institutions should review their loaning policies so that they can reduce loan repayment problems arising from loan, institutional and lender characteristics.

Naana (2011) conducted a study to investigate the determinants of loan defaults among SMEs in Abossey-Okai, Accra, using survey method. Structured questionnaires were administered to owners of SMEs in Abossey-Okai who accessed loans from the Ghana commercial bank from December 2005 to September 2009. The research is line with current efforts by bankers, regulators and international lending institutions to unravel the problem of persistent loan default among small business that has led to high non-performing loans in the banking sector. The findings from indicated that borrower screening mechanism employed by the GCB was defective and inefficient and credit need assessment conducted by the bank was flawed which increased the risk of default. Results from the study also depicted that high officer-application ratio tends to reduce efficiency in credit assessment which increases risks of loan default. The findings of the study supported the assertion that SME loan default is the outcome of flawed financial role of banks and flawed public policy regimes.

2.4 Conceptual Framework
A conceptual framework is a product of qualitative process of theorization which interlinks concept that together provides a comprehensive understanding of a
phenomenon or phenomena (Jabareen, 2009). The concepts that constitute a conceptual framework support one another, articulate their respective phenomena, and establish a framework-specific philosophy that defines relationships. The conceptual framework of this study relates to independent variables; loan factors, lender factors, and type of the financial institution on loan_default
Independent Variables

Figure 2.1: The Conceptual Framework

Source: Author, 2017
CHAPTER THREE

3 METHODOLOGY

3.1 Introduction
This chapter presents the analysis methodology that was adopted in conducting the study so as to realize the study’s objective. This chapter documents the planning and methodology of the study. It describes very well the analysis style, target population, knowledge assortment procedures and knowledge analysis strategies.

3.2 Research Design
Bryman and Bell, (2007) defines research design as the structure that guides the execution of a research method, and the subsequent analysis of acquired data. It provides a framework for the generation of evidence that is suited both to a certain set of criteria and to the research question in which the investigator is interested. Descriptive analysis style was adopted during this study. A descriptive analysis determines and reports the means things are (Mugenda & Mugenda, 2003). Creswell, (2002) observes that a descriptive analysis style is employed once knowledge are collected to explain persons, organisations, settings, or phenomena. Descriptive design is ideal as the study was carried out in a limited geographical scope and hence was logistically easier and simpler to conduct considering the limitations of this study (Mugenda and Mugenda, 2003).

3.3 Target Population
Population refers to a complete cluster of people, events or objects having common evident characteristics. In different words population is that the combination of all conforms to a given specification (Borg and Gall, 1989). The population is that the cluster of interest to the scientist the cluster to that the scientist would love the result of the study to be generalized (Gay, 1976). In keeping with Borg and Gall (1989) the target population or universe describes all members of real or hypothetic set of individuals, events and objects. The target population in this study entails all the registered SMEs in the Sub-county and had access to credit. Kitui Central Sub-county has 512 registered SMEs.
in and only 407 SMEs have had access to credit facilities across the five wards (Ministry of trade, investments and cooperatives, 2016)

Table 3.0 Target Population

<table>
<thead>
<tr>
<th>Ward</th>
<th>No. of SMEs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kitui township</td>
<td>179</td>
</tr>
<tr>
<td>Kyangwithya west</td>
<td>42</td>
</tr>
<tr>
<td>Kyangwitha east</td>
<td>56</td>
</tr>
<tr>
<td>Miambani</td>
<td>69</td>
</tr>
<tr>
<td>Mulango</td>
<td>61</td>
</tr>
<tr>
<td>Total</td>
<td>407</td>
</tr>
</tbody>
</table>

3.4 Sampling Frame
A sampling frame is a convenient list of all units in the population. The sampling frame forms the basic material from which the sample is drawn (Rangaswamy, 2010). According to Kothari et al, (2014), a sampling frame is the list of sampling units that contains the names of all the items or the universe (in case of finite universe only). This is intended to represent the elements of the population and the ideal sampling frame is a complete listing of the elements of the population. Ngechu (2004) underscores the importance of selecting a representative sample through making a sampling frame. The list of all SMEs registered within the county in 2017 constituted the sampling frame for this study and was obtained from the Ministry of trade, investments and cooperatives, Kitui County.

3.5 Sample Size and Sampling Techniques
The study adopted a simple random sampling method to select a reasonable number of SMEs to represent the target population. The study was confined to those SMEs who have once benefited from credit. This sampling method provides us with an efficient system of capturing, in a small group, the variation or heterogeneity that exist in the target population (Mugenda & Mugenda, 2003). According to Mugenda and Mugenda (2003), in a population of less than 10,000 elements, a sample of between 10%-30% of the target
population is considered adequate for generalization of the findings to the whole population.

However, Mugenda and Mugenda (2003) added that the selected sample size should be comprised of at least 30 elements. From the Sub-county (across all 5 wards i.e. Kitui Township, Kyangwithya West, Kyangwithya East, Miambani and Mulango wards) the researcher used a sample of 20% of the total population of 407 to get 81 SMEs. Kothari, (2008), considers sample of 20% is ideal for a population less than 1000 elements population.

**Table 3.1: Sample Size**

<table>
<thead>
<tr>
<th>Ward</th>
<th>No. of SMEs</th>
<th>20% distribution</th>
<th>sample size</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kitui township</td>
<td>179</td>
<td>0.2 * 179 = 35.8</td>
<td>36</td>
</tr>
<tr>
<td>Kyangwithya</td>
<td>42</td>
<td>0.2 * 42 = 8.4</td>
<td>8</td>
</tr>
<tr>
<td>Kyangwithy East</td>
<td>56</td>
<td>0.2 * 56 = 11.2</td>
<td>11</td>
</tr>
<tr>
<td>Miambani</td>
<td>69</td>
<td>0.2 * 69 = 13.8</td>
<td>14</td>
</tr>
<tr>
<td>Mulango</td>
<td>61</td>
<td>0.2 * 61 = 12.2</td>
<td>12</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>407</strong></td>
<td><strong>0.2 * 407 = 81.4</strong></td>
<td><strong>81</strong></td>
</tr>
</tbody>
</table>

**3.6 Data Collection Instruments and Procedures**

The study used primary knowledge solely. Primary knowledge for this study was collected directly from specific SMEs by use of structured questionnaires. A form may be a schedule of assorted queries meant for self-completion by survey participants (Brace, 2008). It's a value effective technique to field. The questionnaires contained each open and closed-ended queries. The structured queries were employed in an attempt to conserve time. Associate in Nursing additional on facilitate in easier analysis as they're in immediate usable kind whereas the unstructured queries were used thus on encourage the respondent to present an in-depth response while not feeling control back in revealing any data.
3.7 Ethical Considerations
The researcher handled the data collected with confidentiality. The data collected from the SMEs weren’t altered to satisfy any hidden or personal interest. The researcher also facilitated informed consent so as to let the respondents know what the research was all about. The respondents were additionally educated that they were free to exit from the study as they wanted to protect them from any harm, i.e. psychologically or morally.

3.8 Data Analysis
The data collected for this study was accurately scored and consistently organized in an exceedingly manner that facilitates analysis so as to change the scientist add up of the info. Data analysis was done in spite of everything knowledge had been collected and clean. The info from the sector was coded in keeping with the themes studied during this study. A applied math package for social sciences (SPSS) package twenty four.0v was wont to aid within the analysis. the sort of knowledge analysis tool that was used trusted the sort of knowledge that was used: qualitative or quantitative (Walsh & Wigens, 2003).

Quantitative data was analyzed through the utilization of a mixture of descriptive statistics significantly frequency distributions tables. Correlation and multiple correlation analysis were wont to confirm whether or not the independent variables along predict the variable at ninety nine confidence level (0.01 significance level). Gupta (2009) asserts that multivariate analysis provides estimates of import of the experimental variable from values of the dependent variables. The subsequent statistical regression model was wont to live the practical relationship between the freelance and every of the four freelance variables:

\[ LD = K + \beta_1 LF + \beta_2 LF + \beta_3 IF + \epsilon \]

Where:
- \( LD \) = Loan_default
- \( LF \) = Lender Factors
- \( LF \) = Loan Factors
- \( IF \) = Institutional Factors
ε = Error term

K=Loan_default intercept, \( β_1, β_2, β_3, & β_4 \) are regression coefficients

In the process of examining the relationship between variables, the researcher used ANOVA to compare the means of two groups on the dependent variable (Green & Salkind, 2012). ANOVA and T-tests were accustomed test the importance of the model in measurement the result of financial institution factors and loan_default by SMEs at 99% confidence level and 1% significant level.
CHAPTER FOUR

4.0. RESULTS

4.1. Introduction

This chapter contains data presentation analysis and interpretation within the demographic knowledge of the study participants, loan characteristics, varieties of money establishments and loan defaulting knowledge. The chapter conjointly presents correlations and regressions analysis between the dependent and therefore the freelance variables studied during this study. The analysis was administrated exploitation the applied math Package for Social Scientists (SPSS). The results were bestowed in tables.

4.2. Descriptive Statistics

The researcher administered questionnaires to eighty one study participants however 2 of them didn’t come their questionnaires therefore N=79 questionnaires were completed and came. the info collected from the seventy nine questionnaires was entered and analyzed to make the premise for the findings of this study.

4.2.1. Gender of The Study Participants

In this study, 1 represented “male” while 2 represented “female” study participants. The findings were summarized and presented in table 4.1 below.

Table 4.1: Gender of the Study Participants

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Male</td>
<td>55</td>
<td>69.6</td>
<td>69.6</td>
</tr>
<tr>
<td>Female</td>
<td>24</td>
<td>30.4</td>
<td>100.0</td>
</tr>
</tbody>
</table>

The findings in table 4.1 above revealed that Majority (69.6%) of the study participants were male while the females were 30.4%.
4.2.2. Duration in Business Operation

The researcher analyzed data on the duration within which the participant had been in business operations. There were four categories; 1: less than 1 year, 2: 1-5 years, 3: 6-10 years and finally 4: 11 years and above. The findings were summarized in Table 4.2 below.

<table>
<thead>
<tr>
<th>Duration</th>
<th>Frequency</th>
<th>Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>less than 1 year</td>
<td>10</td>
<td>12.7</td>
<td>12.7</td>
</tr>
<tr>
<td>1-5 years</td>
<td>31</td>
<td>39.2</td>
<td>51.9</td>
</tr>
<tr>
<td>6-10 years</td>
<td>24</td>
<td>30.4</td>
<td>82.3</td>
</tr>
<tr>
<td>10 years and above</td>
<td>14</td>
<td>17.7</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Majority (39.2%) of the SME had been in business operations for a period between one and five years whereas the smallest amount range of the study participants had been within the business for fewer than one year. People who had been in business for a period of 6-10 years and quite ten years were 30.4% and 17.7% severally.

4.2.3. Level of Education of Study Participants

The researcher also categorized the study participants based on their level of education; 1: primary, 2: secondary, 3: college/university and 4: None. The findings were summarized in Table 4.3 below.

<table>
<thead>
<tr>
<th>Level of Education</th>
<th>Frequency</th>
<th>Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary level</td>
<td>14</td>
<td>17.7</td>
<td>17.7</td>
</tr>
<tr>
<td>Secondary level</td>
<td>31</td>
<td>39.2</td>
<td>57.0</td>
</tr>
<tr>
<td>College/University</td>
<td>28</td>
<td>35.4</td>
<td>92.4</td>
</tr>
<tr>
<td>None</td>
<td>6</td>
<td>7.6</td>
<td>100.0</td>
</tr>
</tbody>
</table>

The study findings in Table 4.3 revealed that majority (39.2%) of the study participants had secondary level of education whereas the smallest amount (7.6%) had not achieved any
primary of education. the first and College/University level consisted of 17.7% and 35.4% respectively.

4.2.4. **Mode of Loan Repayment**

The researcher had four modes of loan repayment: direct money deposit, raised standing orders, continued saving deposits and electronic cash transfers. The findings of this study on the mode of loan compensation utilized by the study participants were summarized in table 4.4 below.

<table>
<thead>
<tr>
<th>Mode of Loan Repayment</th>
<th>Frequency</th>
<th>Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct cash deposit</td>
<td>47</td>
<td>59.5</td>
<td>59.5</td>
</tr>
<tr>
<td>Raised standing orders</td>
<td>10</td>
<td>12.7</td>
<td>72.2</td>
</tr>
<tr>
<td>Continued savings deposits</td>
<td>13</td>
<td>16.5</td>
<td>88.6</td>
</tr>
<tr>
<td>Electronic money transfers</td>
<td>9</td>
<td>11.4</td>
<td>100.0</td>
</tr>
</tbody>
</table>

The findings in table 4.4 above revealed that majority (59.5%) of the study participants used direct cash deposit as the mode of loan repayment while the least (11.4%) used electronic money transfers. Raised standing orders and continued savings deposits were used by 12.7% and 16.5% respectively.

4.3. **Correlation Analysis**

The first objective of this study was to examine the effect of Lender characteristics on loan default by SMEs in Kitui Central Sub-county. The lender characteristics were measured using mode of loan repayment and the structure of the rate of interest. The modes of loan repayment were four: 1: direct money deposits, 2: Raised standing orders, 3: Continued savings deposits and 4: Electronic cash transfers. The structure of rate of interest (IR) consisted of 1: Flat Rate and 2: Reducing Rate. The study participants were asked to state if they had ever failed in payment of their loan installments. Their responses were either 1 for Yes or 2 for No. Correlation analysis carried out on their responses to
determine the association between lender characteristics and Loan_default. The findings were summarized in table 4.5 below.

The second objective was to investigate the effect of loan characteristics on loan_default by SMEs in Kitui Central Sub-county. The loan characteristics were measured using size of loan and the loan repayment interval. The size of loan was divided into six categories; 1: 5,000-20,000, 2: 20,001-50,000, 3: 50,001-100,000, 4: 100,001-200,000, 5: 200,001-1,000,000 and 6: 1,000,001 and above. The loan repayment intervals were three; 1: Weekly, 2: monthly and 3: Annually. The responses for missing the payment of installments were 1 for Yes and 2 for No. the researcher carried out correlations to establish the association between the loan characteristics and Loan_default. The results were summarized in table 4.5 below.

The third objective of this study was to find out the effect of type of financial institution on loan_default by SMEs in Kitui Central Sub-county. There were two types of financial institutions used in this study; 1: Bank and 2: Non-bank. Correlations analysis was carried out to find out the association between the type of financial institution and loan_default. The research findings were summarized in table 4.5 below.
### Table 4.5: Correlation Analysis

<table>
<thead>
<tr>
<th></th>
<th>Loan_defaul</th>
<th>Mode of loan repayment</th>
<th>Structure of IR</th>
<th>Size of loan</th>
<th>Loan repayment interval</th>
<th>Type of financial institution</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Loan_default</strong></td>
<td>Pearson</td>
<td><strong>Correlation</strong></td>
<td><strong>Correlation</strong></td>
<td><strong>Correlation</strong></td>
<td><strong>Correlation</strong></td>
<td><strong>Correlation</strong></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>.644**</td>
<td>.774**</td>
<td>.335</td>
<td>.240*</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>.774**</td>
<td>.335**</td>
<td>.240**</td>
<td><strong>.605</strong></td>
</tr>
<tr>
<td></td>
<td></td>
<td><strong>Sig. (2-tailed)</strong></td>
<td>.000</td>
<td>.000</td>
<td>.003</td>
<td>.033</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Pearson</td>
<td>.644**</td>
<td>1</td>
<td>.495**</td>
<td>.271*</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>.644**</td>
<td>.495**</td>
<td>.271*</td>
<td>.183</td>
</tr>
<tr>
<td></td>
<td></td>
<td><strong>Sig. (2-tailed)</strong></td>
<td>.000</td>
<td>.000</td>
<td>.016</td>
<td>.106</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Pearson</td>
<td>.774**</td>
<td>.495**</td>
<td>1</td>
<td>.358</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>.774**</td>
<td>.495**</td>
<td>.358**</td>
<td>.468**</td>
</tr>
<tr>
<td></td>
<td></td>
<td><strong>Sig. (2-tailed)</strong></td>
<td>.000</td>
<td>.000</td>
<td>.001</td>
<td>.229</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Pearson</td>
<td>.335**</td>
<td>.271*</td>
<td>.358**</td>
<td>.598**</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>.335**</td>
<td>.271*</td>
<td>.598**</td>
<td>.456**</td>
</tr>
<tr>
<td></td>
<td></td>
<td><strong>Sig. (2-tailed)</strong></td>
<td>.003</td>
<td>.016</td>
<td>.001</td>
<td>.000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Pearson</td>
<td>.240*</td>
<td>.183</td>
<td>.137</td>
<td>.598</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>.240*</td>
<td>.183</td>
<td>.598**</td>
<td>.350**</td>
</tr>
</tbody>
</table>
Sig. (2-tailed)   .033   .106   .229   .000   .002

Pearson

Type of Correlation   .605**   .394**   .468**   .456**   .350**   1
financial institution

Sig. (2-tailed)   .000   .000   .000   .000   .002

**. Correlation is significant at the 0.01 level (2-tailed).
*. Correlation is significant at the 0.05 level (2-tailed).

4.3.1. Lender Characteristics and Loan_default

The results in table 4.5 suggested that there was a medium positive correlation at 99% confidence level between the mode of loan repayment and loan_default (r=0.644, p=0.000). Since 0.000 is less than 0.01, it was concluded that there was a significant relationship between the mode of loan repayment and loan_default. The findings also revealed that there was a strong positive correlation at 99% confidence level between the structure of rate of interest and loan_default (r=0.774, p=0.000). Since 0.000 is less than 0.01 it was concluded that there was a significant relationship between the structure of IR and loan_default.

4.3.2. Loan Characteristics and Loan_default

The results in table 4.5 above suggested that there was a weak positive correlation at 99% confidence level between size of loan and loan_default (r = 0.335, p = 0.003). Since 0.003 is less than 0.01, it was concluded that there was a significant relationship between size of loan and loan_default. The results also suggested that there was a weak positive correlation at 99% confidence level between size of loan and loan_default (r = 0.240, p = 0.033). Since 0.033 is greater than 0.01, it was concluded that there was no significant relationship between the loan repayment interval and loan_default. However, the relationship between the loan repayment interval and loan_default was significant at 95% confidence level since 0.033 is less than 0.05.
4.3.3. Type of Financial Institution and Loan_default

The findings presented in table 4.5 above indicated that there was a medium positive correlation at 99% confidence level between type of financial institution and loan default ($r = 0.605, p = 0.000$). Since 0.000 is less than 0.01, it was concluded that there was a significant relationship between the type of financial institution and loan default.

4.4. Coefficients of Correlation

Multiple correlations were also carried out to find the relationship between the independent and dependent variables as well as amongst the independent variables themselves. The findings on the relationship between the independent variables as presented in table 4.5 suggested that there was a significant relationship at 99% confidence level between mode of loan repayment, structure of rate of interest and type of financial institution ($r = 0.495, p = 0.000$) and ($0.394, p = 0.000$) respectively. However, the relationship between mode of loan repayment and size of loan as well as loan repayment interval was significant at 95% confidence level ($r = 0.271, p = 0.016$) and ($r=0.183, p=0.106$) respectively.

There was a significant relationship between the structure of rate of interest and size of loan as well as type of financial institution ($r=0.358, p=0.001$) and ($0.468, p=0.000$) respectively. There was no significant relationship between the structure of rate of interest and loan repayment interval ($r=0.137, p=0.229$). There was a significant relationship at 99% confidence level between the size of loan and loan repayment interval as well as the type of financial institution ($r=0.598, p=0.000$) and ($0.456, p=0.000$) respectively. There was a significant relationship at 99% confidence level between loan repayment interval and type of financial institution ($r=0.350, p=0.002$).

4.5. Regression Analysis

The researcher used multiple correlation analysis to check the effect of change of independent variables on the dependent variables. The regression was used since it could produce an equation that would help in the prediction of the dependent variables from a
given independent variable and vice versa. It might additionally show how a unit
increases or decreases of the independent variable would affect the dependent variables.
The model summaries indicated the predictors of the loan_default.

4.5.1. Model Summary

The model outline for the predictors and their completely different levels of predicting
loan_default are as shown in table 4.7 below.

Table 4.6: Model Summary Table

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.861a</td>
<td>.742</td>
<td>.724</td>
<td>.264</td>
</tr>
</tbody>
</table>

a. Predictors: (Constant), type of financial institution, loan repayment interval, mode of
loan repayment, structure of IR, size of loan

In view of the results in table 4.7 above, the R-value of 0.861 indicates a strong positive
correlation between the factor influencing loan_default among SMEs in Kitui Central Sub-
county. In view of the coefficient of determination (R-square) of 0.742, the four predictors
account for 74.2% of variability in loan_default by SMEs in the study area. Table 4.8
below presents coefficients and p-values associated with the study variables.

Table 4.7: Regression Coefficientsa

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
</tr>
<tr>
<td>(Constant)</td>
<td>-.141</td>
<td>.192</td>
</tr>
<tr>
<td>Mode of loan repayment</td>
<td>.140</td>
<td>.034</td>
</tr>
<tr>
<td>Structure of IR</td>
<td>.547</td>
<td>.076</td>
</tr>
<tr>
<td>Size of loan</td>
<td>-.036</td>
<td>.028</td>
</tr>
<tr>
<td>Loan repayment interval</td>
<td>.097</td>
<td>.086</td>
</tr>
<tr>
<td>Type of financial institution</td>
<td>.296</td>
<td>.085</td>
</tr>
</tbody>
</table>
a. Dependent Variable: Loan_default

The regression function extracted from the table is presented below.

Regression model: \( LD = K + \beta_1 LF + \beta_2 LF + \beta_3 IF + \epsilon \)

Missed payment of installments = Loan_default (LD)

Specific Regression Model: \( LD = -0.141 + 0.140 (LF) + 0.547 (LF) – 0.036 (LF) + 0.097 (IF) \)

Loan_default= -0.141 + 0.140(mode of loan repayment) + 0.547(structure of rate of interest) – 0.036(size of loan) + 0.097(loan repayment interval) + 0.296(type of financial institution). The regression analysis in table 4.8 above shows how a unit change of the independent variable changes the dependent variable. The betas for mode of loan repayment, structure of rate of interest, loan repayment interval and type of financial institution are positive indicating that every unit increase in any of the four independent variables would cause a positive change in the dependent variable with the following quantities: mode of loan payment (0.140), structure of rate of interest (0.547) loan repayment interval (0.097), and type of financial institution (0.296). The beta for the size of loan is negative indicating that a unit increase in size of loan would cause a negative change in the dependent variable in the following quantity: size of loan (0.036).

The summary in table 4.8 above also shows a statistical significance of each independent variable. Mode of loan repayment, structure of rate of interest and type of financial institution were found to be statistically significant in explaining loan_default since \( p=0.000, p=0.000 \) and \( p=0.001 \) were less that 0.01 respectively. Size of loan and loan repayment interval were found not to be statistically significant in explaining loan_default since their p-values were 0.205 and 0.263 respectively. An analysis of variance was also carried out to test the goodness of fit with respect to the model overall and summarized in table 4.9 below.

Table 4.8: ANOVA Table

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Squares</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
a. Dependent Variable: Loan_default

b. Predictors: (Constant), Type of financial institution, Loan repayment interval, Mode of loan repayment, Structure of IR, Size of loan

The results in table 4.9 above indicates that F-statistic was 42.013 and a p-value of 0.000 (which is less than the significance level of 0.01) indicating that the overall model was statistically significant. Therefore, mode of loan repayment, type of financial institution, loan repayment interval, size of loan, and structure of rate of interest have a significant effect on loan_default in the area of study.
CHAPTER FIVE

5.0. DISCUSSION

5.1. Introduction

This chapter presents a discussion of the key observations of this study significantly on the variable and therefore the freelance variables and the way the observations of this study relate with those of different connected studies.

5.2. Main Discussion

According to the observations of the study, majority of the study participants used direct money deposit as their mode of loan reimbursement. The section below may be a discussion of the 3 objections studied during this study.

5.2.1. Effects of the Lender Characteristics on Loan_default

On the lender characteristics studied, the findings of this study unconcealed that there was a positive relationship between the mode of loan reimbursement and loan_default additionally as between the structure of rate of interest and loan_default. The interpretation of those findings is that use of a lot of advanced modes of loan reimbursement or shifting from straightforward to a lot of advanced or technologically complicated strategies of loan reimbursement is probably going to will increase cases of loan_default by borrowers within the study space. The findings of this study were totally different from the findings of the opposite studies reviewed during this study as a result of the centered on however loan_default was influenced by factors aside from the mode of loan reimbursement.

For instance, there's a study that was administrated by Makorere (2014) in African country. He examined the factors touching loan_default behavior as a result of experiences showed that a lot of financial institutions were still facing low loan recovery. The results of the study established that in most incidences, high rate of interests discouraged business to grow within the sense that the bigger part of the profit generated went back to the institutions to service the loan that was once given to the receiver. He urged that the financial institutions ought to impose cheap and competitive rate of interests to verify effective compensation. In another study done by Maina and Kalui (2014) wherever they assessed institutional_factors contribute to loan_defaulting in MFIs in African nation, it established that credit policies, loan recovery procedures, and loan
appraisal method had a major impact on the loan default rate or loan delinquency prevalence.

In another study administrated by Evusa (2015) on the causes of loan default among the purchasers of Equity bank it absolutely was established that the most important factors influencing nonpayment of borrowed loans were each internal and external. The paper recommended that banks’ credit policies be reviewed to match the highly volatile economic trends within financial markets with a strong emphasis on institutional appraisals on credit worthiness. According to Hunt (2006) who examined the credit assignation technology of lenders and therefore the reimbursement behavior of borrowers at a rural establishment supported 504 sample observations, it absolutely was established that modification the loan contract terms by reducing the grace amount on loans and rejecting applications that had long process times increased the pool of credit worthy borrowers.

5.2.2. Effects of the Loan Characteristics on Loan default

On the loan characteristics studied, the findings of this study revealed that there was a positive relationship between loan repayment interval and loan default. This indicated that an increase in the loan repayment interval is likely to increases cases of loan default among the SME borrowers in the study area. It was not clear why this was so because the findings of other studied have suggested that an increase in the loan repayment interval is likely to significantly reduce cases of loan default among the borrowers (Roslan and Karim, 2009).

Roslan and Karim, (2009) on microcredit loan repayment behavior in Malaysia, also revealed that male borrowers and borrowers who had a longer duration for repayments had a higher probability of defaulting. However, this study did not explore to find out the probability of loan defaulting across male and female borrowers. Roslan also reported that borrowers involved in non-production oriented business activities such as in the service or the support sectors who had training in their particular business and who borrowed higher loans had lower probabilities of defaulting.
However, there was a negative relationship between size of loan and loan_default. The interpretation of this is that an increase in the size of loan borrowed is likely to decrease cases of loan_default. These findings were in agreement with those of Makorere (2014) where he found out that borrowers of bigger loans were more likely to default than those of relatively smaller loans. According to Makorere (2014), the main reason for an increased probability of loan_default with a decrease in size of loan is that, borrowers of smaller loans were described as financially unstable while borrowers of bigger loans were described as financially stable with investments which enable them to repay their loans promptly without defaulting.

According to a study carried out by Ibeleme, Okpara and Odionye (2013) on the loan size and repayment performance of palm oil palm producers and processors in Federal Republic of Nigeria using Abia State as a case study, it was established that loan size by oil palm processors was considerably determined by processing expertise gross financial gain and rate of interest. On loan repayment rate and credit worthiness rating, results of data analysis showed that loan-asset ratio and distance between home and source of loan were significant determinants of loan repayment rate.

On loan characteristics, this study only investigated the effect of loan repayment interval and loan size on loan_default. In another study by Roslan Abdul Hakim et al. (2007), it was concluded that that loan factors affect loan_default. However a study conducted in Malaysia by Roslan and Karam (2009) indicates that SMEs who had borrowed higher loans had lower probabilities of defaulting.

5.2.3. Effect of Type of Financial Institution on Loan_default

On the type of financial institution, the findings of this study revealed that there was a positive relationship between the type of financial institution and loan_default. The interpretation of this is that the SME borrowers from commercial banks were less likely to default the payment of their loan compared to their counterparts from non-commercial institutions. These findings were in line with those of Kibosia (2012) which established
that there were more non-performing loans in non-commercial financial_institutions than in the commercial banks. This was because the non-commercial financial_institutions had not put emphasis on credit risk management.

According to a study administrated by Kibosia (2012) on the link between Non-performing Loans related to SME sector and its determinants among business banks in African nation, it absolutely was established that Loan_defaults by SMEs has considerably been increasing and variety of determinants affected the loan_defaults key among them rate of interests and the way long the business has been operational. Also, it was evident that for all the banks who lend to SME, the SME loan book contained a significant level of Non-performing loans. The study recommended that commercial banks should put more emphasis on Credit Risk Management and adopt credit scoring in vetting of SME customers loan requests.

5.3. Summary of The Findings
Considering all the independent variables used in the study, it was evident that, only three variables; the mode of loan repayment, the structure of rate of interest adopted by the lending institution and type of financial institution, were highly associated with loan_default. Loan repayment interval and size of loan were not significantly associated with loan_default. Factually, all the lender characteristics studied and type of financial_institutions were significantly associated with loan_default. None of the loan characteristics were significantly associated with default.
CHAPTER SIX
6.0. CONCLUSIONS AND RECOMMENDATIONS

6.1. Introduction
This section presents the conclusions made in the study and the recommendations derived based on the observations of this study.

6.2. Conclusions

6.2.1. Effects of Lender Characteristics on Loan_default
On the primary objective, this study examined the influence of loaner characteristics on the loan_default. Supported the findings of this study, it absolutely was over that there was a major relationship between loaner characteristics and loan_default. Shift of the mode of loan reimbursement from straightforward to a lot of technologically advanced modes will increase the probability of loan_default and the other way around. A amendment of the structure of the rate of interest from flat rate to reduced rate will increase the chance of loan_default.

6.2.2. Effects of Loan Characteristics on Loan_default
Secondly, this study explored the effect of loan characteristics on loan_default. Based on the findings of this study, it was concluded that there was no significant relationship between the loan characteristics (size of loan and loan repayment interval) and loan_default. An increase in loan repayment interval is likely to increase the probability of loan_default while an increase in the size of loan is likely to decrease chances of loan_default.

6.2.3. Effect of The Type of Financial Institution and Loan_default
Thirdly, based on the findings of this study, it was concluded that there was a significant relationship between the type of financial institution and loan_default. Loan_default rate is likely to be higher in non-bank financial institutions than in bank financial institutions.

6.3. Recommendations
The first recommendation goes to the policymakers such as the Central Bank of Kenya, Credit Bureau authority and other policymakers; there's a desire to develop policies which will standardize and guarantee uniformity within the money establishments particularly within the space of credit thus on cut back cases of loan_default. This can be as a result of the characteristics of the loaner were found to possess a major relation with loan_default within the study space. However, the money establishments ought to conjointly contemplate rewriting their disposal policies in order that they will cut back loan reimbursement issues related to loaner, loan and institutional characteristics.

The second recommendation goes to the financial institutions themselves; this study recommends that the lending financial institutions in the study area should guarantee enhanced and improved attention on the client needs as far as lending is concerned. This is specifically when choosing the loan repayment methods to the customers as well as putting emphasis on credit risk management, training of staff and adoption of credit scoring in vetting SMEs customer loan requests.

The third recommendation goes to the academicians and the researchers where this study suggests that there is need for more investigation into the area of factors associated with loan_default among SMEs in Kenya. There are several queries that haven’t been answered by the findings of this study. The study is additionally recommending a lot of investment in any analysis to supply a wider information additionally as deeper understanding of those and different factors which may influence loan repayment or may contribute to loan default in the study and similar areas in Kenya.
REFERENCES


APPENDICES

Appendix I: Introductory Letter
Felix Sammy Syomane
Po Box 170-90200
Kitui, Kenya

December, 2017,

Dear Respondent,

**Re: MBA Research Project**
This questionnaire is designed to gather data/information pertaining to financial factors influencing loan_default by SMEs in Kitui Central Sub-County for academic purpose only.
The study is being carried out for management project paper as a partial fulfillment of the Degree of Masters in Business Administration at the South Eastern Kenya University.
Your responses shall be treated with maximum confidentiality and in no instance name will be mentioned in my report.
Your cooperation will be highly appreciated.
Yours Sincerely,

Felix Sammy Syomane
MBA student
REG NO. D61/KIT/20721/2016
Appendix II: Transmittal Letter

SOUTH EASTERN KENYA UNIVERSITY
OFFICE OF THE DIRECTOR
BOARD OF POST GRADUATE STUDIES

P.O. BOX 170-90200
KITUI, KENYA
Email info@seku.ac.ke

TEL: 020-4213859 (KITUI)
Email directorbps@seku.ac.ke

DATE: 18th December, 2018

Our Ref: D61/KIT/20721/2016

Syomane Felix Sammy
Masters of Business Administration
C/O Dean, School of Business and Economics

Dear Sammy,

RE: PERMISSION TO PROCEED FOR DATA COLLECTION

This is to acknowledge receipt of your Master in Business Administration Proposal document entitled: "Financial Institution Factors Influencing Loan Default by SMEs in Kitui Central Sub-County".

Following a successful presentation of your Masters Proposal, the School of Business and Economics Board of Examination in conjunction with the Directorate, Board of Postgraduate Studies (BPS) have approved that you proceed on and carry out research data collection in accordance with your approved proposal.

During the research work, you will be closely supervised by Dr. Kevin Wachira. You should ensure that you liaise with the supervisor at all times. In addition, you are required to fill in a Progress Report (SEKU/ARSA/BPS/F-02) which can be downloaded from the University Website.

The Board of Postgraduate Studies wishes you well and a successful research data collection exercise as a critical stage in your Master of Business Administration.

Prof. Felix Ngunzo Kioli
Director, Board of Postgraduate Studies

Copy to: Deputy Vice Chancellor, Academic, Research and Students Affairs (Note on File)
Dean, School of Business and Economics
Chairman, Department of Business and Economics and Entrepreneurship
Director, Kitui Campus
Dr. Kevin Wachira
Appendix III: Questionnaire

Section A: Background Information

1. Indicate your Gender
   1) Male [  ]
   2) Female [  ]

2. Indicate the period of your business operation
   1) Less than one year [  ]
   2) 1-5 years [  ]
   3) 6-10 years [  ]
   4) 10 years and above [  ]

3. What is your highest educational qualification?
   1) Primary education [  ]
   2) Secondary education [  ]
   3) College/University [  ]
   4) None [  ]

SECTION B: LENDER FACTORS

1. What mode of loan repayment do you use to pay your loan?
   1) Direct cash deposits [  ]
   2) Raised standing orders [  ]
   3) Continued Savings deposits [  ]
   4) Electronic money transfers [  ]

   Others, specify……………………………………………………………………………………
   ………………………………………………………………………………………………………

3. Do you think rate of interest structure affects loan default?
   1) Yes [  ]
   2) No [  ]

4. How was the rate of interest structure?
   1) Increasing rate [  ]
   2) Flat rate [  ]
3) Reducing rate [ ]

5. Would you attribute the type of loan collateral to influence loan_defaulting by the SMEs?
   1) Yes [ ]
   2) No [ ]

   Please explain your above answer……………………………………………………………………
   …………………………………………………………………………………………………………………
   …………………………………………………………………………………………………………………
   …………………………………………………………………………………………………………………

SECTION C: LOAN FACTORS

1. Tick the reason for the choice of the financial institution

   1) Convenience to the institution [ ]
   2) Condition given by the institution [ ]
   3) Ease of getting the loan [ ]

2. What was the size of your loan?

   1. 5,000-20,000 [ ]
   2. 20,000-50,000 [ ]
   3. 50,000-100,000 [ ]
   4. 100,000-200,000 [ ]
   5. 200,000-1,000,000 [ ]
   6. Above 1,000,000 [ ]

3. What duration interval do you make your loan repayments?

   1. Weekly [ ]
   2. Monthly [ ]
   3. Annually [ ]

3) Did you repay the loan within the specified time period?

   1. Yes [ ]
   2. No [ ]

3. If No in (4) above what actions did the financial institution take against you for the poor loan repayment?
4. What are some of the reasons for your loan default?

7. Evaluate the extent to which following loan characteristics influence loan repayment by SMEs in Kitui County, Kenya? Use the following scale as appropriate:

1-Not at all; 2- Minimal extent; 3- Moderate extent; 4- Large extent; 5- Very large Extent

<table>
<thead>
<tr>
<th>Loan characteristics</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loan size/amount</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loan repayment period</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Collateral value</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number of installments</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loan application costs</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loan type</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

SECTION D: TYPE OF THE FINANCIAL INSTITUTION

1. Indicate the type of the institution you took your loan from?
   2. Bank [ ]
   3. Non bank institution [ ]

3. State the reason for the choice of the above financial institution

4. In your own opinion do you think the source of credit by SMEs influences loan repayment?
   1) Yes [ ]
   2) No [ ]

If Yes in (2) above, explain briefly
5. How would you rank the following factors as causes of loan default?


<table>
<thead>
<tr>
<th>Loan characteristics</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Untrained bank staff</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inadequate number of staff for loan collection</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lack of aggressive credit collection Methods</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Diversion of loans</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Under-financing</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Banks negligence in monitoring</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

SECTION D: LOAN_DEFAULT?

1. Does the financial institution give a grace period after giving you the loan?
   1) Yes [ ]
   2) No [ ]

3) If yes, for how long
   1. 1 month [ ]
   2. 2 months [ ]
   3. 3 months [ ]
   4. 6 months [ ]
   5. 1 year [ ]
   6. More than 1 year [ ]

7. If no, please explain why?
   ....................................................................................................................................
   ....................................................................................................................................
   ....................................................................................................................................

8. Have you ever missed to pay your installments,
   1. Yes [ ]
   2. No [ ]
9. If yes, for how long?
   1. 1 month [ ]
   2. 2 months [ ]
   3. 3 months [ ]
   4. 6 months [ ]
   5. 1 year [ ]
   6. More than 1 year [ ]

7. If no, please state why
   ..........................................................................................................................
   ..........................................................................................................................
   ..........................................................................................................................

8. Have you ever delayed in payment for your installments,
   1. Yes [ ]
   2. No [ ]

3. If yes, for how long?
   1. 1 month [ ]
   2. 2 months [ ]
   3. 3 months [ ]
   4. 6 months [ ]
   5. 1 year [ ]
   6. More than 1 year [ ]

7. If no, please state why
   ..........................................................................................................................
   ..........................................................................................................................
   ..........................................................................................................................

Thank you for your co-operation

The Researcher
RE: REGISTERED SME’S IN KITUI CENTRAL SUB-COUNTY

Following your request on the number of SME’s in Kitui Central Sub-county, we hereby confirm to you that according to our recent data we have 512 registered SME’s in Kitui Central Sub- county across the five Wards. Further, its only 407 SME’s which have access to credit from financial_institutions by December 2017.

Sincerely
Sharon Munyao
PTO.
Kitui County