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Effect of Credit Processes on Financial Performance of Microfinance Institutions in Kenya

Loise Wanjiku Ndirangu

Student, Department of Economics, Accounting and Finance,
Jomo Kenyatta University of Agriculture and Technology, Kenya

Fred Buluma

Lecturer, Department of Economics, Accounting and Finance,
Jomo Kenyatta University of Agriculture and Technology, Kenya

Daniel Wanyoike

Associate Chairman, Department of Entrepreneurship, Technology, Leadership and
Management, Jomo Kenyatta University of Agriculture and Technology, Kenya

Abstract:

Micro-finance institutions are important in banking the low-income earners and advancing credit facilities that enable them to improve their living standards. These institutions help to develop individuals and businesses owned by low income earners especially in third-world countries. However, their financial performance is deterred by the problems of ineffective financial management leading to loss of interest income. According to bank supervision report of the year 2016, loss of loan interest income was detrimental to achievement of profitability goals among micro financial organizations. Due to this situation, there was a need to assess financial performance from angle of processes involved in advancing and repaying loans. The objectives of the study were on aspects of monitoring process of loans, loan appraisal processes and loan policy. Theories reviewed included; agency theory and information asymmetry theory. The researcher used descriptive survey research design targeting the Managing directors, Finance Managers and credit risk managers. Census technique was used to include all the 30 respondents into the study. Data was collected through questionnaire and analyzed using descriptive statistical methods (mainly frequencies and percentages) and inferential statistical techniques (Correlation and regression analysis). The results revealed that the firms ensured that the borrower understood the current payment process of the loan. Similarly, the firm considered the economic conditions before giving loans. The findings also revealed that the firm monitored interest rates behavior and also that the firms monitored central banks conditions on loans. The study recommended that microfinance institutions in Kenya should make the clients understand the loan acquisition and payment processes. The microfinance institutions gave considerations to the economic conditions before giving loans. The study made suggestions for further studies to be undertaken on factors affecting credit policy implementation in lending institutions.

Keywords: Credit Processes, monitoring process, credit appraisal, loan policy, financial performance, microfinance institutions

1. Introduction

Finance is an important phenomenon that leads organizations towards ensuring smooth operations (Gitman, Juchau & Flanagan, (2015). Therefore, firms need efficient and effective financial management to achieve their goals. Financial management is involved in planning and control of organizational financial resources. It is part of overall management of an organization in the area of sourcing of funds and utilization of the same for the purposes of generating returns for the company (Bolton, Chen & Wang, 2011). The practice of financial management determines the way and the level at which microfinance institutions performs financially. It indicates the extent to which the micro-finance goals are achieved. The results are measured against the goals and policies in the business operations of the organization (Ahmed & Malik, 2015).

Provision of loans is the main reason for existence of microfinance institutions (Khavul, 2010). Loans generate a lot of revenue to the microfinance institutions in the form of interest and other charges on loans. This revenue takes a high a percentage of the entire revenue, performance and profitability of financial institutions. Loans, as said, are a double-edged sword. This means that if loans are not well managed it can be a bane to the development of a microfinance institution; this happens when loans become delinquent (Greuning & Bratanovic 2014).When this happens, the performance of the institution is put in jeopardy. This is because when banks have chunks of non-performing loans, it makes it impossible for that institution to grant more loans; in effect reducing the profit level of the said bank and even results to retrenchment of employees leading to unemployment. Loss of interest income can cause financial crisis leading

to eventual collapse of the microfinance bank (Ahmed & Malik, 2015). It is mainly brought up by alteration of terms of credit which contribute to credit risks.

Microfinance institutions create economic opportunities particularly for low-income individuals (Ashta, Couchoro & Musa, 2014). Influence of microfinance is not limited to individual customers' extents to communities as whole through increase access to goods and services. For instance, some lending institutions have ventured into real estate business to provide housing services. Microfinance has performed well in developed countries due existence and application of effective credit processes. Provision of loans is a major activity and main source of income. The interest earnings enable the microfinance to engage in more profitable business that puts their performance on an upward trajectory. To achieve adequate interest income, appropriate credit processes must be put in place (Ali, 2015).

In most developed countries such as United States of America, microfinance institutions have strengthened their credit process by using other more established financial institutions to supply microfinance products (Pedrini, Bramanti, Minciullo & Ferri, 2016). Institutions such as banks have well developed alternative credit scoring which enables microfinance to do better in credit management. They also adhere to the regulatory framework for microfinance and adoption of networks as social collaterals. In Malaysia, microfinance institutions make their customers understand the credit processes through credit advisory services initiatives (Mokhtar, 2011). This enables them to provide adequate microcredit loans which enable customers to engage in viable business to increase household income. However, if customers fail to understand the credit process, the repayment problems arise. It implies that microcredit loans at that point cannot achieve the goals of the microfinance due to problems in repaying loans. Nawai and Shariff, (2012) noted that loan performance was influenced by loan motoring and time taken to disburse the loans and repayment for the same.

Regionally, microfinance institutions play a major role in serving low-income individuals and entities excluded formal banking sector in Africa. Addae-Korankye, (2014) noted that loan size, interest amount, nature of appraisal and monitoring have huge implications on performance micro-loans lending institutions. It was suggested that the high default rates could be minimized through training and evaluation of loan officers. These institutions ought to establish and implement effective policies and monitor them properly. The policies should inform the credit processes for effective financial performance.

Locally, microfinance institutions are meant to provide loan facilities to enable loan income to carry out businesses for their economic benefits. Njeru, (2012) noted that loan delinquency was the main problem facing microfinance institutions. Inability to pay in time is as a result of microfinance institutions specific factors and self-help groups' factor. Their credit management systems are not effective to lead to desirable financial performance. Management practices (securitization of loans, limits of credits and group lending) for credit risks influence performance (Moti et al, 2012). Maritim, (2013) noted that non-committal to loan payments contributed to microfinance banks' failure in Kenya. CBK and Kenya Bankers Association (KBA) has taken some measures to reduce non performing accounts which include listing them as defaulters in the Credit Reference Bureau (CRB) hence showing their defaults history (CBK 2010). The CBK reported non-performing loans increased from 1.8 trillion in June 2014 to 2.2 trillion in June 2015 an increase of 22.1% and the pre-tax profit for the sector increased by 8.0 percent from Ksh.71.0 billion in June 2014 to Ksh. 76.7 billion in June 2015. The bank's Assets maintained 970.1 Billion and liabilities of 2,507.3 Billion which translates to liquidity ratio of 38.7 %. Past studies have confirmed that non-performing Loans affects bank profitability; some studies have failed to confirm existence of effects of nonperforming loans on profitability.

1.1. Statement of the Problem

Microfinance industry contributes to economic wellness of a country by helping the low-income earners to fulfill their financial needs in Kenya (Wangai, 2014). Microfinance institutions depend on the income from the payment of loans advanced to the borrowers for growth. Loan repayment on the other hand depends on the effectiveness of the credit processes in place. Income generation has been hindered by the problems of non-performing loans. Exposure to credit risks has negated the benefits associated with provision of credit facilities to the borrowers (Mishkin & Eakins, 2016). Microfinance institutions have suffered loan defaults significantly reducing the interest income. Furthermore, they get losses of the principal amounts leading to financial crisis in regard to the customer deposits. According to A report by Central Bank of Kenya (CBK, 2016) indicated that consistent rise in amounts of non-performing loans in microfinance institutions was due to inappropriate credit processes. This has adversely affected their financial performance. Financial performance of microfinance institutions is yet to be discussed in relation to credit processes as far as previous research studies are concerned. Gatuhu, (2013) carried out a study on the effect of credit management on the financial performance of microfinance institutions in Kenya. Findings indicated that financial performance of microfinance determines the way a client is appraised, credit risks and loan collection policies. It is against this background that the researcher carried out a study on the effect of credit processes on financial performance.

1.2. Research Objectives

- To find out the effect of monitoring process on the financial performance of microfinance institutions in Kenya.
- To determine the effect of credit appraisal on the financial performance of microfinance institutions in Kenya.
- To assess the effect of the loan policy on the financial performance of microfinance institutions in Kenya.

1.3. Research Hypotheses

- H_{01} : Monitoring processes has no significant effect on the financial performance of microfinance institutions in Kenya

- H₀₂: Credit appraisal has no significant influence on the financial performance of microfinance institutions in Kenya
- H₀₃: Loan policy has no significant effect on the financial performance of microfinance institutions in Kenya

2. Literature Review

Literature review outlines the theoretical review, conceptual framework, review of literature on study variables and empirical review of past related studies.

2.1. Theoretical Review

Theories that are related to the study were reviewed. They include; agency theory and theory of information asymmetry.

2.1.1. Agency Theory

Agency theory as cited by Pandey, (2010) addresses the relationship where agents who are managers are contracted by the principal who are the owners of the company to run business on their behalf. When interests of the agents and owners clash, the agency problem comes. Agency problems make companies to incur agency costs that to some extent affect financial performance. Therefore, financial organizations such as microfinance institutions have to prevent conflicts between managers and agents as much as possible. Establishment and implementation of effective credit processes is a responsibility of the managers. They should do so for the interests of the owners. Risk avoidance and reduction promotes financial performance and this can be contributed by applying appropriate credit processes in microfinance institutions (Dawar, 2014).

Agency theory explains the agency problems arising from conflicts between the managers and the owners. The managers may not apply right credit processes hence leading to loan defaults. This is a loss to the owners and it could have been done deliberately without due consideration for the credit risks (Dawar, 2014). This happens when the interests of shareholders are not prioritized by the managers. However, in the situations of few or no conflicts, the interests of the owners will be prioritized hence the managers will apply most effective credit processes to promote adequate interest income from the loans. Agency Theory was relevant and applicable to the study because the microfinance institutions managers and owners may have different interests. For instance, managers may be corrupted to loan some borrowers without adhering to the credit processes. When such borrowers default, the organization suffers losses because the manager put his or her interest first and did not follow the proper credit procedures.

2.1.2. Theory of Information Asymmetry

Theory of information asymmetry states the entity which is more informed than others in the financial markets is always better placed to negotiate on various transactions (Shehata, 2014). This theory is applied by financial institutions such as micro-finance institutions in the area of interest rates on loans. There is need to have adequate information in the market to inform adjustments to the interest rates according to different economic situations. Accumulation of large amounts of non-performing loans can be attributed to lack of information to guide credit processes in microfinance institutions.

Lack of efficient information can lead to immense risk exposures like non-performing loans in microfinance institutions (Shehata, 2014). Microfinance institutions depend on information in the credit markets to make loaning decisions. If the businesses borrowing from them have more information, they are at a disadvantage based on the rates that they provide loans. Moreover, these organizations operate in competitive environments. Other financial institutions may have more information than them in regard to interest rates. This is a competitive edge against them and their financial performance will be affected based on credit processes used (Moss, Neubaum & Meyskens, 2015).

2.2. Conceptual Framework

A conceptual framework shows the relationship between variables and indicates whether independent variable influence or affect the dependent variable. Figure 1 illustrates how financial performance is related to credit processes (monitoring processes, credit appraisal and loan policy).

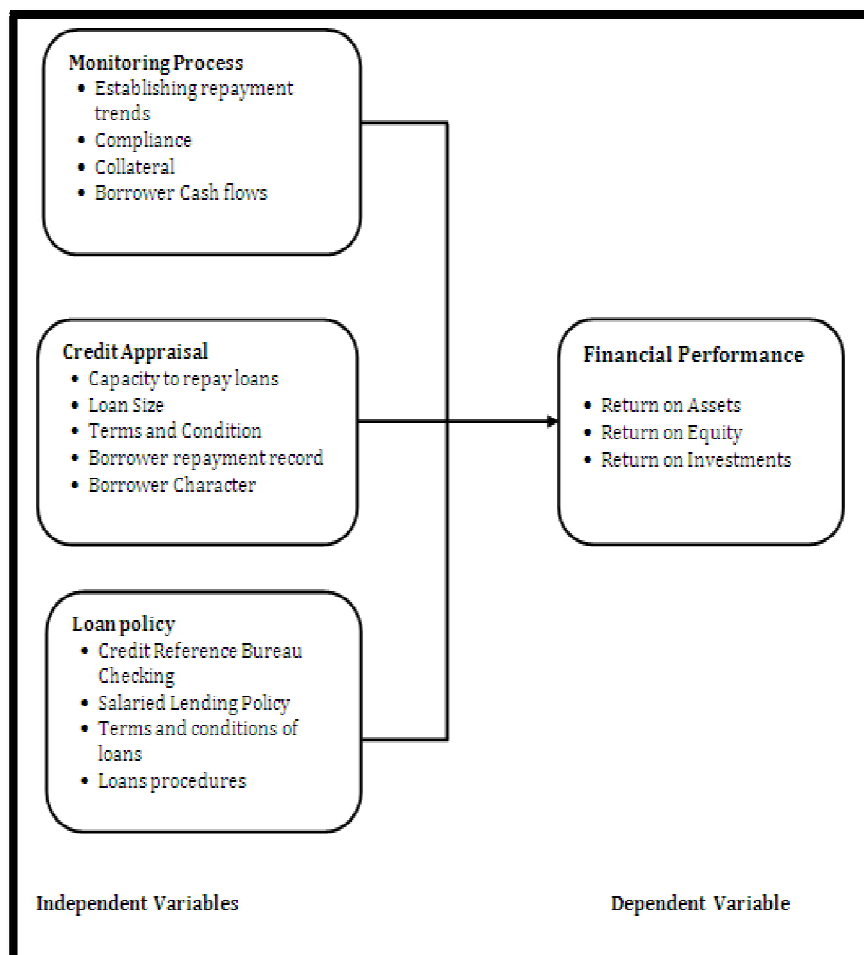


Figure 1: Conceptual Framework

2.3. Review of Literature on Variables

This section discusses all the variables that form the study, showing their relationship with the financial performance. The study variables include; monitoring process, Credit appraisal process, loan policy and financial performance.

2.3.1. Monitoring Process and Financial Performance

According to (Greuning & Bratanovic, 2013) trends in loan repayment determines how financial goals of an organization will be achieved. Monitoring process is a crucial credit process in ensuring that due diligence is done by the loan officers. It is important to understand the financial ability of the borrower through proper monitoring process. Credit loans are structured in compliance with the existing procedures by the microfinance institution. The problem of non-performing loans starts with lack of right monitoring process or ignorance of the available process by the loan officers (Bagchi, 2013).

Monitoring of the borrower cash flows also affects the financial performance microfinance institutions (Agier & Szafarz, 2013). Risk exposure on the part of the borrowers changes with the passage of time and the movements the economic variables. The microfinance should be mindful of this and provide loans with the consideration for the same. Credit administration function appropriately when senior management understands and demonstrates that it recognized the importance of cashflow element of monitoring process (Basel, 2017).

Application of advanced technology in finance make credit processes a success in microfinance institutions (Ahmed & Malik, 2015). It is used to establish cash flow trends hence monitoring of individual credits is effective. Information technology is used for the purpose of analyzing, monitoring and controlling credit in microfinance. This makes it easy for the microfinance to tack the trends of loans in a portfolio. Therefore, microfinance banks ought to develop and implement comprehensive procedures and information systems to monitor the condition of individual borrowers (Basel, 2015).

Credit procedures need to lay out the process for tracking and revealing anomalies on loan facilities. For good financial performance to be achieved in microfinance, all credit transactions should be subjective to frequent monitoring processes for identification and correction of errors (Koford & Tschoegl, 2016). This requires loan officers who are qualified and competent in credit management. This was also noted by Bagchi, (2013) who stated that proper compliance with collateral assessment is fundamental for credit risk management. Marphatia & Jiwari, (2014) noted that monitoring processes helps the microfinance to interact well with the customers. This can impact on the loan repayment due to the fact that the borrower ability is well understood by the microfinance bank. The staff have to possess knowhow on how to monitor the loan processes and identify areas where the risks can arise.

2.3.2. Credit Appraisal and Financial Performance

Credit appraisal determines the worthiness, eligibility and the quantity of funds that the borrower qualifies for in a microfinance institution (King'ori, Kioko & Shikumo, (2017). All borrowers should be taken through the credit appraisal process of the microfinance bank to assure the repayment capacity of the borrower. Failure to conform to this leads to the accumulation of Non-performing loans. Niaz and Azimun, (2015) noted that as a result of rising number of non-performing loans and competition in the banking sector, majority of commercial banks have strongly focused on credit risk assessment, the initial stage is the loan appraisal process. Credit appraisal is one of the major aspects that lending institutions need to enhance performance for interest income generation (Sufi & Qaisar, 2015).

Loan appraisal is conducted for different reasons including the use of appraisal as a selection tool, to quantify risk, to assist in decision making, and also to ensure that there is good quality business with excellent credit worthiness (Mureithi, 2010). The foregoing underpins the importance of credit appraisal process among lending institutions which include commercial banks. The process was found to be also important in addressing non-performing loans which are contributed by long legal procedures and inappropriate evaluation of credit risk. Lack of sufficient supervisions of activities and projects, and also intentional default, and also valuation of credit appraisal model affect performance.

A study by Moti et al., (2012) stated that crucial element for management of credit is efficient customer management and relationship. They noted that failures in repaying credit are caused by loan appraisal processes that not objective and ineffective in microfinance institutions. The problem of non-performing loans can only be addressed through proper appraisal processes focused on history of the customer in repaying loans and the financial ability in terms of income. Failing to consider those aspects of credit appraisal process is detrimental to financial performance of microfinance institution (Moti et al., 2012).

2.3.3. Loan Policy and Financial Performance

Loan policy entails the principles and plans used by financial institutions to advance credit to the customers (Ali, 2015). Loan policy is part of credit processes in microfinance institutions which enable them to make decisions concerning offering loans to the clients and how payments should be made. Loan policy contains the terms and conditions which must be met by the borrower. Gatuhu, (2013) noted that one of the items considered by most microfinance banks is Credit Reference Bureau (CRB) listing. It is within the loan policy that the borrower should have good record in previous loan records. However, microfinance institutions have endured difficult financial situations due to defaults resulting from disregard to loan policies (Ali, 2015).

Financial sustainability shows whether an organization will survive in the turbulent market in the long-term. Sustainable microfinance has effective loan policy that promotes financial performance (Gatuhu, 2013). These policies have to be compatible to the economic market conditions within which the financial institutions operate. Policies on credit facilities are determinants of loan repayments in microfinance banks in the long run. Therefore, the clients should be made to understand the loan policy and make informed decisions on the amount to borrow and repay in adherence to the terms and conditions.

According to Donou-Adonsou and Sylwester, (2015) lenient and unstable credit policies lead to loan defaults. This explains the accumulation of non-performing loans in microfinance particularly in developing countries. Credit management is not taken with seriousness it deserves by some microfinance institutions. Without effective credit management, there is no chance that reliable loan policy can exist. It is through credit management practice that loan policies are created. Unreliable loan policies increase credit risks which in turn affects financial performance negatively.

2.3.4. Financial Performance

Financial performance entails measuring the results from organizational operations against the goals. Performance is weighed in terms of the revenue generated and net income against the targets by the organization (Bassem, 2012). It used to indicate the sustainability and efficiency in the short-term and long-term. Credit processes are fundamental as far as financial performance is concerned. They are highly associated with income generation of the microfinance institutions. Interest income is a major source of income that depends on the credit processes. Monitoring process involves following up on the loans from the time they are provided to the time they are repaid.

Inappropriate monitoring process hinders repayment and as a result, the financial performance is negatively affected in microfinance. The funds given out as loans are the owners funds (Adebimpe, Ikechukwu & Okafor, 2010). Revenue in terms of interest income can be termed as return on equity since it was obtained from the shareholders' funds. Therefore, return on assets (ROA) is an indicator of financial performance of microfinance. Return on Equity is measured on percentage basis. It is the ratio of the net income to the total shareholders' equity. Microfinance institutions have income generating assets. For example, the loans are assets on the books of the microfinance. The returns generated from loans and other assets are known as Return on Assets and indicate the level of financial performance. Return on Assets is the ratio of the net income to the total assets (Moshi, 2016).

The main aim of microfinance institution is to make profits. Higher levels of profits indicate higher levels of financial performance. The profitability is also measured in terms of the ROA and ROE. Low levels of ROA and ROE indicates that the microfinance is performing poorly (Wanjiru, 2013). It is necessary to carry out effective credit appraisal to promote better financial performance. In order to generate enough interest returns, the borrowers have to be appraised well. There should be no doubt concerning the payment ability of the individual or entity. It is upon this appraisal that the credit should be approved for better performance to be achieved. ROE and ROA also depends on the loan policy of the microfinance. The practice and policies that guide the way loans are managed is very important. Failure to adhere to the

policy can jeopardize the repayment since the credit process will have been violated leading to inadequate financial performance (Al-own & Alhadab, 2017).

2.4. Empirical Review

The researcher has reviewed past empirical studies related to monitoring process, loan appraisal process and loan policy. It was done to identify relevant gaps that needed to be filled. A study by Njeru, (2012) on factors influencing late payment of loans and failure to honor loan contractual obligations revealed that lack of understanding the operation of self-help groups contributed to loan delinquency in microfinance institutions. This has strong effect on financial performance. The regression analysis findings indicated that the association between the loan delinquency and financial performance had a t-value of 3.097 which was statistically significant. Therefore, according to their findings, microfinance institutions and self-help groups influenced loan delinquency hence performance.

A study by Addae-Korankye, (2014) sought to establish the causes and control of loan defaults in Ghanaian microfinance industry. During the time of undertaking the study, these institutions were not performing well financially. It was established they lacked proper loan monitoring processes and that they were no reliable procedures for granting loans. The borrowers were not well appraised yet their loans were approved. The interest on loans was too high hence most borrowers ended up defaulting since they were not able to repay. This means that there were no proper credit processes for monitoring and appraising customers.

Gatimu, (2015) analyzed the institutional factors contributing to loan defaults. He found that loan repayment failed due to inappropriate credit policies, poor recovery procedures wrong credit appraisals. These factors had a significant influence on the loan default rate among micro-finance institutions in Kenya. Micro-finance institutions had not taken interest in them thus the study attributed inadequate performance to them. Kodongo and Kendi, (2013) carried out a comparative study between individual lending and group lending. They used data from microfinance institutions in Kenya to do evaluation. They aimed to establish which method of acquiring loans was most preferred by microfinance. The findings indicated that most cases of default cases were from individual lending than group lending. Therefore, group lending was preferred to individual lending. It promotes financial performance through interest payments than individual lending. The study was about lender preference in regard to individual and group borrowing. The current study was about monitoring process, appraisal and policy effects on financial performance.

Gatuhu, (2013) sought to establish how management of credit in microfinance institutions influenced their financial performance of microfinance institutions in Kenya. The factors that were analysed included; appraisal of the borrower, control of credit risk and the policies applied in loan collections. Findings maintained that appraising the clients before granting loans was important loan defaults were attributed to lack of proper appraisal. Moreover, he found that control mechanisms and policies for credit affects financial performance of microfinance banks. Waweru and Spraakman, (2012) investigated performance measures by selected Kenyan microfinance institutions. The results revealed that performance measures used are developed based on the nature of business engagement. The output measures are used more than process measures. This major focus may not be on the credit processes but the returns yielded by the loan despite the fact that the returns depends on the success of the processes. They noted that clients are more interested in performance measurement in regard to loan guarantee in situations where a member of a group is borrowing. The current study analyzed the effect of credit processes on financial performance.

3. Research Methodology

Research methodology outlines the research design, target population, sample size and sampling technique, data collection instruments, pilot test and data analysis and presentation.

3.1. Research Design

According to Meyers, Gamst & Guarino, (2016) research design states the framework under which a research study is carried out. It indicates the type of research being undertaken. The researcher utilized descriptive research design. This design assisted in describing the credit processes and financial performance through depicting the respondents accurately. It also helped in collection of detailed information for analysis. Descriptive research design is suitable for research studies based on actual views of the respondents. Due to this fact, the researcher was able to validate the findings from the study (Schwartz-Shea & Yanow, 2013).

3.2. Target Population

According to Jonker and Pennink, (2010) population refers to the well-defined individuals or groups that have similar characteristics. Target population is the total number of people or individuals as whole from where the researcher draws and generalises the conclusions of the research study. The targeted respondents should possess useful information for the study. The study targeted the managing directors, finance managers and credit risk managers from Faulu, Kenya Women Finance Trust (KWFT) and Rafiki microfinance institutions in Kenya. These individuals are deemed to possess information in regard to credit processes and financial performance of their institutions. The targeted population was composed of 30 respondents from the three microfinance institutions. They were composed of 3 managing directors, 10 finance managers and 17 credit risk managers.

3.3. Sample Size and Sampling Technique

Sample size refers to the number of units that are chosen or selected from population and data is collected (Walliman, 2017). Sample should adequately represent the whole population. Sampling involves choosing elements to

represent the whole population. The study adopted census technique. All 30 directors, finance managers and credit risk managers were included into the study. A population of 30 individuals was small and manageable hence it was possible to engage all of them in carrying out the study.

3.4. Data Collection Instruments

The tools that a researcher employs in order to obtain study data are referred to as research instruments (Houy, Fettke & Loos, 2010). This study employed closed-ended questionnaire, which is also referred to as structured questionnaire to gather data for this study. Structured questionnaire involves the use of questions with possible answers to the questions that saves time for the study respondent in responding to the questions (Houy, Fettke & Loos, 2010). Structured questionnaire is able to gather more data from respondents in a quicker manner as was desired in this study due to limited time allocated for research work by the university.

3.5. Pilot Test

Pilot test is carried out in preparation for the final study to determine the reliability and validity of the data collection instrument (Walliman, 2017). 10% of the study sample size was used for the preliminary study.

3.5.1. Reliability of the Data Collection Instrument

According to Walliman, (2017) an instrument is consistent if similar results are given after different tests. (Drost, 2011) noted that Cronbach alpha is suitable for measuring reliability. Therefore, the research used Cronbach alpha ranging from 0-1 values. All values exceeded 0.7 meaning that the questionnaire would give reliable results for the study. Reliability test results are shown on Table 1.

Variables	Test Items	Alpha Value
Monitoring Process	8	0.794
Credit Appraisal	5	0.801
Loan Policy	8	0.779

Table 1: Results of Reliability Test

3.5.2. Validity of the Data Collection Instrument

Fraenkel and Wallen, (2016) observed that an instrument may be constructed to measure a number of things hence the validity of such instrument must be established. Grinnell, (2014) observed that the pretest of research instruments is more concerned with the difficulties respondents face in answering the questions. It was further advocated that before testing the instruments, it was important to define the variables to be measured and asked the supervisor to evaluate the content which was approved.

3.6. Data Analysis and Presentation

Data analysis means cleaning and transforming data to obtain the information that is useful for interpretation and presentation. The researcher used Package for Social Sciences (SPSS) to aid data analysis. It used descriptive statistics that included frequencies, percentages, means and standard deviations and inferential statistics applying correlation and multiple regression analyses. These involved descriptions and establishing of relationship between variables. The results of the analyses were presented through tables and figures. The following multiple regression model was adopted.

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

Where;

Y represents Financial Performance as measured by ROE and ROA.

β_0 represents the regression model Constant

X_1 represents Monitoring Process

X_2 represents Credit Appraisal

X_3 represents Loan Policy

ε represents error term

4. Research Findings and Discussions

This section outlines the descriptive and inferential findings of the study their discussions and interpretations

4.1. Descriptive Findings

Credit processes have been described to find out their effect on financial performance. Findings are discussed and presented in tables. Items described include; monitoring process, credit appraisal, loan policy and financial performance.

4.1.1. Descriptive Analysis for Monitoring Process

The researcher wanted to obtain respondents views on monitoring process and Table 2 shows the statistical results in details.

Statements	SA (%)	A (%)	N (%)	D (%)	SD (%)	Mean	Std. Dev
The microfinance institutions ensure that the borrower understands the current payment process of the loan.	43.0	32.9	16.5	7.6	0.0	4.11	.947
The microfinance institutions consider the economic conditions before giving loans.	40.5	46.8	8.9	3.8	0.0	4.24	.772
The firm monitors interest rates and behavior.	36.7	25.3	24.1	11.4	2.5	3.82	1.130
The microfinance institutions monitor central banks conditions on loans.	35.4	32.9	21.5	10.1	0.0	3.94	.992
The microfinance institutions monitor the trends of different borrowers in loan repayment.	44.1	44.2	4.1	6.5	1.3	3.63	1.064
The microfinance institutions ensure that the borrower comply to the requirements and terms of the credit.	36.7	39.2	20.3	3.8	0.0	4.09	.850
Microfinance institutions ensure frequent contact with borrowers.	40.5	55.7	3.8	0.0	0.0	4.37	.559
The microfinance institutions monitor the flow of the borrower's business through the bank's account.	40.5	45.6	11.4	2.5	0.0	4.24	.755

Table 2: Descriptive Statistics for Monitoring Process

The study established that 43% of the respondents strongly agreed (mean = 4.11; Std. dev = 0.947) that their microfinance institutions ensure that the borrower understands the current payment process of the loan and admitted (mean = 4.24; Std. dev = 0.772) by 87.3% that the microfinance institutions considers the economic conditions before giving loans. Furthermore, they at least agreed (mean = 3.82; Std. dev = 1.130) that the micro finance monitors interest rates and behavior and also concurred (mean = 3.94; Std. dev = 0.992) that the firm monitors central banks conditions on loans. Findings also indicated that respondents had differing opinions (mean = 3.63; Std. dev = 1.064) on whether microfinance institutions monitor the trends of different borrowers in loan repayment. Furthermore, the findings showed that 36.7% and 39.2% of respondents strongly agreed and agreed respectively (mean=4.09; Std. dev = .850) that the microfinance institutions ensure that the borrower comply with the requirements and terms of the credit. Moreover, it was concurred (mean = 4.37; Std. dev = .559) that the microfinance ensures frequent contact with borrowers. It was also admitted (mean = 4.24; Std. dev = .755) by 86.1% of the respondents that the firm monitors the flow of the borrower's business through the bank's account. Based on the descriptive findings, it can be implied that indeed the monitoring processes in the loan acquisitions and repayment affects financial performance of microfinance institutions in Kenya. Most of the respondents strongly agreed and agreed with statements based on indicators of monitoring process. It can be stated that inappropriate processes can lead to poor performance in microfinance institutions. Repayment for loans depends on the borrower understanding of the process where monitoring action belongs for better repayment and hence good financial performance.

4.1.2. Descriptive Analysis for Credit Appraisal

The researcher sought to find out the effect of credit appraisal on financial performance of microfinance institutions. Descriptive findings for credit appraisal are shown on table 3.

Statements	SA (%)	A (%)	N (%)	D (%)	SD (%)	Mean	Std. Dev
The microfinance institution assesses the repayment capacity of the borrower.	49.4	43.0	6.3	1.3	0.0	4.41	.670
The microfinance institution assesses the borrower's character, reputation or track record for repaying debts.	46.6	50.6	2.5	0.0	0.0	4.44	.549
The microfinance institution considers the capital the borrower puts toward a potential investment.	36.7	39.2	20.3	3.8	0.0	4.09	.850
The microfinance institution considers the collateral against the loan applied.	53.5	42.7	3.8	0.0	0.0	4.22	.714
The microfinance institution Conditions to how a borrower intends to use the loan.	35.5	50.6	13.9	0.0	0.0	4.34	.855

Table 3: Descriptive Statistics for Credit Appraisal

The findings of the study shown on table 3 indicate that 49.4% and 43% of respondents strongly agreed and agreed respectively (mean= 4.41; Std. dev = 0.670) that the microfinance institution assesses the repayment capacity of the borrower and also 46.6% and 50.6% strongly agreed and agreed respectively (mean = 4.44; Std. dev = 0.549) that their microfinance institution assesses the borrower's character, reputation or track record for repaying debts. Additionally, 75.9% stated that their institutions consider the capital the borrower puts toward a potential investment and also strongly agreed (mean = 4.22; Std. dev = 0.714) that collateral against the loan applied was a factor of major consideration. 50.6% agreed (mean = 4.34; Std. dev = 0.855) that the microfinance institution conditions to how a borrower intends to use the loan. According to the descriptive findings, the credit appraisal in microfinance institutions affects their financial performance. The conditions pertaining collateral and history of the borrower are some of the factors considered when appraising loans. Lack of proper appraisal can lead to lending to unqualified borrower who has high degree of default thus contributing to loss and poor financial performance. Therefore, ineffective loan appraisals have been confirmed to have partly contributed to non-performing loans in Kenyan Microfinance institutions.

4.1.3. Descriptive Analysis for Loan Policy

The researcher sought to find out the effect of credit appraisal on financial performance of microfinance institutions. Descriptive findings for loan policy are presented on table 4.

Statements	SA (%)	A (%)	N (%)	D (%)	SD (%)	Mean	Std. Dev
As one of our policy we check credit reference bureau record of our loan applicants	52.2	35.1	6.4	5.2	1.1	3.45	1.068
Our microfinance institution embraces salary check of system.	38.5	37.4	21.0	3.1	0.00	4.61	.991
Our borrowers have to meet us Loaning terms and conditions.	30.2	49.3	12.7	6.5	1.30	3.56	1.072
Our microfinance institution follows the loaning procedures to the later.	41.8	39.2	3.8	15.2	0.0	4.08	1.035
Our microfinance recovers our loans through direct debits.	30.7	57.9	7.8	3.6	0.0	4.48	.888
Our credit policy is well implemented to deal with credit risk management.	31.5	41.9	11.4	8.1	7.1	3.75	1.068
The microfinance institution has stringent credit policies on the loan default.	40.5	35.4	19.0	5.1	0.00	4.11	1.891
The policy of the microfinance institution affects financial performance.	35.2	29.4	23.7	10.5	1.30	3.76	1.235

Table 4: Descriptive Statistics for Loan Policy

Study findings showed that 52.2% of the respondents strongly agreed (mean = 3.45; Std. dev = 1.068) that their microfinance institutions have incorporated credit reference bureau in their loan policy to check record of r loan applicants. Majority (75.9%) also concurred that the microfinance institution embraces salary check of system. However, respondents were indifferent (mean = 3.56; Std. dev = 1.072) that the borrowers have to meet the loaning terms and conditions but 41.8% strongly admitted that their microfinance institutions follow the loaning procedures to the later. Moreover, 57.9% concurred that their microfinance recovers the loans through direct debits and had differing opinions

(mean = 3.75; Std. dev = 1.068) on whether credit policy was concerned with approaches to implementation of long-term and short-term strategies of risk management. Majority of the respondents agreed (mean = 4.11; Std. dev = 1.891) that the microfinance institution has stringent credit policies on the loan default and were indifferent (mean = 3.76; Std. dev = 1.235) that the policy of the microfinance institution affect performance. Considering the descriptive findings of the study, the practices and procedures regarding the loans in microfinance institutions in Kenya determine their success or failure. Findings have revealed that the loan policy determine the financial performance based on the repayments. Ineffective loan policies lead to high rates of defaults and delinquency hence deterring effective financial performance in microfinance institutions.

4.2. Inferential Findings

This section presents the findings of the inferential analysis and pertinent discussions on relationship between the various component of credit processes (monitoring processes, credit appraisal and loan policy) and financial performance. Correlation analysis and multiple regressions analysis were applied.

4.2.1. Correlation Analysis between Monitoring Processes and Financial Performance

The researcher correlated the process of monitoring credit and financial performance. Table 5 shows the results.

Monitoring Process	Financial Performance	
	Pearson Correlation	.462**
	Sig. (2-tailed)	.000
	N	22

Table 5: Correlation between Monitoring Processes and Financial Performance

*. Correlation Is Significant at the 0.05 Level (2-Tailed)

Correlation analysis shows that the relationship between monitoring processes and financial performance was positive and statistically significant ($r = 0.462$; $p < 0.05$). Therefore, monitoring process affected financial performance of microfinance institutions. Lack of proper monitoring process causes defaults and loan delinquencies that hinder desirable financial performance. It also implied effective financial performance was dependent on enhancement of monitoring processes.

4.2.2. Correlation Analysis between Credit Appraisal and Financial Performance

The researcher sought to establish relationship between the Credit Appraisal and Financial Performance. The results are shown on table 6.

Credit Appraisal	Financial Performance	
	Pearson Correlation	.780**
	Sig. (2-tailed)	.000
	N	22

Table 6: Correlation between Credit Appraisal and Financial Performance

*. Correlation Is Significant at the 0.05 Level (2-Tailed)

The findings indicated in Table 6 show that there existed a positive and statistically significant relationship between credit appraisal and financial performance in microfinance institutions in Kenya ($r = 0.780$; $p < 0.05$). It means that credit appraisal affects microfinance institutions' financial performance. Ineffective appraisal qualifies the wrong clients that end up defaulting on loans and subjecting then institution into losses hence poor performance. It also implies that good financial performance is highly dependent on effectiveness of credit appraisal on the borrower.

4.2.3. Correlation Analysis between Loan Policy and Financial Performance

Correlation analysis was performed to establish whether financial performance was associated with loan policy. Table 7 shows findings.

Loan Policy	Financial Performance	
	Pearson Correlation	.328*
	Sig. (2-tailed)	.028
	N	22

Table 7: Correlation between Loan Policy and Financial Performance

*. Correlation Is Significant at the 0.05 Level (2-Tailed)

The findings as illustrated in Table 7 showed that there existed a positive and statistically significant relationship between loan policy and financial performance in microfinance institutions ($r = 0.328$; $p < 0.05$). The foregoing correlation results implied that greater adherence to loan policies was likely to result in moderate enhancement in performance.

4.2.4. Multiple Regression Analysis

Multiple regressions carried out to show whether financial performance could have been predicted from variations in the credit processes. Table 8 shows the model summary with correlation coefficient **R** and coefficient of determination R^2 .

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.761 ^a	.579	.514	.29113

Table 8: Regression Model Summary

a. Predictors: (Constant); Monitoring Process, Credit Appraisal, Loan Policy

b. Dependent Variable: Financial Performance

The results of the foretasted correlation as outlined in Table 4.10 were also found to be significant. The results illustrated by the coefficient of determination ($R^2 = 0.579$) meant that 57.9% of financial performance could have been explained by the studied elements of credit processes.

Model	Sum of Squares	df	Mean Square	F	Sig.
1 Regression	5.541	3	1.847	8.252	.000 ^a
Residual	2.016	18	.112		
Total	7.557	21			

Table 9: Analysis of Variance (ANOVA)

a. Predictors: (Constant), Monitoring Process, Credit Appraisal, Loan Policy

b. Dependent Variable: Financial Performance

Table 9 shows that the model with all the factors was fit for the study after analysis of variable. The F statistic value ($F_{3,18} = 8.252$; $p < 0.05$) was significant. Therefore, all independent variables (credit processes) taken together significantly affected the financial performance of Microfinance institutions.

Model	B	Unstandardized	Standardized	t	Sig.
		Coefficients	Coefficients		
		Std. Error	Beta		
1 (Constant)	.902	.515		1.753	.086
Monitoring Process	.394	.141	.842	3.922	.010
Credit Appraisal	.452	.096	.791	4.715	.000
Loan Policy	.517	.211	.427	2.454	.019

Table 10: Results for Overall Model

a. Dependent Variable: Financial Performance

The study as shown in Table 10 illustrates three distinct but related statistical results. Generally, the indicated results were in tandem with the following regression model. The results indicated the suitability of the regression model which was interpreted as follows.

$$Y = 0.902 + 0.394X_1 + 0.452X_2 + 0.517X_3 + 0.515$$

The researcher applied t-statistic test because it is suitable for small populations or samples. The study population was 30 respondents thus t-test fitted in well. The results shown on Table 4.12 implied that a change of 1 unit in financial performance was subject to a change of 0.394unit in monitoring processes, 0.452unit in credit appraisal and 0.517unit in loan policy while at the same time holding other factors (0.902) constant. The findings further indicated that loan policy (0.517) were the most important element of credit processes. In essence, while holding all other factors (including the variables) constant, 0.394 unit in monitoring processes would result in 1-unit change in financial performance; 0.452 unit in credit appraisal would result in 1-unit change in financial performance; 0.517 unit in loan policy would result in 1-unit change in financial performance.

4.2.5. Hypotheses Testing

The results of the t-test statistics were employed to address the null hypotheses. The null hypothesis in table 11. t-test was used since the current study population is below 30.

Null Hypotheses	Accept/Reject	Decision Rule	Conclusion
H ₀₁ : Monitoring process has no significant effect on the financial performance of microfinance institutions in Kenya	Reject	t=3.922; p < 0.05	There was a relationship between monitoring processes and financial performance
H ₀₂ : Credit appraisal has no significant influence on the financial performance of microfinance institutions in Kenya	Reject	t = 4.715; p < 0.05	It was concluded that there exists significance relationship between credit appraisal and financial performance
H ₀₃ : Loan policy has no significant effect on the financial performance of microfinance institutions in Kenya	Reject	t = 2.454; p < 0.05	It was concluded that there exists significance relationship between loan policy and financial performance

Table 11: Hypothesis Testing

5. Summary of the Findings

Summary of findings was made on the monitoring processes, credit appraisal and loan policy according to the study objectives.

5.1. Summary of Monitoring Process

Study findings revealed that monitoring processes in the loan acquisitions and repayment affects financial performance of microfinance institutions in Kenya. Most of the respondents strongly agreed and agreed with statements based on indicators of monitoring process. The study findings established that 43% of the respondents strongly agreed (mean = 4.11; Std. dev = 0.947) that their microfinance institutions made their customer understand the loan payment processes. 87.3% of the respondents admitted (mean = 4.24; Std. dev = 0.772) by 87.3% that microfinance institutions takes into account the prevailing economic conditions when advancing loans. Furthermore, they at least agreed (mean = 3.82; Std. dev = 1.130) that the microfinance institutions monitor interest rates and behavior and also concurred (mean = 3.94; Std. dev = 0.992) that the firm monitors central banks conditions on loans. Findings also indicated that respondents had differing opinions (mean = 3.63; Std. dev = 1.064) on whether microfinance institutions monitor the trends of different borrowers in loan repayment. Based on correlation analysis results, relationship between monitoring processes and financial performance was positive and statistically significant ($r = 0.462$; $p < 0.05$). This implied that lack of proper monitoring process led to defaults that hindered desirable financial performance. Regression analysis results led to rejection of first null hypothesis. The t-value=3.922 was significant at 95% confidence level. Therefore, financial performance was affected by monitoring process.

5.2. Summary of Credit Appraisal

According to the study findings, the credit appraisal in microfinance institutions affects their financial performance. It was deduced that lack of proper credit appraisal contributed to inadequate financial performance in microfinance institutions. 49.4% and 43% of the respondents strongly agreed and agreed respectively (mean= 4.41; Std. dev = 0.670) that their microfinance institutions make assessment of the borrower ability to repay loan before giving the same. Furthermore, 46.6% and 50.6% strongly agreed and agreed respectively (mean = 4.44; Std. dev = 0.549) that their microfinance institution considered the reputation and character of the loan borrower. Moreover, 75.9% of the respondents revealed that their institutions consider the capital the borrower puts toward a potential investment as part of credit appraisal. Correlation analysis indicated that the relationship between credit appraisal and financial performance was positive and statistically significant ($r = 0.780$; $p < 0.05$). That meant that microfinance institutions' financial performance was affected by the appraisal of the loan borrowers. The regression analysis results meant that second null hypothesis was rejected as t-value= 4.715 was significant at 95% confidence level. This implied that changes in credit appraisal affected changes in the financial performance of microfinance institutions in Kenya.

5.3. Summary of Loan Policy

Findings of the study indicated that practices and procedures regarding the loans are key determining factor in microfinance institutions; financial performance. As such, ineffective loan policies lead to poor performance portrayed by high rates of defaults and loan delinquency. 52.2% of the respondents strongly agreed (mean = 3.45; Std. dev = 1.068) that their microfinance institutions use credit reference bureau as practice in their loan policy to check record of applicants before advancing loans. 75.9% strongly agreed and concurred that their microfinance institutions embraced salary check off system and was part of their loan policy. However, most respondents were indifferent (mean = 3.56; Std. dev = 1.072) that the borrowers had to meet the loaning terms and conditions. This meant that they had differing views concerning terms and conditions which are generally crucial in loan repayments. The issue of loan policy had fundamental implications on financial performance based on the correlation analysis findings. Correlation analysis indicated a positive and statistically significant relationship between loan policy and financial performance ($r = 0.328$; $p < 0.05$). It showed that loan policies influence financial performance. Based on regression analysis results, third null hypothesis was rejected since t-value=2.454 was significant at 5% significance level hence financial performance was determined by loan policy of microfinance institutions.

6. Conclusions

Conclusions were made by the researcher based on the summary of major findings of the study. They were made based on study.

6.1. Monitoring Processes

It can be concluded that monitoring processes in the loan management by microfinance institutions influence the financial performance. The understanding of process of paying the loan is important. The cases of increased non-performing loans are caused by ineffective monitoring process in microfinance institutions. The process ought to consider the economic conditions and ensure that they are accounted for in the monitoring and giving loans to the customers. Lack of proper consideration for economic conditions can lead problems on cost of loan if the microfinance institutions attempt to adjust charges on loans against the wish of the borrower. Financial performance also depends on the monitoring of the trends of different borrowers in loan repayment. Failure to ensure that borrower comply with the requirements and terms of the credit negatively affects financial performance. Moreover, the microfinance institution has to frequently contact borrower to enhance good relationship that can assist in repayment of loans.

6.2. Credit Appraisal

In conclusion, it can be stated that the effect of credit appraisal is felt in the microfinance institutions' financial performance. These organizations used the funds contributed by shareholders and returns on the same funds are the Returns on Equity. ROE indicate the level of financial performance of microfinance institution. The findings indicated that the capacity of the borrower to repay determines the amount of revenue that the microfinance institution will earn as interest income. The loans provided by the microfinance are their assets and the interest is the return on assets. Therefore, if the borrower has the capacity to pay, the level of income from the side of interest on loans will increase thus increase on ROA hence financial performance. The approval on capacity to pay is crucial to microfinance institutions. Inability to assess the borrower's character, reputation and track record for repaying debts has hindered financial performance of microfinance institutions. Improper consideration for collateral against the loan applied and use for the loan works effective financial performance.

6.3. Loan Policy

It can be concluded that the policies that guide provision and payment of loans in microfinance institutions affect financial performance. It is through policy frameworks that they check credit reference bureau record of their loan applicants before giving loans. However, policies are not always followed and the consequences are failure to pay hence poor performance. Loan policy also advocates for consideration of the nature and source of income of the borrower. Therefore, microfinance embraces salary check of system. Study findings revealed that the borrowers have to meet the loaning terms and conditions in regard to their salaries. Credit policy is effective if it can deal with short-term implementation as well as long term approach to credit risk management.

7. Recommendations

The following recommendations were made from conclusions of the study;

- The study recommended that microfinance institutions in Kenya should ensure that the borrower understands the current monitoring process and payment of the loan. They should give considerations to the economic conditions before giving loans. They should also monitor the interest rates and behavior of the borrowers and also the study recommends that the microfinance institutions and other financial players should monitor the central banks conditions on loans.
- The study recommended that the microfinance institutions should formulate and implement effective credit appraisal strategies. This will enable them understand the borrower in detail and make loaning decision based on the proper analysis of the client.
- The study also recommended that the microfinance should have loan policies that are compatible with existing financial regulations by the central bank of Kenya. These policies should also fit the nature and financial ability of the target clients.

8. Suggestions for Further Studies

The study has suggested further studies on influence of credit recovery processes on financial performance of microfinance institutions. The study further encouraged studies to be done on factors affecting credit policy implementation in microfinance institutions.

9. Limitations of the Study

The researcher carried out the study from only three major microfinance institutions (KWFT, Faulu and Rafiki) in Kenya. The small microfinance institutions were not considered and maybe they could have given different information on credit processes. Some respondents filled the questionnaires reluctantly saying that they were busy. The findings mostly depended on the willingness of the respondents to provide right information which was not confirmed beyond the opinion as expressed. Besides, interpretation of the study findings on the few MFIs in generalization of the findings is deemed to be a limitation of the present research.

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