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

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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 a 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 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% confidencelevel between the size of loan and loan_default (r=0.335, p=0.003). There was also a weak positive correlation between the loanrepayment interval and loan_default (r=0.240, p=0.033). The relationship between loanrepayment interval and loan_default was significant at 95% confidence level. There was medium correlation and a significantrelationship at 99% confidencelevel 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) ar those loans that ar 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 oneparty to an agreement decides to change his/her behavior tothe disadvantage of the opposite party once the contract hasbeen 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 adverseselection inthe 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

Loandefault 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 developingcountries should be concerned with the high defaultrates in SMEs lending because of its involuntary negative effects on SMEs financing. According to Packer (2012), some of the effects attributed to default in loanrepayment 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 loandefault 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 defaultis usually is like a trade-off whereby he/she has to compare betweenthe penalties in lostreputation from loan_default against the opportunity cost of forgoinginvestments because of workingout the immidiate 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 loanrepayment 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 creditfrom both banks and microfinanceinstitutions. 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, Kyangwitha East, Kyangwithya West,

Miambaniand Mulangowards) out of which, only 407SMEs had access to credit acilities (*Ministry of Trade, InvestmentsandCooperatives, Kitui County*).

1.2 Statement of the Problem

The smalland mediumenterprises have access to credit from thefinancial_institutions i.e. Banks and MFIs. Highdefault rates in SMEs disposal ought to be of major concern to policy manufacturers in developingcountries, owing to its fortuitous negativeimpacts on SMEs funding (Ntiamoah, 2014).. The Bank management report ready by the CBK (2011) urged that the delayed payments and provisioning ofloans, and therefore the high interestrates 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 December2014 to Ksh.147.3 billion inDecember2015.

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 2015to 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 a pair of016 from half-dozen.8 p.c in December 2015. Most of those will increase were related to reimbursement loan_default by SMEs (CBK, 2016).

Loanrepayment 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 financialcondition. Ochung (2013) conducted an investigation to find out the factors associated with loan_defaults of SMEs financed byCooperativeBank in Kangemi and Kawangware areas in Nairobi, Kenya. His study found out thatmajority of SMEs were mainly inhibited by a number of factors which included poor management, irregular income and high competitionfrom the businesses which are well established.

Kibosia (2012) also carried out a study on the causes of the high rates of loanrepayment 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 bySMEs inKitui centralSub-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 inKitui centralSub-county.
iii. To realize the effect of type of the institution onloan_default bySMEs in Kituicentral 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 thelifeblood of mosteconomies round the world which any governmentcannot afford toignore this sector. The findingsof this studyare going to be of nice importance as a result of it investigated the factorsinfluencing 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 loanrepayment by SMEs. The study aimed at establishing the determinants of loanrepayment 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 thefindings of thisstudy, itis 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 commercialbanks, MFI's, SACCOs and others will also benefit from the findings of this study since it has established the majordeterminants of loan repayment. This study has also added onto the already available pool of knowledge on loanrepayment and SMEs. In addition, prospective scholars may use the study as part of their empirical studies.

1.6 Limitations of the Study

Thestudy was restricited 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 factorsinfluencing loandefault by SMEs in KituiCentral Sub-County. The study investigated only three variables and how they impacted on the dependent variables; lender characteristics, loan characteristics, and firm characteristicson loanrepayment 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

Thischapter captures the literature review on the various theories that underpin the factorsinfluencing loan_default by SMEs, conceptual framework and empirical review of the literaturerelevant 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 riskierborrowers have access toriskier comes with lower chance of success however the next come if theysucceed, 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 contractchanges his behaviorto the disadvantage of the opposite partyonce the contract hasbeen 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 mostcases lenders don't seem to be sure that after a loan isadvanced to the receiver (SMEs), it absolutely was usedfor its meantpurpose, orthat the receiver applies the expected amounts of complementary inputs, particularly effort andentrepreneurial talent that is that the basis for the agreement to supply the loan. Ifthese inputs ar but 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 wasdeveloped byAkerlof (1970). This theory argues that party of an economictransaction, should have the adequate knowledgeabout the otherparty to be able to makeaccuratedecisions. The main assumption of this theory is that thecharacteristics of allproducts transacted in the marketshould beequally observed byall agentsor businessrepresentatives. Whensuch assumption fails to hold, i.e. when there is asymmetry of information, prices are distorted and do not achieveoptimality in the allocation of resources. The asymmetry information theory continues to argue that, the market participants often hold this informationasymmetrically(Messai, 2013).

Akerlof (1970) showed however we have a tendency to might get adverse choice within the markets within the presence of informationalasymmetries. 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 SMEmanagers and outsiders posses non-public data regarding the enterprisecharacteristics. the idea conjointly assumes that the borrowers additionally have some important data on the sort of the establishment of come stream or investment opportunities that ar seldom proverbial by the money organizations.

Financial_institutions perceive and ar 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) 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 theirrole as insurersand because the underwriters. {it could|it's going to|it should} be untrue that the insurancepurchasers have superiorinformation; in truth these firms may have higher estimates of a person's health risks than what the individualhimself orherself has.

According to a test conducted by Chiappori (2000) in the Frenchmarket forautomobile insurance, the findings agreed with the conclusions made by Warue (2013). Theasymmetric informationtheories predicted that, amongobservationally identicalindividuals, those with morecoverage were more likely to have moreaccidents. When Chiappori (2000) carried out this test, he found no correlationbetween the unobserved risky states and accident frequency. On critical analysis of the two theories discussed above, it is noted that the theory of moralhazard is inadequate in because it ignores the fact that SMEs are rationalinvestors and they always makethe best investmentdecision.

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. Accordingto the informationasymmetry 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 sectionpresents a brief discussion of the institutional_factors that have been investigated by the previousstudies 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 Tanzaniabecause previous studies and experiences had shown that the many financial_institutions were facing poor loanrecovery. His study used a cross-sectional researchdesign because the study wasconducted only once in point and time. The study used a samplesize 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 unconcealed 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_default 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 loanborrowers from Agro-Bank Asian country. Agro-Bank may be a business establishment specializing in loans toborrowers concerned in agricultural business. aside from givinglarge-scale loans, it conjointly provides small-scale loans like microcreditloans 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 informalrelationship betweenMFIs andborrowers could facilitate in observance and earlydetection of issues which will arise innon-repayment ofloans. 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 betweenNon-performing Loans related to SME sector and its determinantsamong business banks in African nation. The analysis methodologyused was a descriptivesurvey style and therefore the population of was all business banks in national capital region. The population of thestudy 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 thathave an effect onthe 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 targetpopulation of the studywas the highest management of three hundred non-public colleges in national capital County. The study usedstratifiedsampling 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 soughtto investigate thedeterminants of loanrepayment by (SMEs) in Nairobi County, Kenya. The study employed adescriptive researchdesign and a sampleof 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 financialinstitution 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.

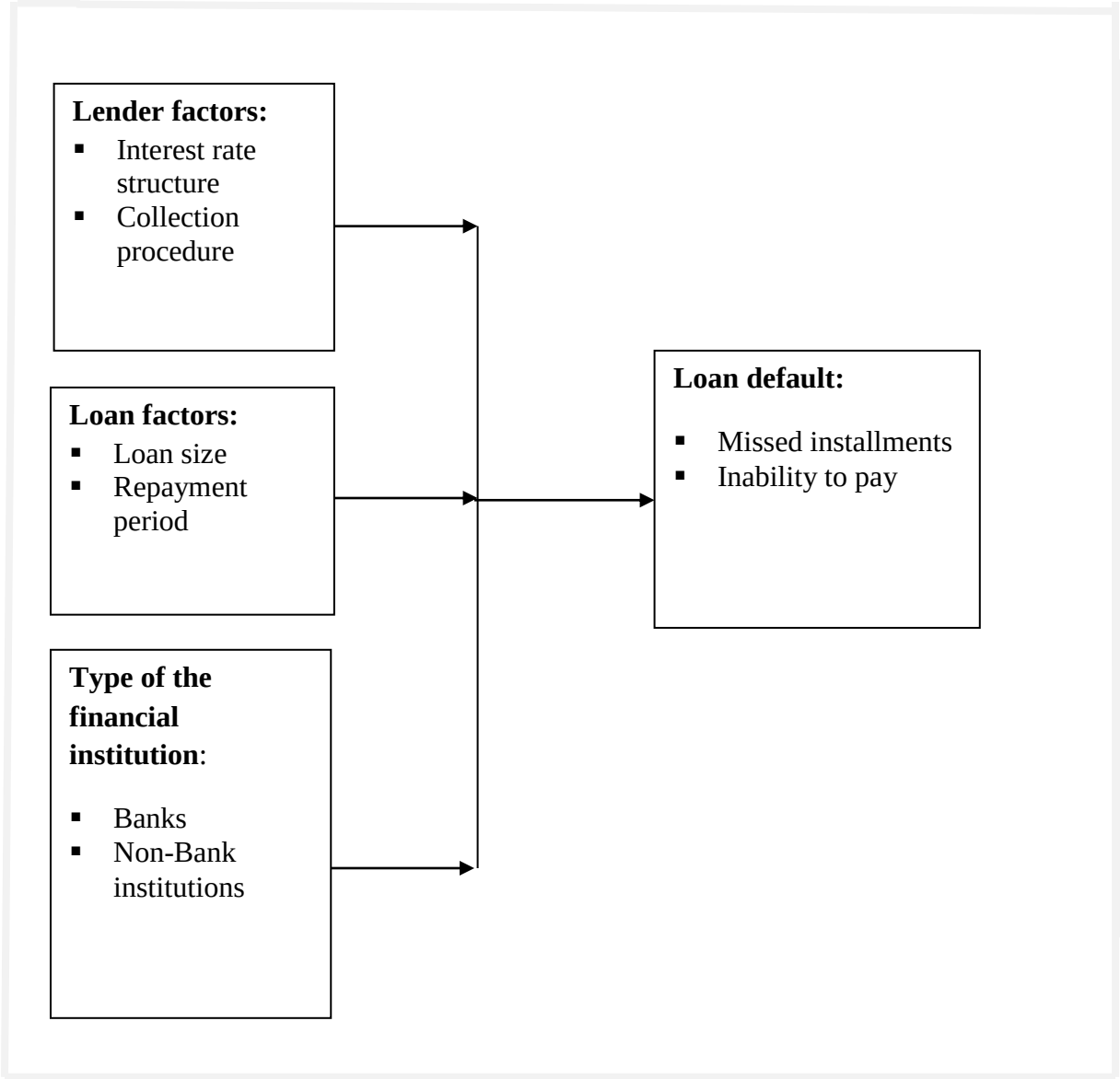
The study used the logit regression to model the determinants of loanrepayment by SMEs in Nairobi County. The study findings established that loan, institutional and lender characteristics are major determinants of loanrepayment by small and medium enterprises in Nairobi County, Kenya. The study concluded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

Naana (2011) conducted a study toinvestigate thedeterminants 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. Thefindings of thestudy supported the assertion that SME loan_default is theoutcome of flawed financial role of banks and flawed public policy regimes.

2.4 Conceptual Framework

A conceptualframework is a product of qualitative process of theorization which interlinks concept that together provides a comprehensiveunderstanding of a

phenomenon or phenomena (Jabareen, 2009). The concepts that constitute a conceptualframework 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; The conceptualframework of this study relates to independent variables; loan factors, lender factors, and type of the financial institution on loan_default



IndependentVariables **DependentVariable**

Figure 2.1: The Conceptual Framework

Source: Author, 2017

CHAPTER THREE

3 METHODOLOGY

3.1 Introduction

This chapterpresents the analysis methodologythat was adopted inconducting thestudy 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 researchdesign 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 ar (Mugenda & Mugenda, 2003). Creswell, (2002) observes that a descriptive analysis style is employed once knowledge ar collected to explain persons, organisations, settings, or phenomena. Descriptive design is ideal as the study was carried out in a limitedgeographical scope and hence was logistically easier and simpler to conduct considering the limitations of thisstudy (Mugenda andMugenda, (2003).

3.3 Target Population

Population refers to 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 resultsof 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 hypotheticsetof individuals, events and objects. The targetpopulation in this study entails of all the registeredSMEs in theSub-county and hadaccess tocredit. KituiCentral Sub-county has 512 registeredSMEs

in and only 407 SMEs have hadaccess to creditfacilities across the fivewards(Ministry of trade, investments andcooperatives, 2016)

Table 3.0 Target Population

Ward	No. of SMEs
Kitui township	179
Kyangwithya west	42
Kyangwitha east	56
Miambani	69
Mulango	61
Total	407

3.4 Sampling Frame

A sampling frame is a convenient list of all units in the population. The sampling frame forms the basic material fromwhich thesample isdrawn (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. Thelistof all SMEs registered within the county in 2017 constituted thesampling frame for thisstudy and was obtainedfrom theMinistry of trade, investments and cooperatives, Kitui County.

3.5 Sample Size and Sampling Techniques

The studyadopted simplerandom samplin method toselect reasonable number ofSMEs to represent the targetpopulation. 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 smallgroup, the variation or heterogeneity that exist in the target population(Mugenda &Mugenda, 2003). According toMugenda andMugenda (2003), in apopulation of lessthan 10,000elements, asample ofbetween 10%-30% of thetarget

population is considered adequate forgeneralization of thefindings to thewhole population.

However, MugendaandMugenda (2003) added that theselected sample size should be comprised of atleast 30 elements. From the Sub-county (acrossall the 5wards i.e. Kitui Township,KyangwithyaWest, KyangwithaEast, Miambaniand Mulangowards) the researcher used a sample of 20% of thetotal 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

Ward	No. of SMEs	20% distribution	sample size
Kitui township	179	0 . 2 * 1 7 9 = 3 5 . 8	36
Kyangwithya	42	0 . 2 * 4 2 = 8 . 4	8
Kyangwithaeast	56	0 . 2 * 5 6 = 1 1 . 2	11
Miambani	69	0 . 2 * 6 9 = 1 3 . 8	14
Mulango	61	0 . 2 * 6 1 = 1 2 . 2	12
Total	407	0 . 2 * 4 0 7 = 8 1 . 4	81

3.6 Data Collection Instruments and Procedures

The study usedprimary knowledge solely. Primary knowledge for thisstudy was collecteddirectly from specificSMEs by useof structuredquestionnaires. 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 feat .The questionnaires contained each open and closed-ended queries. The structured queries were employed in an attempt to conserve time Associate in Nursingd cash additionally on facilitate ineasier analysis as they're in immediate usable kind whereas the unstructured queries were used thus on encouragethe respondentto present an in-depthresponse while not feeling control back in revealingof anydata.

3.7 Ethical Considerations

The researcher handled the data collected with confidentiality. The datacollected from theSMEs weren't altered to satisfy any hidden or personal interest. The researcher also facilitated informedconsent so asto let the respondents know what the research was all about. The respondentswere additionally educated thatthey werefree to exit from the study as theywanted to protect them from any harm, i.e. psychologically or morally.

3.8 Data Analysis

The datacollected for thisstudy was accuratelyscored 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 beencollected and clean. The info from the sector was coded in keeping with the themes studied during this study. A applied math package for socialsciences(SPSS) package twenty four.0v was wont to aid within the analysis. the sort of knowledge analysis toolthat was used trusted the sort of knowledge that was used: qualitativeor quantitative(Walsh &Wigens, 2003).

Quantitativedata was analyzed through the utilization of a mixture of descriptive statisticssignificantly frequencydistributions tables. Correlation and multiple correlation analysis were wont to confirmwhether or not the independentvariables along predict the variable at ninety nine confidencelevel (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). ANOVAand T- tests were accustomed test the importance of the model in measurement the result of financial institution factors and loan_default bySMEs at 99% confidencelevel and 1% significan level.

CHAPTER FOUR

4.0.RESULTS

4.1.Introduction

This chapter contains data presentationanalysis andinterpretation 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 researcheradministered questionnaires to eighty one study participants however 2 of them didn't come their questionnaires therefore N=79 questionnaireswere completedand came. the info collected from the seventy nine questionnaireswas entered andanalyzed to make the premise for thefindings of thisstudy.

4.2.1. Gender of The Study Participants

In this study, 1 represented “male” while 2 represented “female” study participants. Thefindings weresummarized andpresented in table 4.1 below.

Table 4.1: Gender of the Study Participants

		Frequency	Percent	Cumulative Percent
Valid	Male	55	69.6	69.6
	Female	24	30.4	100.0

Thefindings in table 4.1 above revealed that Majority (69.6%) of the studyparticipants were malewhile 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:lessthan 1 year, 2: 1-5 years, 3: 6-10 years and finally 4: 11 years and above. Thefindings weresummarized in table 4.2 below.

Table 4.2: Period of Business Operation

		Frequency	Percent	Cumulative Percent
Valid	less than 1 year	10	12.7	12.7
	1-5 years	31	39.2	51.9
	6-10 years	24	30.4	82.3
	10 years and above	14	17.7	100.0

Majority (39.2%) of the SME had beenin businessoperations for a amount between one and five years whereas the smallest amount range of the studyparticipants had been within the business for fewer than one year. people who had been inbusiness for period of 6-10 yearsand quite ten years were thirty.4% and 17.7% severally.

4.2.3. Level of Education of Study Participants

The researcher also categorized the study participants basedon their level ofeducation; 1: primary, 2: secondary, 3: college/university and 4: None. The findings were summarized in table 4.3 below.

Table 4.3: Level of Education of Study Participants

		Frequency	Percent	Cumulative Percent
Valid	Primary level	14	17.7	17.7
	Secondary level	31	39.2	57.0
	College/University	28	35.4	92.4
	None	6	7.6	100.0

Thestudy findings intable 4.3 revealed that majority (39.2%) of the studyparticipants had secondarylevel of education whereas the smallest amount (7.6%) had not achieved any

primary of education. the first and College/University levelconsisted of 17.7% and 35.4% respectively.

4.2.4. Mode of Loan Repayment

The researcherhad fourmodes of loan repayment: directmoney deposit, raisedstanding orders, continued saving deposits and electroniccashtransfers. The findings of this study on the mode of loan compensation utilized by the studyparticipants weresummarized in table 4.4 below.

Table 4.4: Mode of Loan Repayment

		Frequency	Percent	Cumulative Percent
Valid	Direct cash deposit	47	59.5	59.5
	Raised standing orders	10	12.7	72.2
	Continued savings deposits	13	16.5	88.6
	Electronic money transfers	9	11.4	100.0

The findings in table 4.4 above revealed thatmajority (59.5%) of the studyparticipants useddirectcashdeposit as the mode of loanrepayment while the least (11.4%) used electronic oney transfers. Raisedstanding orders and continuedsavings depositwere used by 12.7% and 16.5% respectively.

4.3. Correlation Analysis

The first objectiveof this studywas to examinethe effect of Lender characteristics on loan_default by SMEs in KituiCentral Sub-county. The lendercharacteristics were measured using mode of loanrepayment and the structure of the rate of interest. The modes of loanrepayment were four: 1: directMoneydeposits, 2: Raisedstanding orders, 3: Continuedsavings deposits and 4: ElectronicCashtransfers. The structure of rate of interest (IR)consisted of 1: Flat Rate and 2: ReducingRate. The studyparticipants were asked t0 state if they hadever failed in payment of their loaninstallments. Their responses wereeither 1 for Yes or 2 for No. Correlation analysiscarried 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 objectivewas to investigatethe effect of loancharacteristics on loan_default by SMEs in KituiCentral Sub-county. The loan characteristics were measured using size of loanand the loanrepayment 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 loanrepayment 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 objectiveof this studywas to find out the effect of type of financialinstitution on loan_default by SMEs in Kituicentral 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 associationbetween the type of financialinstitution and loan_default. The research findings were summarized in table 4.5 below.

Table 4.5: Correlation Analysis

		Loan_default	Mode of loan repayment	Structure of IR	Size of loan	Loanrepayment interval	Type of financial institution
Loan_default	Pearson Correlation	1	.644**	.774**	.335**	.240*	.605**
	Sig. (2-tailed)		.000	.000	.003	.033	.000
Mode of loan repayment	Pearson Correlation	.644**	1	.495**	.271*	.183	.394**
	Sig. (2-tailed)	.000		.000	.016	.106	.000
Structure of IR	Pearson Correlation	.774**	.495**	1	.358**	.137	.468**
	Sig. (2-tailed)	.000	.000		.001	.229	.000
Size of loan	Pearson Correlation	.335**	.271*	.358**	1	.598**	.456**
	Sig. (2-tailed)	.003	.016	.001		.000	.000
Loanrepayment interval	Pearson Correlation	.240*	.183	.137	.598**	1	.350**

	Sig. (2-tailed)	.033	.106	.229	.000		.002
Type of financial institution	Pearson Correlation	.605**	.394**	.468**	.456**	.350**	1
	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 mediumpositive correlation at 99% confidence levelbetween the mode of loanrepayment and loan_default (r=0.644, p=0.000). Since 0.000 is less than 0.01, it was concludedthat there was asignificant relationshipbetween the modeof loanrepayment and loan_default. Thefindings also revealed thatthere was a strong positive correlation at 99% confidencelevel between structure of rate of interest and loan_default (r=0.774, p=0.000). Since 0.000 is less than 0.01 it wasconcluded that there was a significant relationshipbetween the structure of IR and loan_default.

4.3.2. Loan Characteristics and Loan_default

The results in table 4.5 abovesuggested that there was a weak positivecorrelation at 99% confidencelevel between size of loan and loan_default (r = 0.335, p = 0.003). Since 0.003 is less than 0.01, it wasconcluded that there was a significantrelationship between sizeof loan and loan_default. The resultsalso suggested that there was a weak positive correlation at 99% confidence levelbetween 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 relationshipbetween the loanrepayment interval and loan_default. However, the relationship between the loanrepayment interval and loan_default wassignificant at 95% confidencelevel since 0.033 is less than 0.05.

4.3.3. Type of Financial Institution and Loan_default

The findingspresented in table 4.5 above indicated that there was a mediumpositive correlation at 99% confidencelevel betweentype of financialinstitution 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 relationshipbetween the type of financialinstitution and loan_default.

4.4. Coefficients of Correlation

Multiple correlations were alsocarried out to find the relationshipbetween the independent and dependent variables as well as amongst the independentvariables themselves. The findings on the relationshipbetween the independentvariables as presented in table 4.5 suggestedthat there was a significantrelationship at 99% confidencelevel betweenmode of loanrepayment structure of rate of interest and type of financial institution (r = 0.495, p = 0.000) and (0.394, p = 0.000) respectively. However, therelationship betweenmode of loanrepayment and size of loan aswell as loanrepayment interval was significant at 95% confidencelevel (r = 0.271, p = 0.016) and (r=0.183, p=0.106) respectively.

There wasa significantrelationshipbetween th structure of rateof 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 significantrelationship betweenthe structure of rate of interest and loanrepayment interval (r=0.137, p=0.229). There was a significantrelationship at 99% confidencelevel between the size of loan and loanrepayment 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 significantrelationship at 99% confidencelevel between loanrepayment interval and type of financial institution (r=0.350, p=0.002).

4.5.Regression Analysis

The researcherused multiplecorrelation analysis to check the effect of change of independent variables on the dependent variables. The regressionwas used since it could produce an equation that would help in the prediction of the dependentvariables 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 modelsummaries indicated thepredictors of the loan_default.

4.5.1. Model Summary

Themodel outline for the predictors and theircompletely different levels ofpredicting loan_default are as shown in table 4.7 below.

Table 4.6: Model Summary Table

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.861[a]	.742	.724	.264

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

Inview of theresults in table 4.7 above, the R-value of 0.861 indicates a strong positive correlation between the factor influencing loan_default amongSMEs in KituiCentral Sub-county. In view of the coefficient ofdetermination (R-square) of 0.742, the four predictors account for 74.2% ofvariability in loan_default by SMEs in the study area. Table 4.8 below presents coefficients and p-valuesassociated with the study variables.

Table 4.7: Regression Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-.141	.192		-.737	.463
	Mode of loan repayment	.140	.034	.290	4.133	.000
	Structure of IR	.547	.076	.535	7.165	.000
	Size of loan	-.036	.028	-.103	-1.278	.205
	Loanrepayment interval	.097	.086	.085	1.127	.263
	Type of financial institution	.296	.085	.258	3.488	.001

a. Dependent Variable: Loan_default

The regressionfunctionextracted from the table is presentedbelow.

Regression model: $LD = K + \beta_1 LF + \beta_2 LF + \beta_3 IF + \varepsilon$

Missed payment of installments = Loan_default (LD)

Specific Regression Model: LD = -0.141 + 0.140(LF) + 0.547(LF) – 0.036(LF) + 0.097(LF) + 0.296(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(loanrepayment interval) + 0.296(type of financial institution). The regressionanalysis in table 4.8 above shows how a unit change of the independentvariable changes the dependentvariable. The betas for mode of loan repayment,structure of rate of interest, loanrepayment interval and type of financial institution are positiveindicating that every unit increase in any of the four independentvariables would cause a positive change in the dependentvariable with the following quantities: mode of loan payment (0.140), structure of rate of interest (0.547) loanrepayment interval (0.097), and type of financialinstitution (0.296). The beta for the size of loan is negativeindicating that a unit increase in size of loanwould cause a negativechange in the dependent variable in the following quantity: size of loan (0.036).

The summaryin table 4.8 above also shows astatisticalsignificance of eachindependent variable. Mode of loanrepayment, structure of rate of interest and typeof financial institution were found to be statisticallysignificant inexplaining loan_default since p=0.000, p=0.000 and p=0.001 were less that 0.01 respectively. Size of loan and loanrepayment interval were found not to be statistically significant in explaining loan_default since their p-values were 0.205 and 0.263 respectively. Ananalysis of variance was also carried out to test thegoodness of fit with respect to the model overall andsummarized in table 4.9 below

Table 4.8: ANOVA[a] Table

Model	Sum of Squares	df	Mean Square	F	Sig.

	Regression	14.635	5	2.927	42.013	.000[b]
1	Residual	5.086	73	.070		
	Total	19.722	78			

a. Dependent Variable: Loan_default

b. Predictors: (Constant), Type of financial institution, Loanrepayment interval, Modeof loanrepayment, 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 statisticallysignificant. Therefore, mode of loan repayment, type of financial institution, loanrepayment interval, size of loan, and structureof rate of interest have a significanteffect on loan_default in the area of study.

CHAPTER FIVE

5.0.DISCUSSION

5.1.Introduction

This chapterpresents a discussion of the key observations of thisstudy 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 studyparticipants used direct money deposit as theirmode of loan reimbursement. The sectionbelow 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 lendercharacteristics studied, thefindings of this study unconcealed that there was a positiverelationship between themode 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. Thefindings of this study were totally differentfrom 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 thefactors touching loan_default behavior as a result of experiencesshowed 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 urgued 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 creditpolicies, loanrecoveryprocedures, and loan

appraisal method had a major impact on the loan_default rate or loandelinquency prevalence.

In another study administrated by Evusa (2015) on thecauses of loan_default among the purchasers of Equity bank it absolutely was established that the most important factors influencingnonpayment of borrowedloans were each internal and external. The paper recommended that banks' credit policies be reviewed to match the highly volatile economic trends within financialmarkets with a strongemphasis on institutionalappraisals on credit worthiness. According to Hunt (2006) who examined the credit credit assignation technology of lenders and therefore the reimbursement behavior of borrowers at a rural establishment supported 504 sampleobservations, it absolutely was established that modification the loan contract terms by reducing the grace amount on loans and rejectingapplications that had long process times increased the pool of credit worthyborrowers.

5.2.2. Effects of the Loan Characteristics on Loan_default

On the loan characteristicsstudied, the findings of this study revealed that there was a positive relationship between loanrepayment interval and loan_default. This indicated that an increase in the loanrepayment 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 loanrepayment interval is likely to significantly reduce cases of loan_default among the borrowers (Roslan and Karim, 2009).

Roslan and Karim, (2009) on microcredit loanrepayment behavior in Malaysia, also revealed that male borrowers and borrowers who had a longerduration for repayments had a higherprobability 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 borrowersinvolved in non-productionoriented businessactivities such as in the service or thesupport sectors who had training in their particularbusiness and whoborrowed higher loans had lowerprobabilities of defaulting.

However, there was a negativerelationship betweensize of loan and loan_default. The interpretation of this is that an increase in thesize of loan borrowed is likely to decrease cases of loan_default. These findingswere in agreementwith 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 studycarried out by Ibeleme, Okpara and Odionye (2013) on the loan size and repayment performance of sodbuster oil palm producers and processors in Federal Republicof 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 loanrepayment 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 loanrepayment rate.

On loan characteristics, this study only investigated the effect of loanrepayment 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 borrowedhigher loans had lowerprobabilities ofdefaulting.

5.2.3. Effect of Type of Financial Institution on Loan_default

On the type of financialinstitution, the findings of thisstudy revealedthat there was a positiverelationship between the type of financialinstitution and loan_default. The interpretation of this is that the SME borrowers from commercial banks were lesslikely to default the payment of their loan comparedto theircounterparts 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 determinantsamong business banks in African nation, it absolutely was established that Loan_defaults by SMEs has considerably been increasing and variety of determinantsaffected 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 significantlevel of Non-performing loans. The study recommended that commercial banks should put more emphasis on CreditRisk Management and adopt credit scoring in vetting of SMEcustomers loanrequests.

5.3.Summary of The Findings

Considering all the independentvariables used in the study, it was evidentthat, only three variables; the mode of loanrepayment, the structure of rate of interest adopted by the lending institution and type of financialinstitution, were highlyassociated with loan_default. Loanrepayment interval and size of loan were not significantlyassociated with loan_default. Factually, all the lendercharacteristics studied and type of financial_institutions were significantlyassociated with loan_default. None of the loan characteristics were significantly associated with default.

CHAPTER SIX

6.0.CONCLUSIONS AND RECOMMENDATIONS

6.1. Introduction

This sectionpresents the conclusions made in the study and the recommendations derived based on the observations ofthisstudy.

6.2.Conclusions

6.2.1. Effects of Lender Characteristics on Loan_default

On the primary objective, this studyexaminedtheinfluence of the loaner characteristics on the loan_default. Supported the findings of this study, it absolutely was over that there was a major relationship between loaner characteristicsandloandefault. Shift of the mode of loan reimbursement from straightforward to a lot of technologicallyadvanced modes will increase the probabilityofloandefault and the other way around. A amendment of the structure of the rate of interest from flatratetoreducedrate 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 characteristicsonloandefault. Based on thefindings of this study, it was concluded that there was no significantrelationshipbetween the loan characteristics (size of loan size and loanrepayment interval) and loan_default. An increase in loanrepayment 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 thefindingsof thistudy, it wasconcluded that therewas asignificant relationshipbetween the type of financialinstitution 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 firstrecommendation goes to the policymakers such as the CentralBank ofKenya, Creditbureauauthority and other policymakers; there's a desire to developpolicies 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 secondrecommendation goes to the financialinstitutionsthemselves; this studyrecommends that the lendingfinancial_institutions in the studyarea should ought to guarantee enhanced and improvedattention on the client needs as far as lending is concerned. This is specifically when choosing the loanrepayment methods to the customers as well as putting emphasis on credit riskmanagement, training ofstaff and adoption of creditscoring in vettingSMEs customer loanrequests.

The thirdrecommendation goesto the academiciansand the researcherswhere this study suggeststhat there is needfor moreinvestigation into thearea of factorsassociated with loan_default among SMEs in Kenya. . There areseveral 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 factorswhich may influenceloanrepayment or may contribute to loandefault in thestudy and similarareas inKenya.

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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

Our Ref: D61/KIT/20721/2016

DATE: 18h December, 2018

Syomane Felix Sammy
Re g. No. D61/KIT/20721/2016
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 liase 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 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 loanrepayment 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 loanrepayment 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

Loan characteristics	**1**	**2**	**3**	**4**	**5**
Loan size/amount					
Loanrepayment period					
Collateral value					
Number of installments					
Loan application costs					
Loan type					

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 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?

1. Strongly 2. Disagree 3. Neutral 4. Agree 5. Strongly agree

Loan characteristics	**1**	**2**	**3**	**4**	**5**
Untrained bank staff					
Inadequate number of staff for loan collection					
Lack of aggressive credit collection Methods					
Diversion of loans					
Under-financing					
Banks negligence in monitoring					

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

Appendix VI: List of SMEs

THE COUNTY GOVERNMENT OF KITUI

CHIEF OFFICER'S OFFICE KITUI COUNTY

Email:

kituicounty@kenya.go.ke

when replying please quote

P.O Box 33-Kitui

KITUI

COUNTY MINISTRY OF TRADE, INDUSTRY, ICT AND COOPERATIVES

To: Felix Sammy Syomane

South Eastern Kenya University

Date: 4th December, 201 7

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