

**FACTORS INFLUENCING REPAYMENT OF BANK LOANS:  
A CASE OF NIC BANK LIMITED, NAIROBI PROVINCE  
KENYA**

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THE REQUIREMENTS OF THE MASTERS OF ARTS IN PROJECT PLANNING  
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## DECLARATION

I hereby declare that this work has not been submitted to any other university or institute of higher learning for examination/academic purposes.

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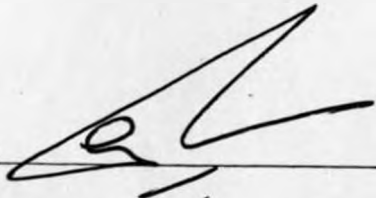
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## **DEDICATION**

**This project is dedicated to my dear parents Charles P.N. Waweru and Rosalind Njeri Waweru who have guided me through my academic journey.**

**It is also dedicated to all Banks in Kenya that strive to minimize loan default among borrowers.**

## **ACKNOWLEDGEMENTS**

In view of the vast undertaking of this study, I recognize that it is not possible to acknowledge the contribution of all.

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## ABBREVIATIONS AND ACRONYMS

<b>CBK-</b>	<b>Central Bank of Kenya</b>
<b>CIS-</b>	<b>Credit Information Sharing</b>
<b>CRB-</b>	<b>Credit Reference Bureau</b>
<b>NIC-</b>	<b>NIC Bank Kenya Ltd</b>
<b>NPL-</b>	<b>Non Performing Loans</b>
<b>ROI-</b>	<b>Return on Investment</b>
<b>SSE-</b>	<b>Small Scale Entrepreneurs</b>

## ABSTRACT

A financial institution assumes a risk whenever a credit facility has been extended to a borrower under a financial contract. The fear of losing funds due to loan default has led to increased attention to Credit risk management which has cushioned the lenders against expected loss. Central Bank of Kenya (CBK) as a regulator has come in strongly in monitoring bank's lending in an effort to reward borrowers who have a good loan repayment history and to curb loan default.

The purpose of this study was to establish the factors that influence loan repayment at NIC Bank Ltd. The research was guided by four objectives namely to establish the extent to which demographic factors influenced loan repayment; to investigate the level at which the type of loan influenced repayment; to determine the relationship between duration of loan and loan repayment and lastly to explore strategies used to improve loan repayment. Both quantitative and qualitative approaches were used in the research study and descriptive statistics was employed to present the findings. The population of interest constituted thirteen loan officers at NIC Bank and ninety two NIC loan customers. Both Open and close ended Questionnaires were used to collect data from the loan officers while Interview guides were used on NIC loan officers. The findings and subsequent discussions were thereafter analysed by SPSS and presented in tables.

The study found that demographic factors influenced loan repayment both positively and negatively. There was a higher loan repayment success rate among high income earners, older borrowers in terms of age and female loanees. The type and duration of loan also positively influenced repayment with long term loans having recorded lower default rate as compared to short and medium term loans. However, the study showed that the level of education did not necessarily influence loan repayment.

The study recommends that NIC Bank should conduct comprehensive credit risk appraisals to ascertain the credit history of the borrower. The bank should also continually advise borrowers on the appropriate loans for implementation of different projects to ensure that funds are fully utilized for the venture they were intended for and maximize on return on investments.

# CHAPTER ONE

## INTRODUCTION

### 1.1 Background to the Study

Banks and financial institutions are the most important organizations in overall financial intermediation and economic acceleration of a country. Banks play a significant role in converting deposits into productive investment. With globalization, banks are facing severe competition in faster financial intermediation in a proper and transparent manner.

In the European markets, banks are not designed to be development institutions or welfare agencies. Their primary goal remains to make the best possible profit for their bank shareholders. Thus, it is argued that if banks are to sustain themselves as profit making corporate entities they will be inclined to entrust their resources to those who can be relied upon to repay their loans with interest. Such borrowers should normally be people who use resources efficiently. However, efficiency is not always the dominant criterion for lending. Bank managers tend to be more influenced by the social structure of borrowers on the assumption that affluent citizens are likely to be more creditworthy and hence can be relied upon to repay their loans (Rehman, 2000).

In the African market the strength of a bank is measured by the quality of the assets it is lending. The higher the quality of the loan portfolio, the greater the chances of a long-term sustainable growth in the assets and liabilities book of the bank. The question of loan repayment therefore forms an integral part of a lending decision since there are many risks inherent in the banking industry. For instance, the borrowers may pre-dominantly be from a lower income group, self-employed and without any collateral assets to be offered to a lender as security for borrowings. This explains why it is almost impossible for the majority to obtain credit facilities from financial institutions that are primarily pegged on collateral and hence the argument that financial services should be easily accessible at all levels of society lingers on.

The participation of NIC Bank limited in Kenya in offering financial services raises the question of how can a commercial bank ensure good repayment rates of their lending program? This is a critical question since the way a commercial bank like NIC limited operates is somewhat different from most microfinance institutions operated by the non-governmental organizations (NGOs). Indeed, one of the main reasons argued for the high default payment among the NIC clients is that lending is based individual lending models whereby the borrower is singly responsible for loan repayment. It has been argued that this single liability does not provide incentive to borrowers to repay the loan.

To ensure that credit facilities are accessible to all, the banking industry has developed products that suit both the personal borrower and the corporate customer. This product innovation has been embraced by the regulator by adjusting interest rates as an incentive to ensuring that every borrower is credit worthy hence awarded a loan that is well within their repayment capability while at the same time fulfilling the borrower's financial needs. This has translated to increased customer satisfaction, reduced loan default, increased profitability for banks which ultimately trickles down to better Return on investments (ROI) for shareholders.

## **1.2 Statement of the Problem**

The issue of disbursement of funds has a profound implication both at the micro and macro level. When credit is allocated poorly, improper investment projects are undertaken and the nations' resources are misappropriated, it increases the cost of funds for future borrowers as banks aim to safeguard shareholders funds while attempting to remain in the competitive market. No other concern in financial market has such a profound effect on the performance of lenders. The problem of loan default reduces the lending capacity of a financial institution. It also denies new applicants access to credit as the bank's cash flow management problems augment in direct proportion to the increased default cases. In other words, it destabilizes the bank's liquidity which has remained at acceptable levels in order to sustain the growing demand of credit facilities.

As commercial banks lending programs fight with the forces of group dynamics to ensure good repayment of the loan, it raises the question on how can a commercial banks ensure

good loan repayment. This in turn, entails the question on what are the determinants of good loan repayment for a commercial bank. It is thus important to investigate and provide empirical evidences on the determinants of the loan repayment for commercial banks and this paper aims to provide insight into the factors that influence loan repayment at NIC bank in Kenya.

### **1.3 Purpose of the Study**

The study intends to identify the main factors that influence repayment of bank loans at NIC Bank Ltd.

### **1.4 Objectives of the Study**

The objectives of this study were:

1. To establish the extent to which demographic factors influence loan repayment in NIC
2. To <sup>assess</sup>investigate the level at which the type of loan acquired by NIC bank clients influences its repayment.
3. To determine the relationship between duration of loan and loan repayment.
4. To <sup>explore</sup>explore strategies to be used to improve loan repayment.

### **1.5 Research Questions**

The study was geared towards answering the following research questions:

1. To what extent do demographic factors influence repayment of a bank loan? And how?
2. To what extent does the type of loan taken influence its repayment?
3. How does the duration of the loan affect its repayment?
4. What are the strategies that can be employed to improve loan repayment?

## **1.6 Significance of the Study**

It was hoped, an analysis of factors affecting loan repayment performance of Corporate, Individual and Small Scale Entrepreneurs (SSE's) borrowers would help policy makers to formulate successful credit policies and programmes that enabled them to allocate scarce financial resources to the development of basic sectors of the economy. It also pinpointed on a policy issue that the government should design or improve to promote the development of SSEs. The research output could also help NIC Bank to evaluate its screening criteria and revise it accordingly. Revision of its criteria in favour of credit worthy borrowers could also alleviate the financial constraint of NIC's personal banking clients, SSEs and Corporate borrowers who are potentially efficient but could not be able to fulfill the bank's lending requirements. It would help the bank to identify the major characteristics that distinguish credit worthy borrowers and defaulters so that it could act accordingly for future screening purpose.

The findings of this study would be used by the banking industry regulators as a basis to lobby for similar research to be conducted as a requirement by other banks to mitigate against bank liquidation as a result of loan provisions.

## **1.7 Assumptions of the Study**

The study was guided by the assumptions that all ethical considerations would be adhered to and the findings of the study would not be harmful; the sample was representative of the population; the data collection instruments had validity and measured the desired constructs and that the respondent would answer the questions correctly and truthfully.

## **1.8 Limitations of the Study**

The study limited its scope to NIC Bank Limited, Nairobi Province as data collection instruments could only be disseminated to respondents within Nairobi province due to financial and time constraints.

Since some respondents were NIC bank employees, they may have been biased in providing correct information about the bank. Additionally, the time allowed for the study did not allow for an analysis of the factors in question from the borrower's side.

### **1.9 Delimitations of the Study**

The study limited its scope to NIC Bank Limited as it started out purely as a financial institution offering Asset Finance facilities to Corporate customers but later diversified its' product range to incorporate individual borrowers under Personal Banking.

The study was conducted with full approval and co-operation of NIC Bank management and this ensured seamless access to primary data for analysis.

### **1.10 Definitions of Significant terms**

**Demographic factors-** these are the elements that characterise a given population and include race, gender, age, income, religion and education.

**Loan Duration-** the period between loan disbursement to full loan repayment

**Short term Loan-** a loan payable within a year

**Medium Term Loan-** a loan payable between two years and five years

**Long term loan-**a loan payable anytime after ten years

**Personal Banking-** is a banking service offered by NIC bank to individual account holders.

**Institutional Banking-** is a banking service offered by NIC bank to corporate account holders

**Loan Repayment-** it is the full payment of loan principle and interest accrued by the loanee to the issuing bank in at a predetermined rate within prescribed terms and conditions.

**Delinquent loan –** This is a loan that is no longer serviced by making repayments

**Credit reference bureau-** This is a company licensed by the Central Bank of Kenya to collect and combine credit information on individuals from different sources and provide information in the form of a credit report upon the request of a lender.

**Credit Information Sharing-** This is a process where lenders and other credit providers submit information about their borrowers to a credit reference bureau so that it can be shared with other credit providers. It is also known as 'Credit Reporting'

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Introduction**

This chapter gives a brief review of some studies focusing on factors influencing repayment of bank loans. The chapter also gives relevant literature concerning the identified factors influencing loan repayment. The chapter also presents the conceptual framework and the operational framework.

#### **2.2 The Nature and Role of Credit Market**

Finance is central to establish and operate productive activity. Sufficient finance is a prerequisite to proper organization of production, acquiring of investment assets and raw materials and development of marketing outlets. Credit is a device for facilitating transfer of purchasing power from one individual or organization to another. As indicated by Eboh (2000) credit provides the basis for increased production efficiency through specialization of functions thus bringing together in a more productive union the skilled labor force with small financial resources and those who have substantial resources but lack entrepreneurial ability.

The link between credit and economic development has captured the attention of economists since long (Wenner & Proenza 2000). With improved financial intermediation, the proportion of financial savings that is diverted by the financial system into non-productive uses falls, and the rate of capital accumulation increases for a given saving rate (Mensah, 1999). He further elaborates the importance of financial intermediation as it enhances saving mobilization by providing a variety of safe financial instruments to savers and ensuring tangible returns on savings. The financial sector contributes to the efficiency of the entire economy by spreading information about expectations and allocation of resources to investors

In more explicit analysis of the association between finance and economic development Wenner & Proenza (2000) treated the banking system and entrepreneurship as the two key enabling agents of development. Wenner and Proenza argue that the banking system's capacity to supply initiative and entrepreneurship in addition to credit creation enabled it to

transfer resources from less productive uses to more economically rewarding uses because those who control existing resource or have claims on current wealth are not necessarily those best suited to use these resources. The banking system credit creation equipped entrepreneurs with purchasing power with which they were able to express overriding command over real productive resources. Financial theorists argue that if economic units relied completely on self-finance, investment will be constrained by the ability and willingness of each unit to save, as well as by its capacity and readiness to invest (Mensah, 1999). In his contribution to the role of financial institutions, Von Pische (1991) admitted that even though finance is a catalyst for investment, it is also a catalyst for poor investment, political patronage, corruption and other types of opportunism.

A credit market differs from standard markets (for goods and services) in two important respects. First standard markets, which are the focus of classical competitive theory, involve a number of agents who are buying and selling a homogeneous commodity. Second in standard markets, the delivery of a commodity by a seller and payment for the commodity by a buyer occur simultaneously. In contrast, credit received today by an individual or firm in exchange for a promise of repayment in the future. But one person's promise is not as good as another. Promises are frequently broken and there may be no objective way to determine the likelihood that promise will be kept (Jaffee and Stiglitz, 1990).

### **2.3 Repayment and Default**

The problem of loan default reduces the lending capacity of a financial institution. It also denies new applicants access to credit as the bank's cash flow management problems augment in direct proportion to the increasing default problem. In other words, it may disturb the normal inflow and outflow of fund a financial institution has to keep staying in sustainable credit market (Eboh, 2000).

The repayment problem could arise either from the demand side, supply side, and both or other external factors. The supply side problems include change in the structure of the bank, change in the lending policy, poor credit appraisal (in assessing the background of the promoter, technical capability, marketability, financial and economic viability of the project) and lack of responsibility and accountability of the staff members of the bank. Concerning NIC there has been no significant change introduced on the general lending policy of the

bank except shifting its attention towards loan collection than loan disbursement, which in fact arisen from severe liquidity problem it has faced. Therefore the problem on the supply side relies more on implementation of the rules and regulations of the bank and on the bank's efficiency of making proper credit assessment. The bank has employed its screening criteria in order to select projects which it thought are credit worthy as well as indetermination of the loan amount. The question here is whether these criteria employed are really the major determinants of the loan repayment performance of projects.

The demand side on the other hand, refers to borrower's age, sex, educational level, household size, management capacity, loan utilization, availability of other sources of income, bank credit experience, specific situation of the enterprise in terms of market conditions, technical capability and specific locations while external factors mainly refers to the general economic condition of the country, government policy and weather condition. In order to combat these pressing problems, the major deterrents behind the poor repayment record should be identified first.

#### **2.4 Empirical Evidence of Factors influencing Repayment**

Some empirical evidence has shown that in most developing economies, savings and credit cooperatives have brought millions of citizens into cohesive financial institutions which are succeeding very well in providing financial services to its members for improving their standard of living (Temu, 1999; Chirwa, 1997). Nevertheless, the existing literature has also indicated that majority of individuals in developing economies have been experiencing problems including diseconomies scale of credit, high interest rate on loan, and very short-term loans (Chirwa, 1997). Such problems have caused high rate of default in most of these developed economies. Likewise, previous studies have established that social-economic and demographic factors such as age, income, marital status, gender, family size and occupation have a bearing on households' credit worthiness and repayment behaviour of the borrowers in the credit market.

Arene (1992) used a regression analysis to identify the variables that have a significance bearing on credit repayment performance by farmers associations in Anambra state in Nigeria. Among others, variables such as size of loan, income, education level and number of

years of farming experience were found to be statistically significant while distance and size of the households were not significant.

Mbata (1994) hypothesized that credit repayment performance from external source depends on duration of loan servicing, size or amount of credit obtained and income generated from the capital, while credit repayment performance from internal sources (member capital) depends on duration of membership, size of the household, amount of credit available, income generated from sales, gender of the household, income transfers received, the type of information and the extent of business diversification. Using standard probability model, the results revealed that gender, amount of loan, member experience and household size were not statistically significant in various specifications while crop sales, the size of enterprise, the degree of diversification, income transfers and quality of information were statistically significant.

Nikhade et.al, (1994) studied crop loan repayment behaviour in cotton growers with the aim of analysing behaviours and characteristics of borrowers along with the causes of non-repayment in crop loans. Relational analysis revealed that the social personal characteristics such as education, annual income, land holding and irrigation influenced positively the borrowing pattern and repayment behaviour of the borrowers. Rambabu et.al, (1994) studied factors influencing attitudes of the small businesses towards credit with the aim of understanding the attitudes of the borrowers and non-borrowers towards credit. It was found that there is negative and significant relationship between age and attitudes of both borrowers and non-borrowers. it was further noted that education exposure to mass media and extension contact were found to be positively significant related with attitude of borrowers and non-borrowers. Harikumar (1991) made an attempt to analyze the utilization of loans, overdues and factors affecting proper repayment and overdues. Contrary to Nikhade et.al,(1994) and Rambabu et.al, (1994), it was found that socio economic factors do not influence loan repayment. Njoku (1997) posited that socioeconomic characteristics of credit beneficiaries had a significant influence in farmers' association performance and loan repayment under the special emergency loan scheme in Nigeria. The results from Cobb-Douglas model shown that loan volume (size), years of member experience, formal education, household size, loan period, farm size, value of assets and interest paid on loan were all highly significant determinants of member's credit societies on performance and loan repayment default. Puthussery (1999) studies the over-dues problem at the beneficiary level analysis with the

aim of identifying the reasons for defaults. It was found that the major reasons responsible for the heavy over-dues are; modification of the subsidy system, will full neglect, high family expenditure, diversion of income from the project and inappropriate government policy.

While the overlap with earlier studies in methodology and general results is inevitable, the contribution of this paper is to provide more empirical evidence on the factors contributing to credit repayment behaviour among borrowers from NIC. The fact that none of these studies were conducted in Kenya or in the region (East and Central Africa) justify the need of providing more empirical and theoretical literature on the growth and sustainability of credit and savings societies in developing countries particularly in those of African continent South of Sahara.

## **2.5 Credit Management Policies**

In the past decades there have been major advances in theoretical understanding of the workings of credit markets. These advances have evolved from a paradigm that emphasis the problems of imperfect information and imperfect enforcement (Hoff and Stiglitz, 1990). They pointed out that borrowers and lenders may have differential access to information concerning a projects risk, they may form different appraisal of the risk. What is clearly observed in credit market is asymmetric information where the borrower knows the expected return and risk of his project, where as the lender knows only the expected return and risk of the average project in the economy institutions are faced with four major problems in the course of undertaking credit activity: to ascertain what kind of risk the potential borrower is (adverse selection);to make sure the borrower will utilize the loan properly once made, so that he will be able to repay it (moral hazard); to learn how the project really did in case the borrower declares his inability to repay and; to find methods to force the borrower to repay the loan if the borrower is reluctant to do so (enforcement) (Ghatak and Guinnane, 1999). These problems of imperfect information lead to inefficiency of credit market which in turn leads to default. Thorough credit assessment that takes into account the borrowers' character, collateral, capacity, capital and condition (what is normally referred to in the banking circles as the 5C's) should be conducted if they are to minimize credit risk

Credit risk evaluation is a complex process, which implies a careful analysis of information regarding the borrower in order to estimate the probability that the loan will be regularly repaid (Vigano,1993).

The probability of regular repayment depends on objective factors related to the borrower's operating

environment, the borrower's personal attitude towards loan obligation, and the bank's ability to evaluate these two aspects through the information it has and to control credit risk specific contractual conditions. Vigano summarized factors affecting credit risk as follows: the customer's ability and willingness to pay, presence of favorable external conditions, quality of information and bank's ability to ensure the customers willingness to pay.

### **2.5.1 The Credit Reference Bureau**

The Central Bank of Kenya (CBK) granted a licence to CRB Africa early this year to offer banking sector credit information sharing services in Kenya. CRB Africa, a wholly-owned Kenyan company, pioneers as the first ever licensed credit reference bureau in Kenya. The licence has been granted pursuant to the Banking (Credit Reference Bureau) Regulations, 2008. The Regulations empower the Central Bank of Kenya to licence and supervise credit reference bureaus (CRBS) in Kenya for institutions licensed pursuant to the Banking Act.

The licensing of CRB marks a new dawn in the Kenyan banking sector; both institutions and customers stand to benefit from credit information sharing. A credit reference bureau collates compiles and disseminates credit information on borrowers within the banking sector through a fully electronic system. Banks will be able to submit credit information and request for and obtain credit references on potential or existing customers, as part of the bank's credit risk management. Credit information sharing will undoubtedly play a pivotal role in reducing the information asymmetry that exists between banks and borrowers. Banks will be able to get credit information on prospective borrowers that will facilitate assessment of credit requests. Conversely, a good credit record for a borrower will act as an incentive for competitive pricing of loan facilities. In a nutshell, credit information sharing will reward and promote good credit track record (GoK, 2010)

## **2.6 Factors Influencing Loan Repayment**

### **2.6.1 Demographics**

It is argued that lending to women can lead to their economic empowerment and inculcate in them a culture of hard work and financial discipline, which can lead to high loan repayment rates. Thus, women borrowers may have high loan repayment rates.

Higher educational levels enable borrowers to comprehend more complex information, keep business records, conduct basic cash flow analysis and generally speaking, make the right business decisions. Hence, borrowers with higher levels of education may have higher repayment rates.

It is argued that older borrowers are wiser and more responsible than younger borrowers. On the other hand, younger borrowers are argued to be more knowledgeable and more independent. Hence, age might have positive or negative effect on loan repayment rates.

Borrowers that have other sources of incomes may use it to make loan repayments. Thus, borrowers with other source of income may have higher repayment rates.

Borrowers who have been in business longer is expected to be more successful with their enterprise. They have more stable sales and cash flows than those who have just started. Thus, those who are more experienced may have more high repayment rates.

### **2.6.2 Type of Loan**

It is argued that as the absolute amount of the loan increases, the authority to delegate responsibility for it is more limited and decision making is escalated further up the management hierarchy of the bank. Furthermore, it is also argued that smaller loan amounts are insufficient creating cash flow problems to the borrowers, significantly affecting the implementation of projects thus the larger the amount, the lower the default rate.

Repayment period refers to the period of time during which the entire loan must be repaid. Ledgerwood (2004) demonstrates that cashflow in part determines the debt-servicing capacity of borrowers. Shorter repayment period might cause the borrower not to have generated enough revenue for borrower to make loan payments. On the other hand, a longer repayment period is detrimental to borrowers if they cannot access future loans until the existing loans

are paid back. Hence both shorter and longer repayment periods can have negative effects on the default rate.

### **2.6.3 Duration of a loan and loan repayment**

NIC Bank loans are categorized into Personal and Corporate loans. Personal loans are granted to individuals whose annual turnover is less than Kes. 50 million and below and whose repayment period is a maximum of 4 years for both short term and medium term loans such as Overdrafts and Term loans. Corporate loans are granted to borrowers with an annual turnover of Kes. 150 million and above. The repayment period for corporate customers is 1 year for short term loans such as Overdrafts and Stock finance facility and 4-7 years for Asset Finance facilities and Term loans.

### **2.6.4 Other Variables Affecting Loan Repayment**

Besides the above variables, we also include marital status, race, number of dependents, training, membership in business society and revenue from projects as the independent variables. The importance of financial services cannot be overemphasized. To this end, households particularly those of developing countries need a range of enabling and sustainable financial services in order to effectively exploit abundant resources in their areas and fulfill their productive potential as well as protecting their families and livelihood. These services may be provided through either formal institutions such as banks, government projects and contract farmer schemes and/or informal institutions including family and friends, local money lenders and rotating or accumulating savings and credit associations. Unfortunately, the state of financial markets in developing countries is characterized by inadequate availability of financing. These financial markets, in particular, continue to be characterized by a number of weaknesses including: limited access to rural customers; high cost of services; absence of convenient savings facilities; financial non-viability of institutions; lack of active competition; and inability to expand services to respond to and create opportunities (Nwanna, 2000).

Owing to these weaknesses, very few portions of the populations have access to financial services because formal financial institution and commercial banks in particular consider lending to small farmers as a risky business and because providing financial services to rural people is considered to be more costly and difficult. Thus (Gonzalez-Vega, 2003), there has been indeed a lag, not only in the delivery of a broad array of financial services, but also in the diffusion of ideas and in the implementation of actions conducive to more efficient, sustainable and broadly-based financial markets. For decades, this has led to the series of direct government interventions through blend of targeted credit programs, interest subsidies and other government policies. Unfortunately the history of supply-led, parastatal-based, top-down and state driven interventions is loaded with deplorable experiences in the face of macroeconomic instability environment, financial repression, distortinary and urban biased policies (Krueger et al., 1991; Yaron, 1992; Yaron et al., 1998; Eboh, 2000; Gonzalez-Vega, 2003; Von Pischke, 2003 Conning and Udry, 2005).

The widespread recognition of the failure of the old paradigm in finance attracted attention from many of the policy makers, donors and international development organisations (Zeller, 2003) and as a result, ushered in a thunderous calling for financial market reforms and withdrawal of ill-advised state programs. A number of factors continue to thwart the development of vibrant financial markets in developing countries (Carter and Waters, 2004). The higher transaction costs associated with dispersed populations and inadequate infrastructure, along with the particular needs and higher risk factors inherent in the financial sector result in an under-provision of financial services. Moreover, where services are available, products are often designed without consideration for the needs and capacities of rural households and agricultural producers.

Like other developing countries the Kenyan credit market is repressed, shallow, segmented and inefficient and dual structured where both formal and informal financial systems operate side by side. This phenomenon has also been well-documented by the earlier studies including that of Zeller et al. (1996), Nwanna (2000); Wenner and Proenza (2000) and Nguyen (2007).

## 2.7 Repayment Performance in Group Lending

Since the 1970s, group-lending programs have been promoted in many developing countries. A common characteristic of group lending is that the group obtains the loan under joint liability, so each member is made responsible for repayment of loans of his or her peers. Joint liability, but possibly more so, the threat of losing access to future credit, incites members to perform various functions, including screening of loan applicants, monitoring the individual borrower's efforts, fortunes and shocks, and enforcing repayment of their peers' loan. (Zeller, 1996).

The existing theoretical models of peer monitoring deduce that repayment performance in group lending programs is positively related to the homogeneity of members with respect to the riskiness of their projects (Stiglitz, 1993; Besley and Coate, 1995). In group-lending programs, the functions of screening, monitoring and the enforcement of repayment are to a large extent, transferred from bank to group members. The financial intermediary reduces recurrent lending transaction costs by replacing multiple small loans to individuals with a larger group loan (Adams, 1988 as cited in Zellar, 1996). This reduction in transaction costs enables financial intermediaries to bank on the poor, who demand small loans and who would not receive any credit under an individual loan contract because of excessive unit transaction costs of small borrowings.

Zeller (1996) argues that probably the most important rationale for group lending is the information and monitoring advantages that group-based financial institutions at the community level have, compared to individual contracts between a bank and a borrower.

Group members get important information like reputation, indebtedness and asset ownership of the loan applicants at a lower cost. They can also easily monitor individual efforts made towards ensuring loan repayment. In addition, groups may also have a comparative advantage in enforcement of repayment by members potentially employing social sanctions or even seizing physical collateral from the defaulter (Besley and Coate, 1995). Moreover, group members appear to be in a better position to assess the reason for default and to offer insurance services to members who are experiencing shock that are beyond their control. (Zeller, 1996).

Despite all the above-mentioned benefits, group lending is not without its problems. There are several factors that may undermine the repayment performance in group lending. Zeller (1996) discusses that since the risk of loan default by an individual is shared by his or her peers, a member may choose a riskier project compared to that in the case of individual contract, and may count on other members to repay his or her loan (adverse selection of risky projects). He further notes that repayment incentives for a good borrower will vanish under joint liability, when he or she expects that significant number of peers will default individuals select those whom they thrust to form a group with, that is they want those who can make regular repayments, have a good concern about the possible loss they face in case of non-repayment, ultimately leading to the exclusion of the poorest of the poor.

Reikne (1996) assessed the factors that lead to the failure of group based lending system in urban areas and he recommended an individual credit system for a better loan repayment. According to him presence of high geographical mobility, low attachment to specific neighborhoods and peer groups consisting of competitors are the factors that frustrate the solidarity of groups in urban areas, and hence group lending is more applicable to the rural environment than to urban society

## **2.8 Credit Markets and Rationing**

The market for credit differs from standard markets for goods and services in two important ways. As we know from the classical competitive theory, the first difference lies in the fact that in standard markets a number of agents take part in buying and selling a homogenous commodity. The second difference lies in the fact that the handover of the good or service and the payment for it occur simultaneously in such markets.

In contrast, credit received today by an individual is exchanged for a promise of repayment in the future. Since promises differ from person to person, and are frequently broken, there may be no objective way of determining that a promise will be kept. That is, moral hazard and adverse selection may affect the likelihood of the promise being kept and hence of that of loan repayment (Jaffe and Stiglitz, 1990)

Considering such basic differences between standard and credit markets, trying to apply the standard supply-demand model is not totally appropriate for analysing the market for promises. If credit markets were like standard markets, then interest rates would be the prices that equate the demand and supply for credit. However an excess demand for credit is common applications for credit are frequently not satisfied, resulting in an excess demand for credit over its supply at the market interest rate (Ibid). This situation is usually termed as credit rationing in the literature review.

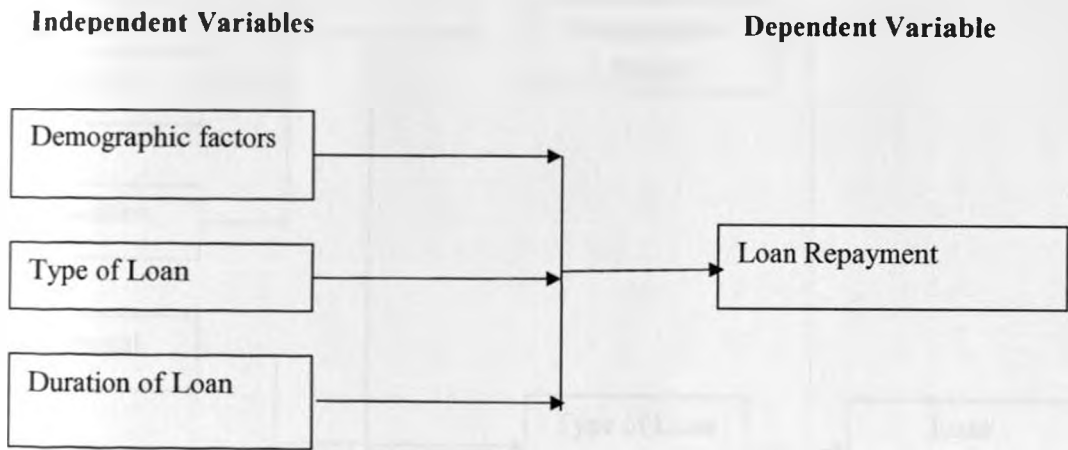
The question to be raised here will be why is credit rationed? The whole story seems to hinge on the fact that prices don't clear the market for credit. In fact credit rationing exists, and this seems to imply an excess demand for loanable funds.

As Stiglitz and Weiss (1981) noted, one way of explaining this condition associates it with short or long term disequilibria. In the short term, it is viewed as temporary disequilibrium phenomenon whereby the economy has incurred an exogenous shock, and for reasons not fully explained, there is some stickiness in the prices of capital (interest rates) so that there is a transitional period during which rationing of credit occurs. On the other hand, long term credit rationing is explained by governmental constraints such as usury laws or minimum wage legislation.

Jalfe and Stiglitz (1990) discuss certain features of loan contracts and loan markets that make standard demand and supply model inapplicable, giving rise to credit rationing. These features include uncertainly the nature of loan contracts, and borrowers risk behaviour. For instance, uncertainty concerning the borrower's ability, or willingness of repaying loans when they are due, results in divergences between promised and actual repayments, creating risk of default.

## 2.9 Conceptual Framework

The conceptual framework shows the relationship of the variables to be measured. The independent variables become the parameters that will be measured and their effect on the dependent variable determined.



*Figure 1: Conceptual framework*

## 2.10 Operational Framework

Figure 2 below represents the diagrammatical view of the variables that define the variables discussed in this research study.

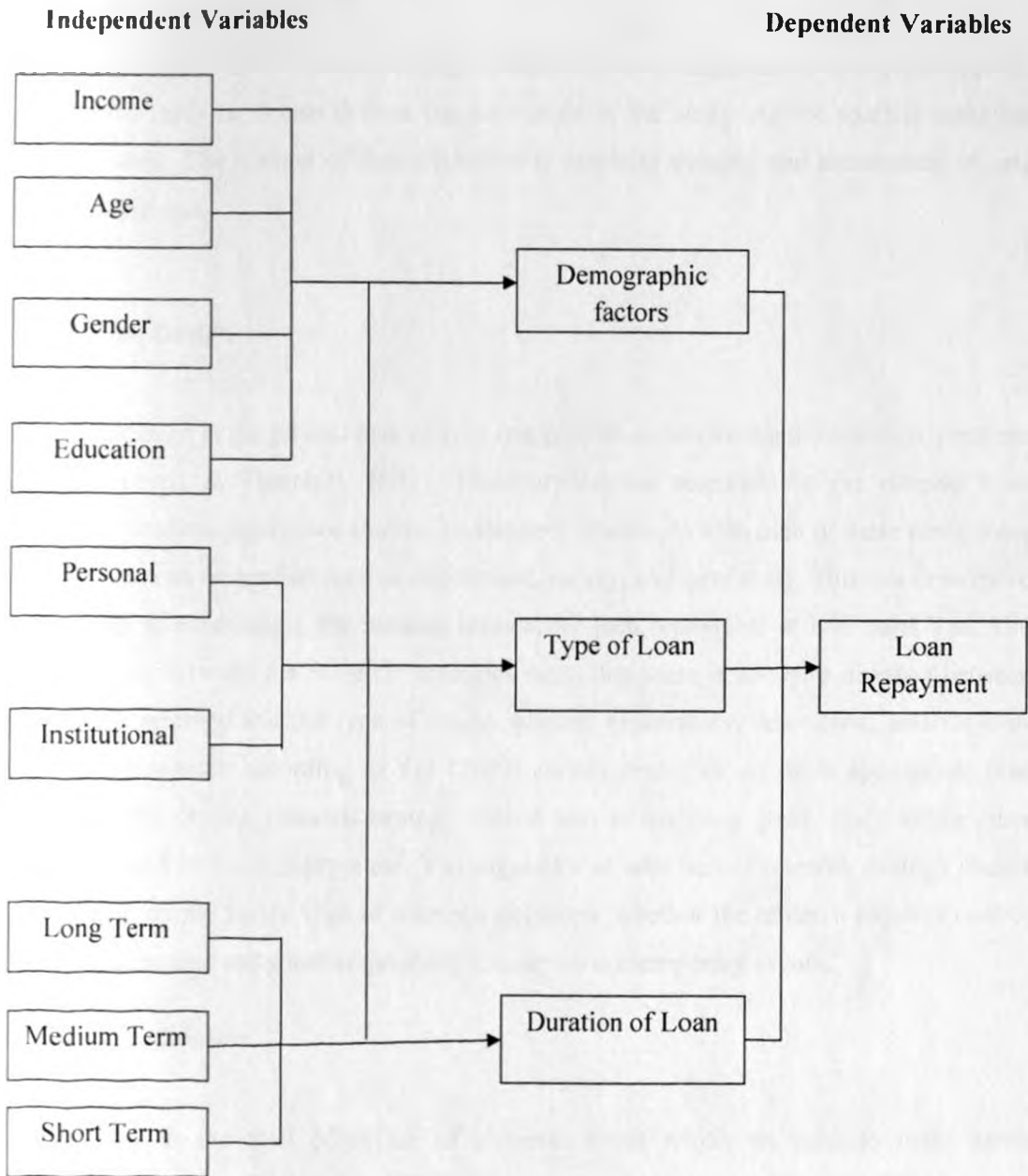


Figure 2: Operational Framework

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

This chapter outlines the research design which offers an explanation into what type of research this study is. It also defines the population of the study and the specific sampling technique used. The method of data collection is carefully detailed and the method of data analysis explained.

#### **3.2 Research Design**

A research design is the general plan of how one goes about answering the research questions (Saunders, Lewis & Thornhill, 2007). There are several research designs ranging from exploratory studies, descriptive studies, explanatory studies. Within each of these designs are strategies that can be applied such as experiment, survey, and case study. This is a descriptive study aimed at establishing the reasons influencing loan repayment at NIC bank Ltd. The large overlaps between the research strategies mean that there is no sharp division between the research strategy and the type of study; whether exploratory, descriptive, analytical or predictive. However, according to Yin (2003) certain strategies are more appropriate than others and the chosen research strategy should aim at avoiding gross misfit when other strategies could be more appropriate. Yin suggests that selection of research strategy should be informed mainly by the type of research questions, whether the research requires control of behaviour/events and whether the study focuses on contemporary events.

#### **3.3 Target Population**

A population is the total collection of elements about which we wish to make some inferences, Cooper and Schindler, (2001). The target population for the proposed study was loan officers and loan clients of NIC bank Limited. All the loan officers at the NIC bank headquarters in Nairobi will be targeted for this study. Specifically the study targeted all the 13 loan officers of the branch This is because other employees, as significant as they are to

loan lending, do not directly and personally interact with the loan clients. The study also targeted loan clients of the bank across two loan categories; 15 institutional and 77 personal.

### 3.4 Sampling Size

A probability sample is frequently more accurate than a census of the entire population. The smaller sampling operation lends itself to the application of more rigorous controls, thus ensuring better accuracy. These rigorous controls allow the researcher to reduce non-sampling errors such as interviewer bias and mistakes, non-response problems, questionnaire design flaws, and data processing and analysis errors.

(Miaoulis and Michener, 1976) acknowledge in addition to determining the purpose of the study and population size, three criteria that need to be specified to determine the appropriate sample size: the level of precision, the level of confidence or risk, and the degree of variability in the attributes being measured. The degree of variability in the attributes being measured refers to the distribution of attributes in the population. The more heterogeneous a population, the larger the sample size required to obtain a given level of precision. The less variable (more homogeneous) a population, the smaller the sample size because a proportion of 0.5 indicates the maximum variability in a population and would often be used in determining a more conservative sample size. For NIC personal loan clients the following formulae was applied to get the sample size.

$$n_o = \frac{(t)_2 * (p) (q)}{(d)_2}$$

$$n_o = \frac{(1.96)_2(0.5) (0.5)}{(0.05)_2} = 384$$

*Source: Cochran (1977)*

### 3.4.1 Sampling Size Procedure

Sampling is a procedure where a fraction of the data is taken from a large set of data and the inference drawn from the sample is extended to the whole group.

There are several sampling techniques that can be employed in a study depending on its nature, strategy and how the population is organized. Sampling techniques may include probability and non-probability techniques. For this study, the stratified random technique was deemed most appropriate. The sampling frame for any probability sample is a complete list of all the cases in the population from which a sample is drawn (Saunders et al., 2007). The list could be of geographical area, institutions, individuals or other units (Churchill and Brown (2007). The sampling frame employed in this study was a list of bank loan officers and loan customers obtained from the Human resource database and the Credit Risk departments of NIC Bank Ltd respectively.

The sample size consisted of 13 NIC loan officers and 92 loan clients. The stratified random technique was applied.

**Table 3.1 Sampling Frame**

<b>Sampling Unit</b>	<b>Sample Size</b>	<b>Percentage</b>	<b>Sample</b>
NIC Loan Officers	13	100%	13
Corporate Loans	30	50%	15
Personal Loan Clients	384	20%	77
<b>Total</b>	<b>427</b>		<b>105</b>

### **3.5 Data Collection Instruments**

Quantitative data collection methods rely on random sampling and structured data collection instruments that fit diverse experiences into predetermined response categories. They produce results that are easy to summarize, compare, and generalize. Quantitative research is concerned with testing hypotheses derived from theory and/or being able to estimate the size of a phenomenon of interest. Qualitative data collection methods on the other hand play an important role in impact evaluation by providing information useful to understand the processes behind observed results and assess changes in people's perceptions of their well-being. Furthermore qualitative methods can be used to improve the quality of survey-based quantitative evaluations by helping generate evaluation hypothesis; strengthening the design of survey questionnaires and expanding or clarifying quantitative evaluation findings

The research employs a descriptive research design. It will rely on both primary and secondary types of data. Questionnaires will be used to collect primary data and will mainly target loan officers of NIC bank Ltd. Interviews will be used to collect data from NIC loanees as some are assumed to be semi illiterate and illiterate. Content analysis will also be used to get additional information about the loanees; this will be done by analysing NIC's loan book.

#### **3.5.1 Pilot Testing of Instruments**

For this study a pilot test will be done first. This will be done in order to ensure reliability of the data collection tool. The pretest will be done on a sample of 10 respondents from the population but not on the ones that will finally feel the questionnaires. After the pretest, the questionnaire will be appropriately amended. The amended questionnaires will then be administered to the respondents.

#### **3.5.2 Validity**

For this research, the respondents are expected to answer the questions as per instruction in order for higher reliability to be attained. In cases where more than one of the multiple choices is marked then the feedback will be considered not free from error and would therefore be prone to inconsistency results.

### **3.5.3 Reliability**

The reliability here will be tested by the use of Test retest method and split half method. (Zikmund, 2003). Due to the sensitive nature and content of the research ethical implications are foreseen. The researcher will undertake due diligence in ensuring ensure that all information used to pursue a credible solution to the research problem. Where necessary third party corroboration will be sought and its information considered

### **3.6 Data Collection Methods**

Data collection is a term used to describe a process of preparing and collecting data- for example as part of a process improvement or similar project. The purpose of data collection is to obtain information to keep on record, to make decisions about important issues, to pass information on to others. Primarily, data is collected to provide information regarding a specific topic. Prior to any data collection, pre-collection activity is one of the most crucial steps in the process. It is often discovered too late that the value of their interview information is discounted as a consequence of poor sampling of both questions and informants and poor elicitation techniques .After pre-collection activity is fully completed, data collection in the field, whether by interviewing or other methods, can be carried out in a structured, systematic and scientific way.

A formal data collection process is necessary as it ensures that data gathered is both defined and accurate and that subsequent decisions based on arguments embodied in the findings are valid. The process provides both a baseline from which to measure from and in certain cases a target on what to improve.

### **3.7 Data Analysis and Presentation**

Data collected in the study will be analyzed later with appropriate quantitative and qualitative models. The qualitative data will be analyzed using content and document analysis while the quantitative data will be presented mathematically using statistics such as tables and cross tabulations. Statistical Package for Social Scientists (SPSS) will also be used to provide tables for clarity and ease understanding of the findings.

**Table 3.1: Operationalization of variables**

<b>Objectives</b>	<b>Variables</b>	<b>Indicators</b>	<b>Measurement</b>	<b>Measuring scale</b>	<b>Research design</b>	<b>Type of Analysis</b>	<b>Tools of Analysis</b>
The extent to which demographic factors influence loan repayment	Dependent variable: Loan repayment  Independent variable Demography	-Income  -Age  -Gender  -Education	-Net income in Kes - i)18-35 years ii) Above 35 years -i) Male (x) ii) Female (y) -i) None ii)High iii)University	Ordinal  Interval  Nominal  Ordinal	Qualitative	Descriptive	Median  Mode  Mode  Mode
The extent to which the type of loan influences loan repayment	Independent variable: Type of loan	-Personal loans -Corporate loans	-Number of loans disbursed -Number of loans repaid -Number of loans defaulted	Ordinal	Quantitative	Descriptive	Mean
The relationship between duration of loan and loan repayment	Independent variable: Duration of loan	- Short term loans - Medium term loans -Long term loans	- Less than 1 year  - 1 year to 5 years  - Over 5 years	Ordinal	Quantitative	Descriptive	Mean  Mode  Median

### 3.9 Summary

The chapter started by outlining the research design, the case study method was selected because the study focuses on only one case in the population. The target population was defined as employees of the NIC Bank Ltd with a bias for those working in the credit department. The population was divided into strata from which a sample size will be selected. The chapter then proceeded to outline the procedure for data collection and outlined the method for data analysis.

## **CHAPTER FOUR**

### **DATA PRESENTATION, ANALYSIS AND INTERPRETATION**

#### **4.1 Introduction**

This chapter presents the analysis of the data collected from NIC Bank Limited's Loanees and loan officers. The researcher administered 13 questionnaires to loan officers and 92 interview guides to both Corporate and Individual borrowers. Out of the questionnaires and interview guides administered, all questionnaires and 81 interview guides were returned which represented 100% and 88% of the sample size respectively. The data was interpreted according to the research questions and the results presented. The analysis and findings are based on the responses obtained and summarized into tables using percentages and frequencies.

#### **4.1.1 Results and Discussions**

The findings and data analysis of the study are outlined in this section. The discussions capture the outcomes based on the questions of the study and research objectives that were the main focus.

#### **4.2 Response rate**

The researcher conducted interviews with the Corporate and individual borrowers to get first hand information on repayment of their loans. The researcher scheduled appointments to conduct the interviews while some were conducted over the telephone. All the interviews were in line with a pre-prepared interview guide to obtain objective information relating to loan repayment. The researcher also administered questionnaires to all the loan officers of the NIC Bank limited Nairobi province branches.

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As indicated in Table 4.2 above, 46% of the respondents were male while 54% were female. The researcher also found out that there were slightly more male loan officers than female loan officers at NIC Bank Limited's Nairobi province branches. On the contrary, there were generally more female personal banking clients than there were male clients. This could be an indication of better saving habits by women living in Nairobi Province.

### 4.3 Loan Repayment at NIC Bank, Nairobi Branches

In this study, loan repayment was the dependent variable. The researcher wanted to establish the factors that influenced loan repayment at NIC bank limited; the extent to which demographic factors influenced loan repayment; the level at which the type of loan acquired influenced repayment; the extent to which loan duration affected its repayment; and the strategies used to improve loan repayment.

#### 4.3.1 The Loan Repayment Problem

The researcher sought to find out whether loan default originated from the borrower's or the Bank's side. The loan officers who monitor loan repayment and loanees who were currently servicing different facilities at the bank were questioned on the where the likelihood of loan default would originate, as to whether the problem of default was likely to begin on their side or the bank's side.

**Table 4.3: The Loan Repayment problem**

Category	Yes (%)	No (%)
Loan Officer	0	13
Personal Banking Clients	39	61
Corporate Clients	33	67

The research findings in Table 4.3 indicated that none of the loan officers at NIC bank limited thought the problem of loan default begun from the bank's side. However, 39% of the Personal banking clients were of the opinion that the problem of loan default started from the bank's side while 61% disagreed that the bank's was the main cause of loan default. Additionally, 33% of Corporate clients thought that the problem of loan default originated

from the bank side while 67% were of the opinion that the problems did not originate from the bank. The findings implied that the bank needed to do improve on their credit Risk management by better screening both existing and prospective borrowers in an effort to minimize loan default.

#### 4.4 Influence of demographic factors on Loan repayment

The researcher also sought to find out to what extent demographic factors influenced loan repayment at NIC bank Limited. To establish this, the researcher studied the relationship between the dependent variable and the four parameters namely influence of income on loan repayments; influence of age on loan repayment; influence of gender on loan repayment and influence of education on loan repayment.

##### 4.4.1 Income influence on Loan repayment

The researcher posed the question of whether high income groups had better loan repayment records than low income earners. This was done by requesting the loan officers to indicate which income group had better loan repayment records.

**Table 4.4 Income influence on loan repayment**

<b>Response</b>	<b>Frequencies</b>	<b>Percentages</b>
Strongly Agree	3	23
Agree	9	69
Not Sure	0	0
Disagree	1	8
Strongly Agree	0	0
<b>Total</b>	<b>13</b>	<b>100</b>

The research findings in Table 4.4 indicated that 92% of the respondents were in agreement that high income earners had better loan repayment history than lower income groups. Only 8% of the respondents disagreed with the fact that high income groups have better loan repayment records than lower income groups. The findings could be concluded that high income groups have alternative sources of income and more disposable income that they can

utilize to make loan repayments as opposed to lower income groups who may solely dependent on the loan's project revenues to honour bank loan repayment obligations.

#### 4.4.2 Age influence on Loan repayment

The study wanted to know whether age of the borrowers influenced loan repayment. In particular the researcher sought to find out whether older borrowers performed better in loan repayment as compared to younger borrowers. The respondents were requested to indicate their level of agreement in line with the problem statement. Table 4.5 captured the respondents' opinions

**Table 4.5 Age influence on loan repayment**

<b>Response</b>	<b>Frequencies</b>	<b>Percentages</b>
Strongly Agree	2	15
Agree	7	54
Not Sure	0	0
Disagree	4	31
Strongly Agree	0	0
<b>Total</b>	<b>13</b>	<b>100</b>

The research findings in Table 4.5 indicated that 15% strongly agreed, 54% agreed and 31% disagreed that older borrowers were better loan payers in comparison to younger borrowers. Majority of respondents, 69%, were in agreement that older borrowers at NIC bank limited were better at loan repayment than young borrowers. It was noted from the loanee interviews that the older borrowers were not first time borrowers but had a credit history at the bank. This particular cohort of borrowers had indicated a keen interest on maintaining a healthy relationship with the bank. This could explain the promptness in repaying loans for future loan considerations by the bank. It could also be argued that older borrowers are more financially responsible than younger borrowers.

#### 4.4.3 Gender influence on Loan repayment

The researcher sought to know whether gender of the borrower influenced loan repayment. In particular the researcher wanted to find out whether women borrowers performed better in loan repayments than their male counterparts. The respondents were requested to indicate their level of agreement with the statement that women borrowers are better at loan repayment than male borrowers. Table 4.6 captured their responses.

**Table 4.6: Gender influence on Loan repayment**

<b>Response</b>	<b>Frequencies</b>	<b>Percentages</b>
Strongly Agree	5	38
Agree	6	47
Not Sure	2	15
Disagree	0	0
Strongly Agree	0	0
<b>Total</b>	<b>13</b>	<b>100</b>

The research findings in Table 4.6 indicated that 38% strongly agreed, 57% agreed and 15% were not sure that women were better performers in repaying loans than male borrowers. In totality, a majority of 85% agreed that women are better at loan repayments than men. This could be attributed to the social phenomenon that women have better financial discipline compared to men.

#### 4.4.4 Education Influence on Loan Repayment

The study sought to know whether education level of the borrowers influenced loan repayment and of concern the researcher wanted to find out whether tertiary level-educated borrowers performed better in loan repayments than those borrowers who had lower than tertiary education. The respondents were requested to indicate their level of agreement with the above statement and Table 4.7 showed the responses.

**Table 4.7: Education influence on loan repayment**

<b>Response</b>	<b>Frequencies</b>	<b>Percentages</b>
Strongly Agree	1	8
Agree	3	23
Not Sure	2	15
Disagree	7	54
Strongly Agree	0	0
<b>Total</b>	<b>13</b>	<b>100</b>

The research findings on Table 4.7 indicated that 54% disagreed, 31% agreed while 15% were not sure whether tertiary level educated borrowers performed better at loan repayment than those with lower education. It would be generally accepted that higher education levels would enable borrowers better manage their cash flows; however this was not the case. The high level of disagreement could be attributed to the fact that lower level education borrowers venture into business early and hence have better experience managing their cash flows. Additionally, the high level education borrowers might be masters in their disciplines but not good financial managers.

#### **4.5 Influence of Type of loan on Loan Repayment**

The study wanted to find out whether personal banking loans are better repaid than Corporate loans. The respondents were requested to indicate whether personal banking loans have lower default rate than corporate loans and their responses were captured in the Table 4.8 below

**Table 4.8: Influence of Loan Type on Loan Repayment**

<b>Response</b>	<b>Frequencies</b>	<b>Percentages (%)</b>
Strongly Agree	0	0
Agree	8	61
Not Sure	1	8
Disagree	4	31
Strongly Agree	0	0
<b>Total</b>	<b>13</b>	<b>100</b>

The research findings on Table 4.8 indicated that 61% agreed, 31% disagreed while 8% were not sure whether personal banking loans had lower default rates than corporate loans. This could be attributed to the fact that personal clients attach personal property as collateral and thus the fear of losing it to offset their loan outstanding at the bank as opposed to corporate borrowers who attach shareholder's assets.

#### 4.6 Influence of Loan Duration on Loan Repayment

The researcher wanted to find out the extent to which the duration of a loan influenced its repayment. To achieve this, the researcher sought to find out whether long term loans are repaid more easily as compared to short term loans and whether medium term loans are easily repaid compared to short term loans.

##### 4.6.1 Long Term Loans versus Medium Term Loans

The study wanted to find out if long term loans are repaid better compared to medium term loans and to do this the respondents were asked to indicate their level of agreement with the opinion that longer term loans are better repaid vis-à-vis medium term loans. The responses were indicated in Table 4.9

**Table 4.9: Long Term Loans versus Mid Term Loans**

Response	Frequencies	Percentages
Strongly Agree	0	0
Agree	6	46
Not Sure	1	8
Disagree	6	46
Strongly Agree	0	0
<b>Total</b>	<b>13</b>	<b>100</b>

The research findings in Table 4.9 indicated that 46% agreed, another 46% disagreed while 8% were not sure that long term loans are better repaid than medium term loans. The respondents who agreed to the assertion that longer terms are easily repaid than medium term loans may have reasoned that since longer term loans are obviously for larger amounts, the individual or company management may have better planned or projected the loan repayment before deciding to take up the loan. Those who disagreed may have argued that larger amounts are difficult to manage since they indent into the cash flows that is used in the day to day operations of the business.

#### 4.6.2 Long Term Loans versus Short Term Loans

The researcher wanted to find out if longer term loans are repaid better as compared to short term loans. The respondents were asked to indicate their level of agreement with the opinion that longer term loans are better repaid than short term loans. The responses were indicated in Table 4.10

**Table 4.10: Long Term Loans versus Short Term Loans**

<b>Response</b>	<b>Frequencies</b>	<b>Percentages</b>
Strongly Agree	0	0
Agree	7	54
Not Sure	0	0
Disagree	6	46
Strongly Agree	0	0
<b>Total</b>	<b>13</b>	<b>100</b>

The research findings on Table 4.10 indicated that 54 % agreed and 46% disagreed that long term loans are better repaid than short term loans. The respondents who agreed to the assertion may have reasoned that since longer term loans are repaid within a longer period of time hence business are able to enjoy return on investments as they repay the loans contrary to short term loans which have shorter maturities hence businesses may not have fully recouped their investments to generate income to repay the bank loans.

### 4.6.3 Medium Term Loans versus Short Term Loans

The researcher wanted to find out if medium term loans are repaid more compared to short term loans. The respondents were asked to indicate their level of agreement with the opinion that longer term loans are better repaid against medium term loans. The responses were indicated in Table 4.11

**Table 4.11 Medium Term Loans versus Short Term Loans**

<b>Response</b>	<b>Frequencies</b>	<b>Percentages</b>
Strongly Agree	0	0
Agree	9	69
Not Sure	0	0
Disagree	4	31
Strongly Agree	0	0
<b>Total</b>	<b>13</b>	<b>100</b>

The research findings on Table 4.10 indicated that 69 % agreed and 31% disagreed that medium term loans are better repaid than short term loans. This could be attributed to the fact that medium term loans are not as large as long term loans and therefore are easier to manage. Additionally, medium term loans have longer repayment periods and thus may allow for the project to earn returns that may help in clearing outstanding loan balances.

### 4.7 Major Reasons for Failure in Loan Repayment

The researcher sought to find out the major reasons for loan repayment. The respondents were requested to list the major reasons they thought caused loan defaulting. The frequency Table below captured the respondents' opinions.

**Table 4.12: Major Reasons for Failure in Loan repayment**

<b>Reason For Default</b>	<b>Frequencies</b>	<b>Percentages</b>
Diversion of funds from intended purpose	13	100
Poor credit appraisal	6	46
Death or incapacitation of borrower	11	85
Fluctuating interest rates	7	53
Poor monitoring of loans	4	31
Change of internal credit policies	8	62
Poor risk management	5	38
Loss of source of income	10	77
High interest rates	12	92
Lack of commitment by borrower	3	25
High taxation reducing disposable income	4	31
Lack of adequate security	7	53
CBK regulations	3	3
<b>Total</b>	<b>93</b>	<b>100</b>

The research findings in Table 4.12 above showed that diversion of funds from the intended purpose and high interest rates were the main reasons cited by respondents behind loan defaulting. Additionally, death or incapacitation of the borrower and loss of their source of income were the other two major reasons that attributed to loan default. The reasons cited as least likely to cause loan default were CBK credit regulations and a lack of commitment by the borrower. The researcher therefore concluded that diversion of funds could lead to stalling of underway projects leading to constrained monetary return on investments hence difficulty or ultimate failure to repay the loan.

In addition, high interest rates which cause high installments may lead to inability of the borrower to satisfactorily honor loan installments as and when they fall due. The researcher argued that CBK credit regulations may affect the lender and not the borrower in the short term and therefore may take time to trickle down to the borrower.

## 4.8 Strategies to be used to Improve Loan Repayment

The study finally sought to explore the strategies that may be used to improve loan repayment by motivating the loanee to service their loans. The researched also wanted to find out whether the loanee was well briefed of the terms and conditions of the financial contract before taking the loan and whether the loanee felt that the repayment period was sufficient to service the loan.

### 4.8.1 Factors Motivating Loanees to Service Loans

The researcher wanted to find out the main factors motivating loanees to service their loans. Table 4.13 indicated the responses.

**Table 4.13: Factors Motivating Loanees to Service Loans**

Motivating factor	Responses (Out of 92)	Percentages
Not to lose collateral	92	100
Expectation of getting another loan	80	87
Knowing paying bank loan is an obligation	48	52
To Maintain social status	0	0

The research findings in Table 4.13 above indicated that 100% of the respondents are motivated to service their loans due to fear of losing the assets charged to the bank as collateral. 87% on the other hand cited their key motivator to repay loans as the expectation of easily accessing another loan from the bank in the future. Slightly over half of the respondents were motivated by their conscious drive that repaying a bank loan is solely their obligation which must be met. However, none of the respondents felt that repaying their bank loans would in any way boost their social status.

#### 4.8.2 Adequacy of Loan repayment Period and Understanding of Terms and Conditions

The researcher sought to find out whether the loanees were of the opinion that the repayment period was sufficient to repay the loan and whether the borrowers fully understood the terms and conditions underlying the financial contract. Table 4.14 captured the responses.

**Table 4.14: Repayment Period and Terms and Conditions**

	Yes	No
Is Loan Repayment Period Sufficient?	30%	70%
Are terms and conditions clear?	80%	20%

The research findings in Table 4.14 indicated that 70% of the respondents were of the opinion that the repayment period was insufficient to fully repay the loan while only 30% thought the repayment period was sufficient. On the other hand 80% of the respondents made the assertion that the bank's terms and conditions on the loan were clear while 20% of the respondents thought contrary.

## CHAPTER FIVE

### SUMMARY OF FINDINGS, DISCUSSION, CONCLUSIONS AND RECOMMENDATIONS

#### 5.1 Introduction

This chapter presents the summary of the findings conclusions and recommendations based on the responses from the respondents.

#### 5.2 Summary of Findings

The findings of the research were in accordance to the objectives of the study and were summarized in the Table below:

**Table 5.1: Summary of major findings**

Objectives	Findings	Remarks
To establish the extent to which demographic factors influence loan repayment in NIC bank	<ul style="list-style-type: none"><li>• Higher income groups have better loan repayment record than lower income groups</li><li>• Older borrowers had better records of loan repayment than younger borrowers</li><li>• Women borrowers have better loan repayment records than their men counterparts</li><li>• More educated borrowers are not better at loan repayment than lesser schooled borrowers</li></ul>	Demographic factors seem to greatly influence loan repayment.  Demographics in this study were determined by income, age, gender and education of borrowers. For a bank to realize success in recouping the loan it should factor these variables in its decision when lending to improve its credit risk management
To investigate the level at which the type of loan influences its repayment.	<ul style="list-style-type: none"><li>• Personal Banking loans at NIC have better repayment than institutional loans</li></ul>	The type of loan disbursed determines the success of loan repayment.

To determine the relationship between duration of loan and loan repayment

- Long term loans and medium term loans have the same repayment period terms
- Long terms loans have better repayment than short term loans
- Medium term loans have better repayment than short term loans

To explore strategies to be used to improve loan repayment

- Prevent diversion of funds from intended purpose.
- Advocate for borrower to take a life insurance cover
- Lower rates of interest on loans
- Identify all the sources of income of the borrower

NIC as a lender should do more to bring in more personal banking clients.

Their sales effort should step up loan selling activities to individuals.

The duration of loan influences its repayment.

The bank therefore needs to focus more on longer term loans as they seem to have lesser default. This will enable the bank avoid the risk of default brought about by shorter term loans.

The NIC bank needs to look for better ways to screen and monitor its clients, the bank should also have its clients take cover on their lives during the period of loan to avoid default due to death. Lowering interest rates may ease payment of loan installments.

### **5.3 Discussions of Findings**

The discussions in this research work were done in line with the study objectives and the relationships between the independent variables and the dependent variable were discussed. The dependent variable in the study was loan repayment while the independent variables were; demographic factors; type of loan taken; and the duration the loan. Based on the study findings, the following discussions were made;

#### **5.3.1 Loan repayment Problem**

Loans are useful financial tools that help individuals and businesses participate in the goods and services market when they either do not have adequate monetary resources of their own to do so or when they have none at all. From the literature review, Mensah (1999) offers that if economic units relied completely on self-finance, investment will be constrained by the ability and willingness of each unit to save, as well as by its capacity and readiness to invest. Commercial banks earn interest on monies lent to individuals and institutions. However, they stand to lose their capital investment and interest thereof if the loans are not repaid. From the research findings, and as indicated in Table 4.3, approximately two thirds of NIC bank's loanees believed that loan repayment problem begun on the bank's side either as a result of inadequate repayment periods or lack of clarity in the financial contract terms and conditions. However, 100% of the respondents from the bank asserted that the problem of loan default always originated from the borrower.

From the literature review, the repayment problem could arise either from the demand side, supply side, and both or other external factors. The supply side problems include change in the structure of the bank, change in the lending policy, failure in properly appraising the project document and lack of responsibility and accountability of the staff members of the bank. The demand side on the other hand, refers to borrower's age, sex, educational level, household size, management capacity, loan utilization, availability of other source of income, bank credit experience, and specific situation of the enterprise. The findings of the study as reflected on Table 5.1 were therefore a testament that the problem of loan repayment starts on both the bank's side and the borrower's side.

### 5.3.2 Influence of demographic factors on Loan Repayment

From the literature review, Wenner & Proenza (2000) argued that older borrowers are wiser and therefore more responsible than younger borrowers. On the contrary they argue that younger borrowers are more knowledgeable and more independent. The study revealed that older borrowers are better performers at loan repayment than younger borrowers as indicated in Table 4.5. The findings showed that 69% of the respondents were in agreement that older borrowers at NIC bank limited were better loan repayers than young borrowers while 31% disagreed. This implies that the observation by Wenner & Proenza (2000) that older borrowers are more responsible holds true for NIC bank loanees.

From the literature review, Temu (1999) observes that the level of income of the borrower influences loan repayment. He notes that Borrowers that have other sources of incomes may utilize the funds to make loan repayments (Temu, 1999). Thus, borrowers with other sources of income may have higher repayment rates. Additionally, borrowers who have been in business longer are expected to be more successful in their business ventures. Arguably, this may be as a result of consistent hence stable sales and manageable cash flows as compared to start-ups. The research findings were therefore congruent with the assertions in the literature review as indicated in Table 4.4 which showed that 92% of the respondents were agreeable with the fact that high income earners have better repayment rates than lower income earners. However, loan officers questionnaires revealed that lower income earners have a higher tendency of diverting funds to other uses because of their many unmet financial demands leading to poor repayment.

From the literature review, Wenner & Proenza (2000), argues that lending to women can lead to economic empowerment and inculcate in them a culture of hard work and financial discipline, which may lead to high loan repayment rates. The research findings as indicated in Table 4.6 showed that women were indeed found to have higher loan repayment rates as compared to men. This was attributed to women's natural orientation to life which wires them as better planners and savers. Men were found to be good financial planners but they do not follow through with their plans as their risk seeking nature makes them more susceptible to divert funds to other uses, leading to default.

It was noted in the literature review that higher education levels may enable borrowers to comprehend more complex information, keep business records, conduct basic cash flow

analysis and generally make the right business decisions. The findings of the study however pointed out that highly educated borrowers were not necessarily better loan payers than the lowly educated as indicated in Table 4.7. It is however important to note that this finding was more applicable to the personal banking clients as opposed to corporate clients. This could be attributed to the fact that highly educated individual borrowers may be masters in their disciplines but poor financial managers. At the corporate level, higher education as related to credit management would imply the presence of financial analysts and accountants which may lead to better repayments vis-a vis an organization with lower education like say a rural women's agricultural co-operative.

### **5.3.3 Influence of Loan type on Loan Repayment**

On the basis of the nature of customers NIC Bank Limited offers two types of loans; personal loans to individuals and corporate loans to corporate clients. From the literature review, Ledgerwood (2004) argued that institutions study loans implying a larger amount of money is progressively more carefully monitored. As the absolute amount of the loan increases, the authority to delegate responsibility is more limited and the decision escalated to the bank's management hierarchy. Furthermore, it is also argued that smaller loan amounts are insufficient for projects thus creating cash flow problems to the borrowers hence the larger the amount, the lower the default rate.

However, the findings of the research indicated that two thirds of NIC bank officials were of the opinion that individuals do better than corporate in repaying their loans. This seeming misnomer could be attributed to the fact that individuals are motivated to repay their loans because they attach personal property as collateral for their loans. Corporate clients normally attach shareholder's property as collateral for loans and may not be well motivated to repay their loans on time particularly if the senior management is not part of the directorship of the company. In addition, corporate clients access long term loans which may be harder to continuously follow them up and hence the dismal repayment performance. Another reason for this is that corporate clients are more susceptible to changes in the economic environment hence a small change in regulations and credit policy by CBK, global recession and changes in inflation may cause loan default.

### **5.3.4 Influence of Loan Duration on Loan Repayment**

From the literature review it was noted that the duration of the loan was mostly dependent on the size of the loan. Ledgerwood (2004) observed that since long term loans were usually of a larger amount, decision making was normally made by top level management thus low default rates are expected. On the contrary, short term loan decisions were made by lower management where expertise and experience may lack hence higher default rate. True to this, the findings of this study indicated that long and medium term loans have the same default rates and better repayment rates than short term loans. It could also be argued that eventual short term borrowers lacked sufficient collateral to achieve the medium and long term goals which was an indication of inability to save and own assets hence higher risk profiles and higher expected default rates. In addition, the higher default rates of short term loans could also be attributed to the short repayment period which did not allow for the loan project to earn sufficient returns to pay loan installments..

### **5.3.5 Strategies to Improve Loan Repayment**

As was noted by Eboh (2000) in the literature review, the problem of loan default reduced the lending capacity of a financial institution. It also denied new applicants access to credit as the bank's cash flow management problems augment in direct proportion to the increasing default problem. In other words, it may disturb the normal cash inflow and outflow of a financial institution to enable it remain competitive in the industry. The researcher sought to understand the major reason for failure of loan repayment with the hope of offering solutions that may help in mitigating this problem.

The findings were indicated in Table 4.12 and pointed out diversion of loan funds from the intended purpose by loanees as the main reason that caused repayment problems. In this regard, the bank should initiate strict and thorough monitoring and evaluation programs that will ensure the client has little opportunity for misuse of funds. In the case of assets, the bank should deal directly with the suppliers and reduce the handling of the money by the loanee. The study revealed that high interest rate was a key motivator to failure of loan repayment. As opposed to foregoing both the principal and the interest on loans, banks should attempt to lower their rates so that repayments were not burdensome to the borrower. In the same coin, banks should be lenient when calculating the risk profiles of its borrowers when setting

interest rates for their clients. The interest rate should also reflect the profitability of the business venture hence the higher the profitability of the individual or company the higher the interest rate ad vice versa.

Death or incapacitation of the borrower was also cited as the third most common cause of loan default. The bank should make it a policy to have loans above a certain amount be covered by an Insurance company hence mitigating both the borrower's dependents or the bank from any unforeseen loss. The bank should also establish all alternative sources of income of the borrower in case they lose their main source of income and cannot repay the loan as a result. The banks should also have stable internal credit policies so that the terms and conditions of the loan contract do not change during the period of the loan. Last but not least, the banks should offer reasonable repayment periods and offer a moratorium of at least three months before asking for the first loan installment.

#### **5.4 Conclusions**

The conclusion derived from the research is that there is a wide range of factors affecting loan repayments at NIC Bank Limited, Nairobi province. The loan repayment problem was seen to be caused by the borrowers as opposed to the bank although the borrowers were of the opinion that interest rates should be lowered and longer repayment period granted to enable them comfortably pay back their loans. Demographic factors, type of loans and duration of the loan were seen as the main factors affecting loan repayment at NIC bank Limited, Nairobi Province.

Specifically, demographic factors included income, age, gender and level of education. The study showed that high income groups have better loan repayments but the researcher argued that NIC bank does not target the lower end of the society and thus this particular cohort may find their terms unfavourable hence leading to default. The researcher also found out that older borrowers had high repayment rates and this was attributed to thbuilt a relationship with the bank over the years. Gender also plays a key factor in influencing repayment as women were found to perform better at paying back loans than men. Education was seen as least likely to influence repayment as borrowers with low level education faired fine in repaying their loans. Thus, from the study, all the demographic factors should be taken into consideration when making the lending decision

Another key influencer of loan repayment was seen to be the type of loan given by NIC Bank Limited. The bank was seen to offer personal banking loans and institutional loans. The institutional loans were found to have a higher rate of default than the personal banking loans. The researcher argued that the natures of their projects are complex in nature and therefore difficult to supervise and evaluate. Most of their loans are also long term and staff turnover at the bank hampers continuity in project evaluation and this leads to default. Personal banking loans were found easier to manage and the personal attachment to loan collaterals by the loanee was also seen to be a motivator for repayment. Thus, from the study, closer monitoring of institutional loan projects should be done to bolster repayment rates.

Additionally, another factor influencing loan repayment was found to be the duration of the loan. There was however a contradiction of findings as loans with longer repayment periods were found to perform better than those with shorter repayments. This was in contrast to the finding that institutional loans which normally have longer repayment had higher default rates than personal banking loans which are mostly short to medium term. Be that as it may, the researcher argued that the orientation of NIC bank Limited is such that it targets institutions and longer term individual borrowers and as such the terms for shorter loans may not be very favourable hence a higher rate of default.

Finally the researcher ventured into establishing strategies that may improve loan repayment. The bank will be required to better improve its loan monitoring ability as loan funds were being diverted from their originally intended purpose. The bank will also need to engineer new financial cover products to protect them from default arising out of death or incapacitation of a borrower. Additionally, the bank may need to be a bit lenient when calculating risk profiles of borrowers and assign them lower interests on their loans while laxing the repayment period. On the whole, the bank should look for new strategies to ensure they reduce their loan losses.

## 5.5 Recommendations

Based on the research findings, the researcher hereby makes the following recommendations:

1. NIC Bank Limited should develop thorough screening procedures to give more insightful information about a loan seeker hence reduce the risk of adverse selection.
2. NIC Bank Limited should conduct proper trainings on project management to its loan officers so they can be better placed to monitor and evaluate big complex projects with a view to enhance quick detection of funds being diverted.
3. NIC Bank Limited should invest in research and development of its clients to enable them better understand the demographic composition of its clients which will enable them improve loan repayment rates
4. NIC Bank Limited should offer training on financial management to its loanees to empower them to be able to run their projects successfully.

## 5.6 Areas for further research

Following the study herein, the researcher recommends further research to be done on ways of improving loan repayment in commercial banks in Kenya. This will help avoid a run on banks and improve greater access of credit to borrowers.

Further research is recommended on the constraints loan officers face in monitoring and supervising loan projects and chasing up loan payments. This will help the bank's management to understand the need to train their staff on project management.

In addition, research should be done on the factors influencing interest rates applied on different loan types and how risk profiles of loanees are determined. This will aid industry regulators in determining the interest rate spreads hence encourage borrowing.

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## APPENDICES

### APPENDIX 1: LETTER OF INTRODUCTION

**Charlene Waweru,  
Reg No:L50/70260/08  
University of Nairobi**

**To Whom it May Concern,**

**Dear Sir/ Madam**

**RE: DATA COLLECTION FOR UNIVERSITY OF NAIROBI'S MASTERS PROJECT**

I am the above named student pursuing a Masters of Arts in Project Management degree program at the University of Nairobi due to graduate in September 2010. As part of the program we are required to write a research project on various topics concerning the Kenyan market.

My topic of choice is a case study on your bank titled "Factors Influencing Loan Repayment At NIC Bank Ltd". I hereby kindly request your bank to furnish me with the relevant information to enable me complete my research project. Thank you.

Yours Faithfully,

**Charlene Waweru.**

**APPENDIX 2: QUESTIONNAIRE FOR LOAN OFFICERS**

**Profile of Respondent**

i) Name (Optional).....

ii) Gender {Please Tick one}

a) Male

b) Female

How long is the grace period for majority of the loans by NIC bank?

Less than 5 years     Btw 10-20 yrs     Over 20 yrs

2. Is the grace period given to the loanee enough for the implementation of the project?

Yes

No

3. Are the projects taken out by loanees fully implemented within the intended period of time to ensure repayment?

Always

Most of the times

Sometimes

Never

9. Do most of the loanees start defaulting immediately after taking out the loan?

Always

Most of the times

Sometimes

Never

10a. In your opinion, from which side do you think the problem of default starts?

The bank's side

The borrowers side

others (specify)

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10b. What corrective measure is normally taken? What was the outcome?

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11. On a scale of 1-5 where 1 is strongly agree, 2 is Agree, 3 is No idea, 4 is Disagree, 5 is Strongly Disagree Rate the following factors /statements in determining loan repayments

Parameters	1.Strongly Agree	2.Agree	3.Not Sure	4 Disagree	5. Strongly Disagree
a) High income earners have better loan repayment than low income earners					
b) Older borrowers have better repayment than younger borrowers					
c) Borrowers with higher education have better success repaying their loans					
d) Women borrowers have lower default rates than male borrowers					
e) Personal banking loans have lower default rates than corporate banking loans					
f) Long term loans are easily repaid compared to medium term loans					
g) Long term loans are easily repaid compared to short term loans					
h) Medium term loans are easily repaid compared to short term loans					

12. In your opinion are the three major reasons that lead to failure in loan repayment?

- a) \_\_\_\_\_
- b) \_\_\_\_\_
- c) \_\_\_\_\_

13. What constraints do you face when following up loan repayment?

a) \_\_\_\_\_

b) \_\_\_\_\_

c) \_\_\_\_\_

14. What strategies would you recommend to NIC in order to improve lending approaches?

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**APPENDIX 3: INTERVIEW GUIDE FOR NIC BANK LOANEES**

1. How many times did you take loan from NIC?

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.....  
.....

2. Was the loan you took recently adequate for the intended purpose?

.....  
.....  
.....

3. How much did you request for?

.....  
.....

4. Do you believe that the loan has to be repaid to the bank?

.....  
.....  
.....

5. Which of the following in your opinion is most critical in motivating you to service your loan on time?

- not to loss collateral
- in expectation of getting another loan
- knowing that paying bank loan is my obligation
- others (specify) \_\_\_\_\_
- to maintain social status

6. Is the repayment period sufficient to fully repay a loan?

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7. What do you think is the suitable repayment period?

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8. Do you prefer to service loan instalments monthly, quarterly or semi annually?

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9. In your opinion what should be the repayment duration?

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10. Have you ever gone to the bank after you took the loan? If no, specify reason

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11. Were you well briefed on the loan contract before you signed?

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12. Are there any details that you feel the bank inadvertently left out regarding your loan that has affected you repayment?

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