DETERMINANTS OF LOAN REPAYMENT DEFAULT AMONG SMALL AND MEDIUM ENTERPRISES IN KISUMU CENTRAL SUB COUNTY, KENYA

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DECLARATION

This research project is my original work and has not been presented to any other university or institution for attainment of a degree or diploma awards.

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DEDICATION

To my Parents for the overwhelming support cum encouragement.

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ABBREVIATIONS AND ACRONYMS

CRB   Credit Reference Bureaus

NPL   Non-Performing Loan

OECD   Organization for Economic Co-operative & Development

SME   Small and Medium Enterprises

USAID   United States Agency for International Development

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ABSTRACT

Loan repayment default has been a challenge among SME`s in Kenya. This study checked determinants of loan repayment default among SME`s at Kisumu Central Sub-County, Kenya. The study adopted descriptive cross sectional survey design. Stratified random sampling and Yamane model were used to settle on sample size of 86 SME`s. Questionnaires were administered to owners/managers of SME`s that resulted in 65 successful responses. The Descriptive Statistics; mean, standard deviation, frequency cum percentages adopted to analyze the data. Factor analysis ascertained latent variables in the study. The study established that determinants of loan repayment default are grouped into Ownership, Borrower, Loan and Lender characteristics. The study revealed that ownership characteristics had an average mean of 3.5456, borrower characteristics had average mean of 3.7823, loan characteristics had an average mean of 3.7594, with lender characteristics having an average mean of 3.7594. Factor analysis shown KMO value of 0.473, thus not good as it was below standard threshold of 0.83 and Bartlett`s test significance at 0.000, implying all factors were taken into account. The study recommended stakeholders should establish policies that mitigate on the challenges of the Loan repayment default modeled around ownership, borrower, loan and lender characteristics.

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

Loan repayment default remains a thorny issue to individuals and organizations in varied proportions. Loan repayment default denotes failure of a loanee to service a debt as per the original pact or when it's due (Balogun & Alimi, 1990). Firzil & Nicholas, (2010), expounded it as being that which occurs when a debtor fails to honour mandated legal obligation stipulated in debt contract, thus condition in the debt contract has been subverted or repayment hasn't been done as per stipulated time. Delinquency period being the time interfacing missing a loan repayment and having the loan default. This period offer the debtor an opportunity to evade default, which can be through either linking up their loan service or clear missed payments. Loan repayment default setback is disaster since it triggers system disaster to device suitable loaning strategies cum reliable credit policies. Substantially, the debtor's credit score will drop plus having high interest charged on any future loans. It also discourages financial institutions from further refinancing the firms, which have defaulted, thus putting the defaulters into continuously reduced productivity, while loans secured with collaterals, assets are likely to be seized by the Financing Institution in case of default (Beck, Demirguc-Kunt and Peria, 2017).

This study was anchored on Moral Hazard Theory by Dembe and Boden (1960) postulate that a threat arises when one party to an agreement acts otherwise to the disadvantage of the other party after the contract is signed. Mirrlees, (2015) as a follow up to moral hazard theory, argues the idea conjointly results in monetary loss when people in possession of personal data, take actions that unfavourably present the chance of

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dangerous outcomes. Pecking order theory by Myers & Majluf (1984) denotes enterprises stick to a technique to means of financing, where internal financing is preferred, and opt for debt over equity if external financing is needed.

Kisumu Central Sub County is considered a commercial venture sub county owing to a number of business activities situated in the town. Apart from this, fishing is also a major activity since the larger Kisumu County is situated along the Lake Victoria border .Therefore Trade, Fishing and Farming form the major backbone of the economy of this sub-county. As a result most of the inhabitants of the Sub County depend on these for daily living. Since a third of this population dwell in the city, a number of SMEs are concentrated within Kisumu City (Government of Kenya, 2009).

1.1.1 Loan Repayment Default

Loan repayment defaulting denotes incapability of the person who took the loan to pay the loan installment when due (Balogun and Alimi, 2015). Loan repayment default arises when a loanee fails to honour interest or principal due. During default, an individual or institution is likely to forgo any property used as security to receive the loan. Failure to pay has an undesirable consequence on credit history and credit score, thus challenge of repeat borrowing in the future. This can happen when a loanee misses programmed repayment, or has dishonored a loan agreement (Ameyaw, 2011). Default can transpire when loanee become either reluctant or incapable of servicing the debt (Murray, 2011).

Loan repayment default indicators are: Loan Collection rate which are measured by amounts really paid over amounts due; Loan Arrears Rate being amounts which were due

but have not been paid verse total amounts of loan; Risk Rates Portfolio ascertains residual loans not honoured in time verses total loans outstanding balance.

1.1.2 Determinants of Loan Repayment Default

Atsmegiorgis (2016) grouped Loan Repayment Default determinants into four: individual/loanee, ownership characteristics, loan and institutional/lender determinants. Ownership characteristics include the location of business and the years the business have been in operation. The right location will depend on the type of the business and the customers targeted. Crucial locations will lead to increased sales thus increased revenues. Such businesses have high loan repayments than those not tactically located. The businesses that have been in operation for more than one year have high loan repayment than those, which have existed for less than one year. Further, Ownership structure, type of entity, distance linking SME location cum lending bank affects loan repayment (Nawai & Shariff, 2016).

Breth & okello, (2015) notes, borrowers incorporate financial qualities such as instructive level, conjugal status, and family unit pay level and associate weight in a mass based plans alongside borrowers' attributes, advance qualities, business attributes relate to loan default. The capability to put the advance into useful utilization will rely on the borrowers' trademark. This may take different social monetary measurements including sex, wage level, the family estimate, instructive level and age.

The length of time that credit is extended affects the loan repayment greatly. Loans are designed in a way that allows them to be paid back in regular installments over the loan duration (Ledgerwood 2013). Loan settlement is considerably associated with the size of

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the loan, type of the loan, and the previous experience gotten from paying loan, the purpose of the loan, the level of educational and the collateral type offered (Atsmegiorgis (2014). Other factors such as institutional and social economic influence loan repayment rate. Key features attributable to loan givers are increased collections magnitude, tightened gearshift, good information management, loan executive goodies cum follow ups (Breth and okello, 2015). Further, size of loan, financing cost by moneylender cum time of giving credit affects the repayment rates (Karlan and Valdivia, 2014). Among SMEs, loan defaulters have been increasing due to interest rates, type of loan, repayment period (Kibosia, 2012).

1.1.3 SME`s in Kisumu Central Sub County

Small and Medium Enterprises (SMEs) have ten to fourty nine workers in Small Enterprises while Medium Enterprises have fifty to ninety nine workers. SME`s employ 85 percent of Kenyan workforce, thus is an important subsector contributing to Kenyan economy and other emerging economies (Kiliswa, 2016).

In Kisumu Central Sub County, SMEs conduct their trade and industry activities virtually in all sectors of the economy. These include transport, fishing, finance, agriculture, small scale artisans, construction and manufacturing. The SMEs in Kisumu are categorized by four to seventy five workers plus having a capital assets of fifty thousand to fifteen million Kenya shillings (FKE, 2018). Kisumu Central Sub County in 2018, issued single business permit to 7,000 SME`s generating license income of eighty million, and engaging 80% of Kisumu County workforce. SME`s are essential drivers in Kisumu County economy. Fundamental aspect constraining SMEs development in Kisumu is restricted admittance to financial capital cum credit. The main cause for failing of the

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credit repayment by SMEs in Kenya is owed to the loan money given out lacking any form of collateral to debtors (Ong'olo and Odhiambo, 2015). Also failure to have structures in which the funds are predicted well for the repayment period (Nene, 2014).

1.2 Research Problem

SME`s have considerable input in Kenyan economy similar to other emerging economies. It contributes to 85 percent of the Kenyan work force. Due to the significance of the SME sector in Kenya, the constitution 2010 outline framework for addressing SMEs concerns via regulatory cum institutional changes aligned to devolved governance structure and Micro & Small Enterprises Act 2012 (Ong'olo and Odhiambo, 2015). Most of SMEs have insufficient incomes to bolster growth. Loaning is a major approach in use to trigger business growth cum development in Kenya's SME sector. However, main hindrance to SME loaning schemes remains poor loan repayment (Ochillo, 2017).

Mensah et al. (2013) study surveyed determinants of loan repayment in agriculture cum the farming segments. They emphasized on group lending than individual lending. Makorere (2014) investigated issues that affect the loan repayment manners by Tanzania SME`s. He proved that several financial institutions faced challenge of a rise in loan default balances as some loans issued are not repaid when due. In Kenya, Kibosia (2015) study examined the association connecting non-serviced Loans related to SME sector plus causes amid commercial banks, Kenya. Njangiru et al. (2014) analyzed the loan repayment cum practicability concerns in government micro-credit programs at Murang'a County. In addition, Matheka (2013) examined the reasons why there existed high rates of loan repayment default at the loans funded by the Constituency youth enterprise to the

youth groups within Kitui central constituency thus found several issues influenced loan repayment.

The previous researches focused on diverse sectors like small-scale farming. The studies also focused on other counties thus no study exists on determinants of loan repayment default in SMEs at Kisumu Central Sub County. This has opened conceptual and contextual gap, the study filled, answering the question, what are the determinants of loan repayment default by SME`s at Kisumu Central Sub-County, Kenya?

1.3 Study Objective

The objective of this study was to establish the determinants of loan repayment defaults among SMEs in Kisumu Central Sub-County, Kenya.

1.4 Value of the Study

Given tremendous growth the sector has exhibited during the past few years, SMEs role is significant in the realization of the vision 2030.This sector is also a potential employer and can address the high unemployment rate in Kisumu Sub County and Kenya as a whole. The outcome of this study shall enhance awareness creation to SMEs in knowing the background of non-repayment of loans and how to overcome the challenges. Kisumu Sub County through the County Government of Kisumu shall apply this in empowering the traders so that they can maximize on revenue collection.

These study findings shall help SMEs to establish the factors that influence their capability to repay loans. The government, relevant ministries and other policy makers may use study outcome to formulate policies on loan repayment by SMEs. Financial

institutions like commercial banks, microfinance institutions, SACCOs may ascertain major issues on loan repayment

Information from this study shall be available to various researchers intending to carry out studies on the same subject or advance on other relevant studies. Future researchers and scholars shall find the study handy as it helped beef up existing knowledge on SME`s loan repayment. Scholars may use this study outcome as part of empirical studies.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

The chapter captures literature on the various theories that underpin the study, empirical analysis, conceptual outline cum knowledge gap.

2.2 Theoretical Framework

The chapter presents moral hazards theory, pecking order theory as they relate to loan repayment default.

2.2.1 The Moral Hazard Theory

Moral Hazard Theory as advanced by Dembe and Boden (1960) denote the failure of lender to establish if loans issued to borrowers is directed to the proposed use, or if clients uses loan amount for the inputs corresponding with the business, strength and innovative skill, that are the foundation of the contract in order to get the credit given (Agyapong, 2015). Borrowers face difficulty repaying when contributions are below anticipated (Ghatak & Guinnane, 2014).

The Moral Hazard Theory describes the incapability of banks to monitor borrower's behaviors becomes more pronounced in the case of poor debtors. The fact that the debtors may direct the funds given for different dedications aside from those specified within the contract of the loan, shows that financial institutions shouldn't solely find out the credit worthy of the borrowers whose businesses are small but ought to check the activities they undertake once they obtain the loans (Agyapong, 2015).

Most business loans are granted to catapult business progression and increase their working capital. However, it may occur some loan debtors are not honest in keeping the

contract signed with financial institutions (Makorere, 2014). When loan is diverted it results in moral hazard that causes SMEs failure to repay their loans.

2.2.2 Pecking Order Theory

Pecking order theory postulates skewed information increases cost of financing; Myers and Majluf (1984) popularized it. It sustains that enterprises stick to a technique to means of financing, where internal financing is preferred, and opt for debt instead of equity as external financing. Many researchers like (Asquith and Mullins, 1986; Eckbo, 1986) who have provided proof of inauspicious selection in regards to equity matters have supported the theory. As much as debt is assumed affordable than equity in particular ways, Myers, (1984) posits that information asymmetry interrupts the worth of an entity cum wealth of shareholders. According to Famma & Fench, (2000), profitable firms tend to have little debt checked with non-profitable entities. Murray Frank & Goyal, (2003) on the other hand maintains that large organizations accumulate debts to support and continue with dividend payments whereas small organizations behave differently. The theory's model forecasts on short-lived disparity in investment cum earnings and largely engrossed in debt (Fama, Eugene and Fench, Kenneth, 2000). Businesses with adequate fixed assets are able to generate external finance at lower cost when presenting their belongings for collateral and support the trade-off theory. Firms triggering lofty profit levels can choose internal sources of finance for the investments to debt financing thus abide by pecking order theory. The expanse of debt financing is dependent on economic growth, financial structure, credit availability and legality of the firm. The theory allows firm dynamics to shape the capital structure optimally any time.

Copeland & Weston, (1988) portend business' capital structure becomes function of its cash inflows cum the available opportunities to investment. Profitable entities in relatively slow-growth related industry has no motivation to issue debt, thus low debt-to-equity ratio (Liesz, Thomas J., 2002). They further argue that less profitable businesses in a similar industry may present high debt-to-equity ratio, thus more profitable entities have higher financial muscle. Pecking order aspect forecasts entities following scale of financing where internal financing is preferred to external finance cum debt is preferred over equity. This poses a more convincing explanation on the firms' financing behaviour compared to the conventional bargaining chip. The pecking order theory, anchors on this study as the SMEs have to device possible means for performance improvement and attain sustainability.

2.3 Loan Repayment Default

Loan repayment default has captured the attention of several scholars on different perspective both internationally and locally:

Sileshi, Nyikal & Wangia, (2012) studied issues of loan settlement outcome amongst smallholder farmers in East Hararghe zone, Ethiopia. 140 small scale farmers at Kombolcha and Babile districts were engaged via a questionnaire. Multistage sampling technique adopted. Study established that 71.4 % of smallholder farmers defaulted to repay their loans partially and 28.6 % of smallholder farmers defaulted to repay their loans completely. It also established agro ecological region, off-farm action cum technical support by extension officers affected loan repayment positively. In addition, informal credit, production loss, loan-to-income ratio and social festival affected loan repayment by smallholder farmers negatively.

Ezihe, Oboh & Hyande (2014) examined performance of loan repayment by smallholder farmers who grew maize in Kanke Local Government Area, Plateau State in Nigeria, 90 farmers were selected randomly. The results were analyzed using percentages, means, cum multiple regressions. The findings revealed farmers received average loan of 75,000. Many farmers embraced mixed varieties of maize. The major restraints were high interest rate, less market value of farm produce thus untimely loan disbursement which delayed loan repayment. Study opted more credit from official sources offered to large scale farmers. Timely loan distribution to avoid alteration to other things and successful loan applicants be equipped with adequate loan use skills.

Makorere (2014) explored factors influencing loan default behaviour in Tanzania. Convenience sampling technique arrived at sample of 100. Questionnaires were used and data analyzed via descriptive statistics. The study found grace period, interest rate, moral hazard, profitability, economic stability and electricity rationing strongly affected loan repayment pattern in Tanzania. Study confirmed importance of government intercession in credit management. Financiers' to adopt CRM effectively via condition, capacity, characters, capital cum collateral as measures to control default rate.

Nyamboga et al. (2014) studied impact of financial literacy on SMEs loan repayment. Study concentrated on impact of book keeping skills, credit management (CR) cum budgeting skills on loan repayment by SMEs that benefitted from Equity Group Foundation Training plan in Ngara, Nairobi County, Kenya. The study revealed book keeping, CR cum budgeting skills notably predisposed capability by SMEs to repay loans. It suggested SMEs enroll in financial related programs so as to enhance SMEs abilities.

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Mwangangi, (2014) study examined association connecting borrower credit score and credit repayment outcome using a correlational research design. Questionnaires were administered to 100 corporate clients who had been given loans by the Agricultural Finance Corporation (AFC) over a period of 5 years. Regression was used in data analysis to define the connection linking credit scoring cum repayment outcome of borrower. The study found that credit scoring of a debtor positively predisposed loan repayment outcome. It also facilitated swift loan approval, evenness in lending, plus ground for risk pricing. The study recommends AFC to cooperate with other credit institutions to ensure that they get in depth information on clients before giving them loan.

2.4 Determinants of Loan Repayment Default

There are various aspects of loan repayment default. The study focuses on ownership, borrower, loan cum lender characteristics.

2.4.1 Ownership Characteristics

Ownership structure is the factors which determine the ownership of the business and may affects loan repayment. They include nature of entity, cum distance linking SME location to lending institution (Nawai and Shariff, 2016).

The kind of structure of ownership may bring about lack of loan repayment (Coravos, 2018). Usually, sole proprietors are at a high risk of loan repayment default than those businesses owned by many people (Brehanu and Fufa, 2018). According to Jimenez and Saurina (2015) the type of collateral the owner presents as security, has the possibility of being the reason for loan repayment default. The study found positive relation linking

collateral given by owner to chances of paying back the loan. The business owners with additional source of income or other extra income has high likelihood of paying the loan (Brehanu and Fufa, 2018).

2.4.2 Borrower Characteristics

Borrower's characteristics include age, gender, income status, credit use familiarity, type of business cum volume of investment and may influence loan repayment (Nawai & Sharrif, 2010).

The distance between debtor and creditor institution will be used to determine the demand for security asset (Jiménez, Salas and Saurina, 2014), but it can be tested for chances of failure to repay loan. It is easier to monitor chance of default, when distance linking the debtor to loaning institution appears small. Age of the debtor may also cause the loan repayment default (Mokhtar, Nartea, & Gan, 2012). Time business has been running, if it is long offers enough experience for the business to have sound financial management practices which can reduce loan repayment default. Though at times when the business over relies on its experience, it can cause indiscipline in finances thus resulting in loan repayment default. Those who borrow many loans have the likelihood of failing to repay the loan (Mokhtar et al., 2012). Many loans resulted to stress on the business resources thus making it hard for loan repayment. It was also found that small business failed to pay their loans more than large businesses (Brehanu and Fufa, 2018). The relationship of the borrower and the lending institution can cause loan repayment default. A positive association connecting the borrower with the lending organization reduces likelihood of loan repayment default (Jimenez and Saurina, 2013).

2.4.3 Loan Characteristics

Loan features like loan size, period of repayment, value of collateral, number of installments, application costs and interest charged on loan being issues definite to the loan facility being offered and may impact loan repayment (Karlan and Valdivia, 2014).

There exist various specific loan factors that can result to probable loan repayment default (Foster and Zurada, 2013). The loan loan term has likelihood of resulting to failure of loan repayment. Loans with long-term maturity have a high likelihood of loan repayment default (Roslan and Abd Karim, 2015). Loan schedules as described by Mokhtar, Nartea and Gan (2015) can cause loan repayment default. Loan repayment installment should match how the money flows into the business. The loans installments should be paid in less than one-month intervals. The main reason to which the loan is taken can result to loan repayment default. When the reason of taking the loan is different from business expansion, adding up to production or service provision, loan default is likely to happen (Herrington and Wood, 2013). The interest rate charged on the loan can be the reason for loan repayment default (Salas and Saurina, 2015).

2.4.4 Lender Characteristics

Lenders characteristics includes, time taken between advance application and payment, financing cost, capacity to approach business data, agreeable admission and punishment for delay to comprehensive gatherings are factors that exist within the financial institution granting the loan facility and may affect loan repayment (Korankye, 2014).

They can be traced to the institutions offering credit and may cause loan repayment default. Long loan processing cycle may increase probability of the debtor to miss the

opportunity which is time bound and reason for the loan repayment default. This may encourage loan diversion to other activities other than the purpose of the loan (Faulkender and Petersen, 2016). When the creditor approves less amount of loan than the amount applied for by the debtor, it becomes hard to accomplish the mission of applying for the loan. This may cause loan fund diversion to other purposes thus loan default. The credit institution should thus ensure there is evidence of the purpose for taking the loan. When the interest rate is exorbitant, there is probability of loan repayment default (Claessend, Krahnen, and Lang, 2015).

2.5 Summary of Literature and Knowledge Gap

Most studies in literature were done in different sectors like agricultural sector, micro credit and microfinance sectors. The studies reviewed revealed that different factors that influenced loan repayments. The factors were significant based on the study though maybe insignificant in another study.

The studies established that loan repayment default is a problem in most sectors whether agricultural, government funded programs and in the small-scale sector but obtained varied results. The studies captured other sectors which were different from SME. Due to this, results cannot be generalized to the SME. This leaves a gap in literature, thus need to ascertain aspects of loan repayment default in SMEs at Kisumu central sub-county, Kenya.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter documents Research Design, population, Sample size and sampling technique, data collection cum data analysis.

3.2 Research Design

Descriptive cross sectional survey research design used in the study. Descriptive design enables absolute description of circumstances, resulting in minimum bias in data collection (Cooper & Schindler, 2012).Cross sectional survey proved ideal for data collection from the population to get a general look of the field of study having participants with varied characteristics and demographics (Pasha and Negese, 2014). McCombes, (2019) deduces that descriptive research design uses wide variety of quantitative cum qualitative methods to check variables and the researcher cannot direct or maneuver any of the variables, but only observes and measures them. The following studies successfully used this method, (Madole, 2013; Waithanji, 2014; Omondi & Jagongo, 2018)

3.3 The Population of Study

Population denote whole group of individuals or things the researcher was interested in generalizing the conclusion (Kothari & Garg, 2014).The population of this study consists of 600 SMEs registered by and operating in Kisumu Central Sub-County by June 2019.

Table 3.1: Population of Study

SME`s Category	Target Population
Cosmetics	160
Hospitality	110
Wholesalers and Retailers	210
Health Facility	80
Transporters	40
Total	**600**

Source: (Kisumu county License Report, 2019)

3.4 Sample Size and Sampling Techniques

3.4.1 Sample Size

$$n_s = \frac{N}{\{1 + N(e^2)\}}$$

Yamane, (1967) formula was adopted to get the sample size:

Where,

n_s = Sample size   N= Population size

e = error term =1% with confidence level interval at 90%. Hence

n_s = $\underline{600}$

$\qquad$ $1 + 600(0.1^2_)$

Sample Size (n) = 86 respondents

Abayo and Oloko, (2015) used Yamane model successfully and identified it as the simplest and the best formula for arriving at the sample size of a population thus the motivation for the adoption of the same.

3.4.2 Sampling Method

The targeted population consists of the 600 SMEs operating in Kisumu Central Sub County (Kisumu County SME`s License Report, 2019). Stratified random sampling adopted within strata because SMEs at Kisumu Central Sub County are not homogeneous. Strata from which the samples were selected include; Cosmetics and beauty shops, Hospitality Services, Wholesale and Retail Shop, Health Services and Transport Services.

Table 3.2: Sample Size

SME`s Category	Target Population	Proportion	Sample Size
Cosmetics & beauty shops	160	86/600 = 0.1433	23
Hospitality Services	110	86/600 = 0.1433	16
Wholesale and Retail shops	210	86/600 = 0.1433	30
Health Services	80	86/600 = 0.1433	11
Transport Services	40	86/600 = 0.1433	6
Total	**600**	**86/600 = 0.1433**	**86**

Source: (Researcher, 2019)

The study was confined to SMEs who had benefited from loan. This sampling method offers an efficient system of getting a small group, variation or heterogeneity existing in target population. The selected sample size needs at least 30 elements (Mugenda & Mugenda, 2013).

3.5 Data Collection

The primary data gathered via structured questionnaires. Structured questionnaire conserve time and enable ease of analysis. The questionnaires were filled by the owners of the SME`s. The questionnaire had two sections. Section 1, outlines background information. Section 2, sought determinants of loan repayment default (Appendix 1). Five-point likert scale used: Not at all (1); Minimal extent (2); Moderate extent (3); Large extent (4); Very large extent (5) was used. The questionnaire was administered to the owner of SMEs within Kisumu central sub-county using a drop & pick later method. It had closed ended questions, as Mugenda and Mugenda (2013), posit that closed or the structured inquiries are normally easier to be analyzed completely.

3.6 Data Analysis

Descriptive statistics like mean, frequencies, percentage cum standard deviation identified degree to which various determinants influence loan repayment default among SME`s in Kisumu Central Sub-County.

Factor analysis ascertained latent determinant of loan repayment default among SME`s in Kisumu Central Sub-County, via S.P.S.S software. Data shall be presented in charts and tables as was successfully adopted by Sakwa (2018). Where there was a representation of the communalities before and after the extraction, principal component analysis adopted as extraction method and the varimax with Kaiser Normalization being rotation method. Principal component analysis operates on the postulation that all variables are similar prior to extraction at a value of 1.00 (Kothari and Garg, 2014).

CHAPTER FOUR: DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This chapter presents response rate, SME`s background information, Descriptive Statistics, Factor Analysis of data aligned to the study objective and discussions of the findings.

4.2 Response Rate

Table 4.1: Response Rate

Target Responses	Frequency	Percentages
Response	65	76%
Non Response	21	24%
Total	**86**	**100%**

Source: (Researcher, 2019)

Table 4.1 Shows that, out of the 86 questionnaires sent to Manager/Owners of SME`s, 62 responded and returned completed questionnaires. This indicates response rate of 76%. It was considered adequate for drawing conclusions, consistent with Berg (2004) who observed that 70% and above response rate is good. The 24% of targeted respondents did not return the questionnaires citing busy schedule attending to duties out of office during study period.

4.3 SME`s Type of Business

Table 4.2: SME`s Type of Business

Type of Business	Frequency	Percentages
Wholesale and Retail Shops	29	45%
Cosmetics and Beauty Shops	12	19%
Transport Services	6	9%
Hospitality Services	8	12%
Health Services	10	15%
Total	**65**	**100%**

Source: (Researcher, 2019)

Table 4.2 outlines the type of businesses that the SME`s under study were operating. Out of the 65 SME`s under study, 45% were Wholesale and Retail Shops, 19% were Cosmetics and beauty shops, 9% were offering Transport services, 12% were Hospitality service providers and 15% were offering Health related services. Thus, the highest strata of the SME`s under the study were from established Wholesale and Retail Shops.

4. 4 SME`s Ownership Structure

Table 4.3: SME`s Ownership Structure

Business ownership structure	Frequency	Percentages
Sole Proprietorship	38	58%
Partnership	11	17%
Registered Company	16	25%
Total	**65**	**100%**

Source: (Researcher, 2019)

Table 4.3 illustrates 58% of SME`s were Sole proprietorships, 17% were Partnerships and 25% were Registered Companies. Thus, responses were received from every category of ownership and data gathered that enabled ascertaining determinants of loan repayment default across SME`s of different ownership structure in Kisumu Central-Sub County, Kenya.

4.5 SME`s Years in Business

Table 4.4: SME`s Years in Business

Form of Business	Frequency	Percentages
Less than 3 years	15	23%
4-7 year	24	37%
8-11 years	21	32%
Over 12 years	5	8%
Total	**65**	**100%**

Source: (Researcher, 2019)

Table 4.4 denote 65 SME`s that participated in the study, 23% had been in operation for less than 3 years, 37% had operated between 4-7 years, 32% had been in business for between 8-11 years and 8% had been in existence for over 16 years. This ascertained that all the SME`s had been in business long enough to provide data relevant to determinants of loan repayment default aspects within Kisumu Central-Sub County, Kenya.

4.6 Determinants of Loan Repayment Default

Determinants of Loan repayment default were grouped in terms of ownership, loanee, loan cum lender characteristics. The data analyzed via descriptive statistics cum factor analysis.

4.6.1 Descriptive Statistics

The Descriptive Statistics (mean and std deviation) for the determinants of loan repayment default were obtained from empirical investigation data.

Table 4.5 Ownership Characteristics as Determinant of Loan Repayment Default

Ownership Characteristics	N	Mean	Std. Deviation
Location of Business	65	3.5156	.8736
Years the business has been in operation	65	3.6487	.7186
Type of Business	65	3.6553	.8125
Customers Targeted	65	3.3562	.4532
Ownership structure	65	3.5525	.6348
Average Mean		**3.5456**	

Source: (SPPS Research data, 2019)

The study sought the view of SME`s Owner/Manager the extent to which ownership characteristics determine loan repayment default. Table 4.5 depicts most respondents agreed various ownership characteristics determine loan repayment default (Average Mean = 3.5456). Each element of ownership characteristic registered a high standard deviation, depicting divergent views on extent of influence on loan repayment default.

Table 4.6 Borrower Characteristics as Determinant of Loan Repayment Default

Borrower Characteristics	N	Mean	Std. Deviation
Age of borrower	65	3.6235	.7892
Gender of borrower	65	3.4763	.8126
Level of Education of borrower	65	4.1784	.8265
Business experience of borrower	65	3.7892	.6532
Credit use experience of borrower	65	3.4435	.7358
Household Size	65	3.8235	.7856
Non-business Income	65	4.1258	.3546
Type of Business Activity	65	3.7324	.4123
Amount of business Investment	65	3.8935	.5678
Borrowers attitude	65	4.2351	.5345
Borrowers Family Background	65	3.2345	.6789
Average Mean		**3.7778**	

Source: (SPSS Research data, 2019)

Table 4.6 illustrates most respondents considered borrower characteristics as having moderate effect on loan repayment default (Average mean = 3.7778). Borrower`s level of education, existence of other non business income and borrower attitude determined loan repayment default to a large extent (Mean = 4 and above). Each element of borrower characteristic registered a high standard deviation, depicting divergent views on loan repayment default extent.

Table 4.7 Loan Characteristics as Determinant of Loan Repayment Default

Loan Characteristics	N	Mean	Std. Deviation
Loan Amount/Size	65	4.2313	.6543
Loan Repayment Period	65	3.8783	.7126
Collateral value	65	4.1784	.8265
Number of repayment installment	65	3.7892	.6532
Loan application cost	65	3.2435	.7348
Loan Type	65	3.4234	.5334
Purpose of Loan	65	3.8213	.8124
Previous loan repayment mode	65	3.7456	.5349
Length of time before repayment	65	3.5235	.4367
Average Mean		**3.7594**	

Source: (SPSS Research data, 2019)

Table 4.7 shows that Loan characteristics determined loan repayment default to a moderate extent (Average mean = 3.7594). Loan amount and Collateral value determined loan repayment default to a large extent (Mean = 4 and above). Each element of ownership characteristic registered a high standard deviation, depicting divergent views on loan repayment default extent.

Table 4.8 Lender Characteristics as Determinant of Loan Repayment Default

Lender Characteristics	N	Mean	Std. Deviation
Loan interest rate	65	4.2563	.4562
Penalty for lateness in loan repayment	65	4.1783	.7624
Credit analysis procedure	65	3.1784	.8265
Time lag between loan application and disbursement	65	3.7892	.2532
Lending policies	65	3.2435	.7548
Stringent loan procedures	65	3.6235	.6532
Average Mean		**3.7115**	

Source: (SPSS Research data, 2019)

Table 4.8 illustrates how lender characteristics determine loan repayment default. Majority of respondent agree that various lender characteristics determine loan repayment default (Average Mean = 3.7115). Loan interest and penalty for lateness in loan repayment determine loan repayment default to a large extent (Mean = 4 and above). Each element of Lender characteristic registered a high standard deviation, depicting divergent views on loan repayment default extent.

4.6.2 Factor Analysis

Descriptive Factor analysis conducted to point out important and interesting relationships among observed study data. Principal component method was used with the objective of identifying latent variables that may determine loan repayment default. The purpose of factor analysis was to ascertain simple aspects of the association and allow for conclusive analysis (Anderson, 2004).

Table 4.9: KMO and Bartlett`s Test

Kaiser-Meyer-Olkin Measure of Sampling Adequacy		.473
Bartlett`s Test of Sphericity	Approx.Chi-Square	1138.216
	Df	434
	Sig.	.000

Source: (SPSS Research data, 2019)

Table 4.9 shows the KMO and Bartlett`s test. KMO test measured data suitability for Factor Analysis. KMO test measured sampling adequacy for each variable in the model cum for the complete model. The study data KMO had a value of 0.473, below the KMO standard threshold of 0.83 for it to be considered satisfactory or appropriate for Factor Analysis (Revelle, 2016). Bartlett`s test shows significance at 0.000, implying that any identified factor can be taken into account.

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Table 4.10: Communalities

	Initial	Extraction
Location of Business	1.000	.786
Years the business has been in operation	1.000	.731
Type of Business	1.000	.815
Customers targeted	1.000	.732
Ownership Structure	1.000	.857
Age of borrower	1.000	.789
Gender of borrower	1.000	.793
Level of Education of borrower	1.000	.856
Business experience of borrower	1.000	.674
Credit use experience of borrower	1.000	.563
Household Size	1.000	.635
Non-business Income	1.000	.751
Type of Business Activity	1.000	.732
Amount of business Investment	1.000	.836
Borrowers attitude	1.000	.752
Borrowers Family Background	1.000	.657
Loan amount/size	1.000	.863
Loan Repayment Period	1.000	.568
Collateral Value	1.000	.828
Number of installments	1.000	.736
Loan application costs	1.000	.594
Loan type	1.000	.789
Purpose of loan	1.000	.852
Previous loan repayment mode	1.000	.798
Length of time before repayment	1.000	.853
Loan interest rate	1.000	.743
Penalty for lateness in loan repayment	1.000	.673
Credit analysis procedure	1.000	.872
Time lag between loan application and disbursement	1.000	.673
Lending policies	1.000	.773
Stringent Loan procedures	1.000	.685

Source: (SPSS Research data, 2019)

Table 4.10 illustrate communalities giving fraction of changeability in original variable accounted for by high loading factors, which have Eigen values more than one (Churchill and Lacobucci, 2002). This indicates for example that 74.3 % of variability of loan interest rate and 77.3 % of variability of lending policies are accounted for by factors 1,2,3 and 4, shown in table 4.11.

Table 4.11: Total Variance Explained

Compo nent	Initial Eigen values			Extraction Sums of Squared Loadings			Rotation Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	4.326	40.784	40.784	4.326	40.784	40.784	4.653	27.345	27.345
2	3.187	20.392	61.176	3.235	20.392	61.176	3.428	24.367	51.712
3	2.083	10.186	71.362	2.104	10.186	71.362	2.117	15.457	67.169
4	1.034	5.098	76.460	1.034	5.098	76.460	1.624	9.291	76.460
5	.919	3.223	79.683						
6	.874	2.442	82.125						
7	.826	2.163	84.288						
8	.759	1.879	86.167						
9	.671	1 .368	87.535						
10	.587	1 .293	88.828						
11	.531	1.187	90.015						
12	.495	1.139	91.154						
13	.463	1.117	92.271						
14	.427	1.078	93.349						
15	.389	.987	94.336						
16	.357	.943	95.279						
17	.328	.878	96.157						
18	.284	.783	96.940						
19	.247	.678	97.618						
20	.193	.538	98.156						
21	.161	.474	98.630						
22	.138	.297	98.927						
23	116	.239	99.166						
24	.095	.178	99.344						
25	.087	.159	99.503						
26	.075	.134	99.637						
27	061	.116	99.753						
28	.053	.109	99.862						
29	.045	.084	99.946						
30	.037	.039	99.983						
31	.028	.015	100.000						

Extraction Method: Principal Component Analysis.

Source: (SPSS Research Data, 2019)

Table 4.11 illustrate that new factors are four. The first factor had a value of 4.326, implying that 43.26% of total variance was accounted for by first factor. Second factor had Eigen value of 3.187, denoting that 31.87% of the total variance was accounted for by second factor. The third factor had Eigen value of 2.083%, implying that 20.83% of total variance was accounted for by third factor. Fourth factor had Eigen value of 1.034, denoting that 10.34% of the variance was accounted for by the fourth factor. The four factors cumulatively accounted for by 76.46% of total variance.

Table 4.12: Rotated Component Matrix[a]

	Component			
	1	2	3	4
Location of Business	.032	.256	.367	.213
Years the business has been in operation	.057	.242	.173	.247
Type of Business	.073	.193	.211	.108
Customers targeted	.116	.219	.343	.284
Ownership Structure	.272	.084	.321	.049
Age of borrower	.183	.245	.134	.068
Gender of borrower	.092	.319	.036	.017
Level of Education of borrower	.136	.194	.065	.103
Business experience of borrower	.047	.089	.385	.137
Credit use experience of borrower	.116	.249	.059	.287
Household Size	.216	.036	.281	.075
Non-business Income	.197	.217	.304	.095
Type of Business Activity	.183	.278	.237	.116
Amount of business Investment	.085	.283	.208	.182
Borrowers attitude	.372	.349	.104	.246
Borrowers Family Background	.194	.103	.121	.047
Loan amount/size	.214	.393	.267	.103
Loan Repayment Period	.042	.094	.312	.117
Collateral Value	.253	.127	.205	.138
Number of installments	.083	.382	.147	.301
Loan application costs	.235	.058	.235	.078
Loan type	.102	.206	.218	.123
Purpose of loan	.124	.057	.219	.045
Previous loan repayment mode	.206	.342	.116	.084
Length of time before repayment	.032	.125	.321	.156
Loan interest rate	.036	.214	.131	.114
Penalty for lateness in loan repayment	.293	.221	.204	.037
Credit analysis procedure	.078	.259	.084	.046
Time lag between loan application and disbursement	.116	.041	.082	.332
Lending policies	.245	.192	.123	.095
Stringent Loan procedures	.214	.103	.321	0.53

Extraction Method: Principal Component Analysis

Rotation Method: Varimax with Kaiser Normalization

Source: (SPSS Research data, 2019)

Table 4.12 shows that factor loading values for factors having Eigen values more than or equal to one. It shows a positive correlation (R values for every component in the table are positive).

4.7 Discussions of Findings

Ownership characteristics of the SME`s such as location of business, years the business has been in operation. Type of business, customers targeted and ownership structure affect loan repayment default indicated by average mean of 3.5456 with positive correlation in factor analysis (R values are positive). The findings confirms (Nawai and Shariff, 2016; Coravos, 2018; Brehanu and Fufa, 2018; Saurina, 2015) studies found out that type of firm, cum distance linking SME location to lending bank plus Ownership structure (sole proprietors) are at a high risk of loan repayment default than those businesses owned by many people.

Borrower's characteristics like age, gender, income status, credit use familiarity, level of education, household size, non business revenue, nature of business action, borrower attitude and family background and the amount of investment determines loan repayment default as it recorded average mean of 3.7778 .This is in tandem with (Nawai & Sharrif, 2010; Jiménez, Salas and Saurina, 2014; Mokhtar, Nartea, and Gan, 2012) studies that similarly established, age of the debtor, time the business has been running, if it is long offers enough experience for the business to have sound financial management practices which can reduce loan repayment default.

Loan characteristics like loan size, period of repayment, value of collateral, number of installments, application costs, purpose of the loan are factors that determine the loan

repayment default with an average mean of 3.7594.This is similar to (Karlan & Valdivia, 2014; Foster & Zurada, 2013; Roslan & Karim, 2015; Herrington & Wood, 2013) studies that had similar outcomes though in different context.

Lenders characteristics includes, time taken between advance application and payment, financing cost, capacity to approach business data, agreeable admission and punishment for delay to comprehensive gatherings are factors that exist within the financial institution granting the loan facility and determines loan repayment default with average mean of 3.7115.These revelations are in agreement with (Korankye, 2014; Faulkender and Petersen, 2016) that had similar results though in different context. When the interest rate is exorbitant, there is probability of loan repayment default (Claessend, Krahnen, and Lang, 2015)

The study revealed that loan repayment defaults are attributable to several determinants classified as either Ownership, borrower, loan cum lender characteristics. Thus Financial institutions offering loans to SME`s has to remodel their loaning taking keen interest on the revealed determinants with sound training to increase awareness on loans usage, reduced processing turnaround time and repayment work plan. This were in tandem with Faulkender and Petersen (2016) study that found out that long loan processing cycle may increase probability of the debtor to miss the opportunity which is time bound and reason for the loan repayment default as it may encourage loan diversion to other activities other than the purpose of the loan.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

The chapter outlines the summary, the conclusions of study, recommendation and limitation of the study cum suggestions for further research.

5.2 Summary

The study sought view of SME`s Owner/Manager the ownership characteristics determine loan repayment default. Descriptive statistics analysis shows most respondents agreed various ownership characteristics determine loan repayment default (Average Mean = 3.5456).Each element of ownership characteristic registered a high standard deviation, depicting divergent views on loan repayment default extent.

Majority of respondent considered borrower characteristics as having moderate effect on loan repayment default (Average mean = 3.7823). Borrower`s level of education, existence of other non business income and borrower attitude determined loan repayment default to a large extent (Mean = 4 and above).

Loan characteristics determined loan repayment default to a moderate extent (Average mean = 3.7594). Loan amount and Collateral value determined loan repayment default to a large extent (Mean = 4 and above).

Lender characteristics determine loan repayment default. Majority of respondent agree that various lender characteristics determine loan repayment default (Average Mean = 3.7115). Loan interest and penalty for lateness in loan repayment determine loan repayment default to a large extent (Mean = 4 and above). Each element of Lender

characteristic registered a high standard deviation, depicting divergent views on the extent of influence on loan repayment default.

Factor analysis presents KMO plus Bartlett`s test. Study data KMO had a value of 0.473, below the KMO standard threshold of 0.83 for it to be considered satisfactory or appropriate for Factor Analysis (Revelle, 2016). Bartlett`s test shows significance at 0.000, implying that any identified factor can be taken into account.

The communalities which give the fraction of changeability in the original variable accounted for by high loading factors, which have Eigen values greater than one. This indicates for example that 74.3 % of variability of loan interest rate and 77.3 % of variability of lending policies are accounted for by factors 1, 2, 3 and 4. The new factors are four. The first factor has a value of 4.326, implying that 43.26% of the total variance was accounted for by the first factor. Second factor present Eigen value of 3.187, denoting that 31.87% of the total variance was accounted for by the second factor and so on. The four factors cumulatively accounted for by 76.46% of total variance. The factor loading values for factors with Eigen values more than or equal to one. It shows a positive correlation (R values for every component in the table are positive).

5.3 Conclusion of the Study

The following conclusions are drawn:

Determinants of Loan repayment default by SME`s are inherent in ownership, borrower, loan and lender characteristics, thus stakeholders should be engaged to strike mitigating measures that result in Kenyan economic growth as SME`s employees the biggest population of Kenyan.

SME`s indeed need loans to broaden investment in various business options. It's the increased loan repayment defaults that makes Banks and Microfinance institutions not to be very keen to offer loans to the SME`s within Kenya and beyond.

5.4 Recommendation of the Study

Taking cognizance of the outlined determinants of loan repayment characteristics, the Government of Kenya and County Governments should develop policy frameworks that are conducive for the growth of SME`s in Kenya. The current Youth and Women Enterprises funds be remodeled to allow for continuous revolving credit to SME`s in Kenya. SME`s should be reminded the economic good of securing and servicing of loans to full term.

Before any financial service is offered to SME`s, adequate training should be undertaken to enable them prudently use the funds given to them as credit facility. Microfinance institutions should partner with universities, school of business to design tailor-made training that enhance SME`s management thus growth. These will enable SME`s repay the loans promptly.

5.5 Limitation of the Study

The study considered primary data gathered via questionnaire in a cross sectional survey to SME`s owners. The historical collections associated with secondary data were not considered in the study of SME`s loan repayment default in Kisumu Central –Sub County, Kenya.

This study was limited to sampled SME`s in Kisumu Central-Sub County, though the findings may not be generalized, specific issued that determine loan repayment default unique to certain SME`s could have been missed out.

The study was limited to SME`s mangers/entrepreneurs views, thus did not consider Microfinance institutions and Banks take on aspect of loan repayment default cum effect on growth and financial outcome of SME`s that they dearly support

5.6 Suggestions for Further Research

Another study be done to explore views of Microfinance institutions plus Banks on the determinants of loan repayment default and its impact on performance of SME`s at Kisumu County to see how varied characteristics both in rural and urban setting moderate the outcome of the study.

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APPENDIX

Appendix I: Questionnaire to Owners and Managers of SME`s in Kisumu Central Sub County

Section 1: SME Background Information

1.Nature of your business

Cosmetics ( ) Hospitality ( )   Wholesalers and Relailors ( )   Health Facilities ( ) Transporters ( )

2.Period your business have been operating

Less than 1 year ( )   2-5 years ( )   6-10 years ( )   Above 10 years   ( )

2. Type of business

Sole proprietorship ( ) Partnership ( ) Limited Company ( )

Section 2: Determinants of Loan Repayment Default.

A. Ownership Characteristics

Show the extent the following ownership characteristics influence loan repayment default in SMEs at Kisumu Central Sub County, Kenya? Use the following five-point likert scale:1-Not at all; 2-Minimal extent; 3-Moderate extent; 4-Large extent; 5-Very large extent.

Ownership characteristics	1	2	3	4	5
Location of business					
Years the business has been in operation					
Type of the business					
Customers targeted					
Ownership structure					

B. Borrower Characteristics

Show the extent the following borrower characteristics influence loan repayment default by SMEs in Kisumu Central Sub County, Kenya? Use the following scale:

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

Borrower characteristics	1	2	3	4	5
Age of borrower					
Gender of borrower					
Level of education					
Business experience					
Credit use experience					
House hold size					
Non-business income					
Type of business activity					
Amount of business investment					
Borrower's attitude					
Family background					

C. Loan Characteristics

Show the extent the following loan characteristics influence loan repayment default by SMEs in Kisumu Central Sub County, Kenya? Use the following scale:

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

Loan Characteristics	1	2	3	4	5
Loan size/amount					
Loan repayment period					
Collateral value					
Number of installments					
Loan application costs					
Loan type					
Purpose of loan					
Previous loan repayment mode					
Length of time before repayment					

D. Lender Characteristics

To what extent do the following Lender characteristics influence loan repayment default by SMEs in Kisumu Central Sub County, Kenya? Use the following scale:

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

Lender characteristics	1	2	3	4	5
Interest rate					
Penalty for lateness					
Credit analysis procedure					
Time lag between loan application and disbursement					
Lending policies					
Stringent loan procedures					

THANK YOU FOR YOUR TIME