EFFECT OF CREDIT MANAGEMENT PROCESSES ON FINANCIAL PERFORMANCE OF MICROFINANCE INSTITUTIONS IN COASTAL REGION

By

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MASTER OF SCIENCE IN COMMERCE

(FINANCE AND INVESTMENT)

KCA UNIVERSITY

2023

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A DISSERTATION SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENT FOR THE AWARD OF THE DEGREE OF MASTER OF SCIENCE IN COMMERCE (FINANCE AND INVESTMENT) TO THE SCHOOL OF BUSINESS, KCA UNIVERSITY

OCTOBER, 2023

DECLARATION

I declare that this dissertation is my original work and has not been previously published or submitted elsewhere for award of a degree. I also declare that this contains no material written or published by other people except where due reference is made and author duly acknowledged.

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I do hereby confirm that I have examined the master's dissertation as supervisor.

Supervisor: Dr. Anthony Mwai

Sign…… Date……..

ABSTRACT

Any firm that deals in credit must have credit management processes in place. When done correctly, the process makes sure that the customer pays for the services received. The impact of credit management practices (credit risk control, client credit appraisal, credit terms and conditions, and credit collection strategy) on the financial success of MFIs has received far less attention. Thus, the study in question sought to investigate the effect of credit management processes on the financial performance of MFIS in Coastal region. The study was guided by the following objectives; to determine the effects of credit appraisal on financial performance of MFIs in Coastal region, to establish the effects of credit risk control on financial performance of MFIs in Coastal region, to assess the effects of credit terms on financial performance of MFIs in Coastal region and to find out the effects of credit collection policy on financial performance of MFIs in Coastal region. The study used a descriptive research design. Primary data was collected using questionnaires. SPSS was used to analyse the collected data. The descriptive analysis of the data will used frequency, percentage, mean, and standard deviation. On the other hand, multi linear regression is a technique used in inferential statistics that was used to establish the link between dependent and independent variables. The results of the study revealed that Credit appraisal had a direct and statistical impact on the financial performance of Micro Finance Institutions in coastal region, Kenya. Another key finding of the study was that there is constant review and updating of client's credit worthiness and that the borrower is made to understand the terms of the loan which helps in reducing the risk of default. The researcher recommends that Microfinance Institutions should embrace working closely with their clients, providing not just financial services but also financial education and business support since can improve the credit risk control process by increasing borrowers' financial literacy and their ability to manage their loans effectively**.**

ACKNOWLEDGEMENT

I would like to thank the Almighty God for his mercy and divine providence at this time. Also, I want to extend my profound gratitude to my supervisor, Dr. Anthony Mwai, for his wise direction during the dissertation-writing process. I also like to thank my family, Tina, Santita, Amana, and my parents and siblings, The Msaghas, for their inspiration and support.

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LIST OF ACRONYMS AND ABBREVIATIONS

MFIs: Micro Finance Institutions

CBK: Central Bank of Kenya

SME: Small & Medium Enterprises

YMSL: Yehu Microfinance Services Limited

SMEP: Small and Micro Enterprise Programme

MSME: Micro Small and Medium Enterprise

OPERATIONAL DEFINITION OF TERMS

Credit Appraisal: It is a term used in this study to describe the process by which an MFI evaluates the potential borrower's creditworthiness, bankability, and technical and economic viability (Nakitende, 2019)

Credit collection policy: In this study, the term alludes to specific, written instructions that specify the circumstances and process for debt collection as well as the actions to be followed in the event of a loan default (Gatuhu,2013)

Credit risk control: In this study, it alludes to controlling the likelihood that a business will suffer losses if its borrowers fail to make payments (Moreno 2017).

Credit terms: In this research, refers to the rules that the lender and borrower are required to abide by respecting the loan, as well as the date when repayment for a loan is due.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Any firm that deals in credit must have a credit management process in place. When done correctly, the process makes sure that the customer pays for the services received. The methods an organization employs to make sure its level of credit is appropriate and well-managed are known as credit management practices. It is a component of financial management and includes credit analysis, credit rating, credit classification, and credit reporting (Kalu, Shieler & Amu, 2018). Credit Management refers to the procedures employed by a company to oversee its credit-based sales. Since some businesses have managed their debt activities so successfully to lower credit risk, it is a crucial practice for all businesses that engage in credit transactions (Kalu et al., 2018).

Debt collection processes assist a business take charge of its accounts receivable, save time, and possibly avoid future legal snags (Tawiah & Asante, 2018). Having debt collection strategies in place can help with a variety of things, including identifying the crucial components of successful debt collection and using them to assess the policies in place at the company, ranking accounts to aid an MFI in prioritizing and selecting a suitable contact strategy, gathering all the data required to start crafting meaningful relationships with borrowers upon first contact, and motivating even slow payers and large account holders (Njue, 2020).

Globally studies have been done in regard to debt management practices and financial performance of firms. Erwin, Abubakar and Muda (2018) in their study done in Indonesia found that the presence of an effective debt collection practices, there is an improvement in the performance of lending institutions and this is in terms of an improvement in the return on investment that they experience. The study further

indicated that some of the effective debt collection practices that are applied includes the use of the credit appraisal and credit control measures. On the other hand, a study done in India by Devi and Shaikh (2017) showed that having proper risk management practices such as extensive customer background checks before lending prevents the lending institutions from facing the effects of bad debts and thus improving their performance.

Several academics have performed studies on the relationships between MFI performance and credit management methods regionally in Africa. Sola (2021) notes that client appraisal is a crucial credit management tactic that affects loan repayment in Nigerian microfinance institutions, according to his study on the country. It was consequently recommended that Nigerian microfinance banks employ stringent client appraisal procedures when disbursing loans. In order to help banks undertake complete customer evaluations, the government should also build and maintain an effective Credit Information Tracking system in the micro banking sub-sector. On the other hand, Kalu, Shieler and Amu (2018) did a study in Uganda. According to the study's conclusions, MFIs should consistently stress efficient credit risk detection, credit risk assessment, credit risk evaluation, and credit risk reduction procedures in order to reach the highest level of financial performance.

Scholars have attempted to establish a link between MFI financial performance and credit management techniques in Kenya. In their study in the Nairobi Central Business District, Edwin and Omagwa (2018) came to the conclusion that improving credit risk control, client evaluation, collection policy, and credit terms improves MFIs' financial performance. On the other hand, Mburu, Mwangi, and Muathe (2020) found in their study that lending and debt collection practices significantly impacted how well commercial banks in Kenya performed when making loans. Yet, there was no noticeable difference in the capacity of Kenyan commercial banks to offer loans based on client appraisal.

1.1.1 Credit Management Processes

Screening potential customers to make sure they have the ability and willingness to repay a loan is the first step in reducing credit risk. Microfinance organizations apply the 5Cs credit model to evaluate a client as a viable borrower. According to the 5Cs, loan performance increases as MFIs learn more about their consumers. Character, capacity, collateral, capital, and condition make up the five Cs (Mbah & Wasum, 2019).

Credit risk management is the second step in the debt management process. Delinquency management, credit committees, and loan product design are important credit controls. MFIs can significantly reduce the risk of default by creating loan packages that satisfy the needs of their customers. Establishing a committee of individuals to decide on loans is a crucial measure in lowering the risk of fraud and credit (Mbah & Wasum, 2019). If one person has the power to select who would be eligible for loans, whose loans will be cancelled off or delayed, and the conditions of the loans, this authority might be easily abused and covered up. A key delinquent management method is to establish an organizational culture that promotes quick follow-up on all delayed payment and strict enforcement for arrears. Additionally, MFIs might inform customers who have recently experienced delinquency issues that their payment date is approaching (Mwangi, 2021).

Credit terms and conditions are essential for controlling debt. Lending institutions use credit periods as a criterion to evaluate a borrower's capacity to repay advances. These conditions safeguard against the possibility of default in the event of non-payment and assist in evaluating the credit worthiness of borrowers. They include loan cost, repayment time, and guarantee (Mwangi, 2021).

The collection policy is yet another essential element of the debt management procedure. To ensure that credit oversight is carried out effectively, a financial institution should employ a variety of policies. One

of these regulations is a recovery policy, which is necessary due to the likelihood that customers won't repay firm loans on time. Some customers pay slowly, while others don't pay at all. The collection operation should therefore concentrate on accelerating payments from reticent payers and reducing bad loans damages (Agasha, Monametsi & Feela, 2020).

1.1.2 Financial Performance

Iqbal, Nawaz, and Ehsan (2019) define financial performance as the ability to conduct operations profitably, survive, grow, and adapt to environmental advantages and dangers. MFIs are compensated for lending money and other financial advisory services in the form of interest, penalties, and commissions. Financial revenue also includes income from those other financial assets, like investment income.

The term "loan performance" describes the income or rate of return on various advances. This allows it to determine the number of customers requesting for loans, the amount borrowed, the timely repayment of instalments, the collateral pledged as security for the money borrowed, the number of loan products available, and the rate at which arrears are recovered (Irawati, Maksum, Sadalia & Muda, 2019).

According to Sarker, Sultana, and Prodhan's (2017) research in Bangladesh, where profitability through stockholder's equity is the traditional measure of financial performance, the loan-to-deposit ratio serves as a very strong indicator of earnings because it reveals the state of financial institutions' asset-liability management.

MFIs earn money through charging interest on loans and charging penalties for late payments and fees. A profitable institution's operating income will significantly outweigh its overall expenses. Another factor in deciding fast ratio is liquidity. A high fast ratio indicates that the company is able to pay its outstanding debtors, such as suppliers (Sarker et al., 2017).

1.1.3 Credit Management Processes and Financial Performance

A sound credit management plan will reduce the amount of capital dependent on the borrowers and limit the possibility of bad debt accumulation. According to Manrique and Mart-Ballester (2017), any past-due account will reduce a seller's profit unless he has taken additional late payment fees into account when calculating his market value or is successful in recovering such costs via interest charges. In some competitive marketplaces, the potential of higher sales may entice businesses to extend more credit, but this practice is risky unless it can be proven that the surplus profits from the rising sales will equal the rising costs of lending or that expenses can be recovered by increasing prices.

In their investigation, Kalu, Shieler, and Amu (2018) looked at the financial performance and handling of credit risks of microfinance companies in Kampala, Uganda. According to the study, credit risk appraisal and evaluation have a large favorable effect on the financial health of MFIs, however credit monitoring process and credit risk mitigation have a less significant benefit.

Many Kenyan commercial banks' financial performance and credit risk management were examined by Mercylynne and Omagwa (2017). While the study indicated that the loan evaluation process, lending criteria, and credit policies all had a considerable effect on financial institution performance, the debt collection method was shown to have a far smaller impact. According to the report's results, banks must limit their credit risk exposure in order to optimize their rate of return after adjusting for risk.

The leadership and financial effectiveness of microfinance banks in Kenya's Nyeri County were examined by Nyawira and Omagwa in 2019. Credit extension was not statistically significant in explaining MFI financial performance, according to the study. This implies that extended credit was linked to subpar financial performance. The study concluded that a rise in credit extension would lead to a decline in financial performance.

1.1.4 Microfinance Institutions in Kenya

The legal, regulatory, and oversight framework for MFIs in Kenya is established by the Microfinance Act of 2006 and the subsequent Microfinance Regulations. The Microfinance Act went into existence on May 2nd, 2008. The Microfinance Act's main goal is to control how microfinance institutions are established, run, and operated in Kenya through licensing and oversight. The Act makes it possible for institutions that take deposits and lend money to people to mobilize savings from the broader public, enhancing access, efficiency, and competition (Bitok, Cheboi & Kemboi, 2021).

Recent changes in the microfinance sector have seen MFIs become banks or other types of regulated organizations, both in Kenya and overseas. Together with the increased focus on the role of credit unions, traditional financial institutions like banks could potentially move downmarket and experiment with other financial services companies like postal and savings banks (Walde, 2022).

1.2 Statement of the Problem

Kenya's microfinance organizations provide financial services for the bottom of the socioeconomic pyramid. The first microfinance institutions (MFIs) in Kenya were created in 1990 by the Central Bank of Kenya (CBK), and today they are governed by the Association for Micro-finance Institutions (AMFI), which was founded and certified in 1999 in the Societies Act with the intention of strengthening the Kenyan microfinance sector (Bosire et al., 2014). Nevertheless, the MFIs in Kenya have been experiencing high non-performing loans and as well as declined assets and low client deposits numbers (CBK, 2021). This is whereby the deposit made by the customers declined by Kshs 2.8 billion to be 48 billion in 2022 from 50.8 billion in 2021. This was partially caused by insufficient product diversification aspects like high interest rate earning deposit and savings accounts.

Good credit management is essential for a financial institution's sustainability and continued profitability, and falling credit quality is often the root cause of poor financial performance and condition (Banna, Mia, Nourani & Yarovaya, 2022). According to Adusei and Sarpong-Danquah (2021), the chance of problematic loans increases when credit regulations are relaxed. For businesses, the management of debtors must be efficient and effective. Delays in getting paid when you should from debtors result in more bad debts, major financial issues, and damaged client relationships. Profitability will deteriorate if a payment is made after the deadline; if it is not made at all, there will be a total loss. Given such, it seems sense to deliberately manage credit management at the "front end" (Banna et al., 2022).

While the original micro-credit experiments have been forgotten, contemporary micro-finance institutions (MFIs) may be traced back to the 1970s in countries like Bolivia and Bangladesh (Gutirrez-Nieto & Serrano-Cinca, 2019). Microfinance gained widespread attention as a means of promoting growth after the 2005 United Nations Year of Microcredit as well as the 2006 Nobel Peace Prize awarded to Mohammad Yunus, including the Grameen Bank (Mersland, 2009) Low-income customers, small and medium-sized enterprises (SMEs), customers who are underserved by the conventional banking sector, and economically disadvantaged individuals are among the primary beneficiaries of microfinance services like loans, savings, deposits, savings, financial insurance (Gutiérrez-Nieto & Serrano-Cinca, 2019).

As with any financial institution, the biggest risk in microfinance is making loans that aren't repaid. Due to the fact that most microlending is unsecured, or without the use of traditional collateral, MFIs are particularly concerned about credit risk (Kasoga & Tegambwage, 2021). People who fall under this category are those who are unable to provide an assurance or other kind of collateral in exchange for the cash they borrow from banks and other financial organizations. Due to the significant default risk for interest charges and, in some situations, the principal amount itself, many banks decline to lend to these

clients. These banks had to develop good credit management as a result, which required assessing the current and potential risks associated with loan activities (Abebe, 2022).

Studies have been done in Kenya. Lelgo and Obwogi (2018) examined the effect of financial risk on financial performance of micro finance institutions in Kenya and noted that higher financial risk endeavours affect the financial performance. Wafula, Mutua and Musiega (2017) investigated the influence of financial performance on financial sustainability of microfinance institutions in Kenya. The study reported that poor debt management destabilises the financial aspects of MFIs. The financial management procedures and financial performance of MFIs in Bungoma County, Kenya, were examined by Mabonga and Kimani in 2017. According to the study, weak debt recovery incentives have an impact on financial performance. The gap that the study has is when it comes to methodology where there is the use of explanatory research design while the current study will use descriptive research design. Additionally, the study investigated financial management procedure while this study will be based on the debt management procedures.

There have been attempts to investigate micro-lending and microfinancing in Kenya in the past, but the performance of MFIs has received most of the attention. The impact of debt management practices (credit risk control, client credit appraisal, credit conditions, and credit collection strategy) on the financial success of MFIs has received far less attention. In addition, studies have been conducted in areas other than the coastal region, which is the current study's primary area of interest. Therefore, this research addresses that gap by investigating credit management processes and financial performance of MFIs in Coastal Region.

1.3 Objectives

1.3.1 General objective

The effect of credit management processes on the financial performance of MFIS in Coastal Region

1.3.2 Specific Objectives

i. To determine the effects of credit appraisal on financial performance of MFIs in Coastal Region.
ii. To establish the effects of credit risk control on financial performance of MFIs in Coastal Region.
iii. To assess the effects of credit terms on financial performance of MFIs in Coastal Region.
iv. To find out the effects of credit collection policy on financial performance of MFIs in Coastal Region.

1.4 Research Hypothesis

The following null hypotheses guide this research:

H_0: Credit appraisal is statistically insignificant to financial performance of MFIs in Coastal Region.

H_0: Credit risk control is statistically insignificant to financial performance of MFIs in Coastal Region

H_0: Credit terms is statistically insignificant to financial performance of MFIs in Coastal Region.

H_0: Credit collection is statistically insignificant to financial performance of MFIs in Coastal Region.

1.5 Justification of the study

Most studies have frequently focused on various factors affecting MFIs' financial performance; Lelgo and Obwogi (2018), Wafula, Mutua and Musiega (2017) and Mabonga and Kimani (2017). This study aims at devoting much emphasis on specific debt management processes that affect the financial performance of MFIs in Coastal Region.

The findings of the several studies covered in chapter two are inconsistent. While some studies show a positive association between MFIs' financial performance and their debt management practices, others show a negative relationship. This demonstrates the need for additional research on the debt management process and financial performance of MFIs to address the subject's lack of clarity.

Additionally, it should be mentioned that a number of research examined different individual credit management techniques and their connection to the financial performance of MFIs. This study combines four credit management strategies to provide a more thorough analysis.

1.6 Significance of the study

1.6.1 Research and Academics

The study's findings will be significant to numerous parties. Researchers and academics will use the findings to consider further study in areas where the examination revealed something unique. Future research will make advantage of the empirical studies that were included in the current study. The current study will fill a gap in the research on credit management while also advancing practice and knowledge in the areas of financial performance and credit. The study will also be used in the research to expand the body of knowledge in the field of finance.

1.6.2 Research and Policy

Additionally, the study will help policymakers create more effective regulations for the industry. These MFIs under examination, as well as others in the financial sector, would greatly benefit from the study's conclusions. Because the research's findings will allow companies from all industries to reorganize their credit management policies and critically evaluate their processes in order to develop better methods for interacting with credit systems, even organizations in other sectors may benefit greatly from the study's findings.

1.7 Scope of the study

The study will be conducted among MFIs in Coastal Region. The study investigates credit management processes and financial performance of MFIs in Coastal Region. The study will be conducted in the month of August & October 2023.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

The important hypotheses that underpin this investigation are discussed in this chapter. Additionally, a critical analysis of empirical research on MFI financial performance and credit management procedures is presented. A connection between independent variables and dependent variables is demonstrated by the conceptual framework.

2.2 Theoretical Review

This chapter's theoretical section provides an in-depth discussions on whether existing theories reveal a connection between credit management processes and MFI financial performance.

2.2.1 Asymmetric Information Theory

Akerl proposed this hypothesis for the first time in 1970. According to this idea, most of the time there is no information balance between buyers and sellers, or in the case of this study, lenders and borrowers. This simply indicates that one of the partners has better or even more knowledge than the other, resulting in a lack of transaction power balance. Information asymmetry produces moral hazard, information monopoly, and unfavorable selection.

Adverse selection occurs during credit allocation when lenders fail to distinguish between consumers' levels of credit risk. Lenders will choose the project they believe to be safer when two projects are anticipated to yield equal profits. Adverse selection is a problem that arises during decision-making, which takes place prior to loan disbursement. It has been proven that clients who take on dangerous endeavors often conceal the genuine nature of their projects, taking advantage of the lender's lack of complete

information. Moral hazard is a danger that can arise during the credit allocation process anytime a creditor requests money for a purpose other than what they agreed upon with the lender, who is consequently powerless to prevent it. The danger of moral hazard starts to arise once capital is conceded. Last but not least, there is a connection between the cost of monitoring and other expenses that borrowers conceal in order to claim a lower income than they actually make.

The development and discussion of remedies to the issues brought on by information asymmetry was heavily influenced by two economists. Both Spence (1978) and Stiglitz (1973) proposed signaling and screening, respectively. Spence suggested that there is a chance that people can recognize their type and subsequently communicate information with the other person, solving the problem of information asymmetry. However, Stiglitz's proposed screening, a method for one economic agent to obtain information from another that would otherwise be private, allows the party with less information to persuade the other party to disclose their information with them. Derban, Binner, and Mullineux (2005) recommended screening as a method of credit assessment of borrowers, particularly by banks.

The principle of asymmetric information explains why having access to trustworthy borrower information is crucial for efficient screening. The theory is linked to the objective on credit risk and credit worthiness, and this is because it indicates that having information about a borrower can eliminate cases of defaulters and this will ensure that they only issue credit to clients who are trusted and are not at risk based on the availability of their credit information.

2.2.2 Transactional Cost Theory

Ronald 1937 developed the Transaction cost theory. Transaction cost are defined as the costs associated with running a firm and include: costs of negotiating and monitoring which is normally between the firm and its customers (Kamyabi et al., 2011).This theory recognizes that MFIS can achieve their profitability

through reducing cost in their operations. According to him, MFIS will grow and expand as long as its core activities can be performed on a low cost budget. Lower transaction costs are ideal for increased MFIS income. MFIS will continue to achieve their growth potential, if they perform their activities cheaply and hence enjoy large margins of profit. Transaction cost theory aims at reducing the cost of operation such as labor costs and other expenses that are associated with running an institution this can be achieved through cost cutting. In a financial market transaction costs relate to both deposit and lending costs which make up the largest share of an institutions lending portfolio (Beck, 2006).In developing countries financial costs are associated with high transaction costs (Hiehejes et al.,2013),According to him market fluctuations have an effect on the cost of various transactions carried out by the firms implying that financial performance of MFIS will be affected by the transaction cost incurred .According to this theory any revenue incurred should be charged based on the duration it was incurred. The theory is significant to the study since financial performance will be achieved through minimization of costs, this can be attained by having competent staff in their various departments.

2.2.3 Loanable Funds theory

Wicksell and D.H Robertson, two economists, developed this theory. Loanable funds in an economic entity relate to the quantity of money requested by customers and the amount of money available for supply by lenders. According to Bertocco and Kalajzi (2022), the interest rate is decided when supply and demand for money are equal. There is currently a great deal of opportunity for investors take full advantage of and invest extra, and savers increase their accounts in anticipation of greater income; this is the time when the cost of credit is decided (Bertocco, 2013).

Since the two parties should be reimbursed at the equilibrium position, the theory has a significant impact on both savers and borrowers. Changes in the rate of interest in a money market result from a variety of reasons, including changes in the supply and demand for loans as well as the availability of financing for

lending (Gudgeon et al., 2020). The theory is relevant to this study because it sheds light on how to price loanable funds by identifying the factors that affect them, which has broad implications for managing debtors.

The theory is linked to credit risk, credit worthiness and credit collection policy. In this case, the theory indicates that the amount of loan that is available should be issued to individuals who are not risky, have the credit worthiness and those who have better credit collection terms such as the availability of collateral that can cover the loan should they default. The theory states that with a limited amount of money to loan, only those whom the institution is sure of should be given thee loan since they are above the required threshold set for loan issuance.

2.2.4 Theory of credit Management

The credit management hypothesis is credited to Faraglia, Marcet, and Scott (2008). The theory of credit management states that the country's credit structure should be established so that a predicted change in the market value of the debt will cause a predicted change in coming deficits. Even if the state only issues convertible bonds, this method of credit management still applies. They also took into account that, according to the notion, governments should rather issue long-term debt while investing in short-term assets.

This theory also suggests that fiscal policy and credit structure should be determined upon concurrently. The assumption that the government's capacity to square off unanticipated changes in government expenses or income by selecting the credit value and structure in addition to management size is one of the primary influences on fiscal policy is disproved by this hypothesis (Faraglia, 2008).

Blommestein and Turner (2012) believed that separating monetary policy from credit management produced a positive yield, but this was not confirmed until the global financial crisis. The nation controlled

the budget during this time. As a result, they stressed how important it is to consider how credit management and monetary policy are coherent. Additionally, it can be argued that debt management plays a critical role in reducing the risks associated with fiscal vulnerability by providing protection against budget-impacting events that go beyond the power of a government or business.

Borenzstein, Chamon, Jeanne, Mauro, and Zettelmeyer (2004) argued that in light of these findings, the government should issue credit instruments whose yields properly address government spending in order to control fiscal fragility, which may lead to spending cuts. The theory is helpful in explaining to MFIs the significance of dependable credit management techniques in lowering the risks associated with loan default given that a bank's debtor portfolio is its biggest and comprised of bad loans with the potential for non-performance, which might result in substantial loss to the financial institution and its financial stability.

The theory is related to the last objective on effects of credit collection policy. In credit management, the credit collection policy is key in ensuring that there is effective management which ensures that there is elimination of loses that can be resulted from the default rates.

2.3 Empirical Review

2.3.1 Credit Appraisal and Financial Performance

According to Misati and Kamau, the decision-making process that results in the granting of credit to a borrower still centers on credit appraisal (2015). To decide whether to approve or decline a credit proposition is the primary goal of a credit appraisal. Depending on the loan application, it comprises determining the borrower's capacity to pay back the loan. Throughout the appraisal system, the risk level related to a specific borrower is evaluated along with the borrower's credit worthiness and the stream of projected future cash flows. The study also stated that the assessment should be centered on the client's

purpose, the genuineness of the requirement, the debtor's ability to make payments on the loan amount, and the security.

According to Sharma and Kalra (2015) who conducted a study in Saudi Arabia, the core of a microfinance institution's high-quality loan portfolio is the credit application appraisal. Finding out whether microloan borrowers are creditworthy is a step in the appraisal process. It aims to lessen the impact of borrowers' delinquencies on the lending firm. The microfinance institutions' established policies on credit delivery and recovery procedures frequently serve as the basis for evaluating credit application. Its goal is to decide whether or not to accept a microfinance borrower's request for funding.

According to Ahmed and Malik (2015) who conducted a study in Pakistan, a microfinance institution must assess the borrower's company income to decide whether he can make on-time repayments. A borrower who receives an investment credit and makes a substantial profit is encouraged to manage prompt repayment and is likely to be given consideration for future loans. Most people who get loans have the resources to repay the amount on their own volition. Most lenders are aware, nonetheless, that certain microloan customers are reluctant to fulfill their duties of properly repaying the granted amount. Hence, in order for the credit provided to be repaid efficiently, microfinance institutions must make sure that potential borrowers are screened and that their primary sources of income are identified in advance.

Enoch, Arabo, and Digil (2021) looked into how client feedback affected a microfinance bank's efficiency in Nigeria. In this study, data were gathered using a survey approach, and both primary as well as secondary sources were employed. Surveys were used to collect precise data from respondents. Simple percentages and regression analysis were used for both descriptive and inferential statistics to analyze the data and assess the hypotheses. The results show that client appraisal boosts productivity and efficiency.

Aliija and Muhangi (2017) looked into the effect of loan assessment management systems on credit performance in Uganda's microfinance institutions (MFIs). The report indicates that MFIs rely primarily on client evaluation for credit management. Additionally, it shown that using client appraisal to lower credit risk is a viable strategy. Also, the study found a strong link between client satisfaction and MFI credit success. In order to improve their credit performance, the researcher encouraged MFIs to increase their client appraisal procedures.

In Kenyan commercial banks, Njeru, Mohammed, and Wachira (2016) looked into how credit evaluation affected loan performance. The sample consisted of 86 individuals. That is, among each of the 43 commercial banks registered with the Kenyan Central Bank. It was shown that credit analysis played a very significant role in influencing commercial banks' performance. According to research, credit history and credit referencing were employed more often in credit appraisal because lending substantially relied on prior knowledge.

Mumbi and Omagwa (2017) looked into how some Kenyan commercial banks' financial results were affected by their loan assessment procedures, lending laws, and credit policies. A sample of 50 participants from five banks was gathered for the study using a probability sampling technique and a descriptive research methodology. The information was gathered through questionnaires. The study found that lending criteria, credit standards, and loan appraisal procedures all had a major effect on bank performance. According to the study, banks must limit their exposure to credit risk to acceptable levels in order to achieve the highest risk-adjusted rate of return.

The relationships between loan evaluation and non-performing loans are examined by Thisika and Muturi (2017). A cross-sectional survey design was adopted. Each and every member of the Bungoma town commercial banks' credit departments. The target population consisted of 70 respondents from the nine commercial banks in the town. The study found a statistically significant correlation between credit scores

and loan defaults. It was discovered that there is a positive, significant, and statistically significant correlation between credit assessment and non-performing loans.

Kisaka (2016) looked into how the performance of the loan book in Kenyan commercial banks was affected by liquidity management, credit reference checks, credit capability, guaranties, and customer history. The results demonstrated a positive association between credit score procedures and loan book efficiency in Kenyan commercial banks. Every credit rating indicator had a positive influence on the growth of the loan portfolio of Kenyan commercial banks, according to the regression analysis's findings. The ability to pay back the loan and a credit reporting report had the two biggest effects. Furthermore considered important were the historical background, loan security, and credit rationing.

Ogoro and Onditi (2016) examined how loan lending practices affected the financial results of Kenyan commercial banks. A descriptive research design is used for this. In Kisii town, data from 18 chosen commercial banks are used. According to the study, commercial banks' loan lending policies and financial performance are positively correlated. Additionally, competition, banking sector regulations, and technology all significantly impact the financial success of banks.

2.3.2 Credit Risk Control and Financial Performance

An empirical investigation on the impact of Basel III regulations on bank default risk in Luxembourg was carried out by Giordana and Schumacher (2017). It was mentioned that a bank's lending process, which is determined by trustworthiness and credit risk, requires an accurate and unbiased assessment of a borrower. The accuracy of this assessment significantly influences the results of particular credit agreement in addition to the effectiveness of a bank's lending operations as a whole. Since it affects both the option about offering a loan and the possible amount, the accuracy of the assessment is also important for a borrower.

Research on risk evaluation of housing market segments from the perspective of lenders was done by Wilhelmsson and Zhao (2018). Yet, the poll indicated that lending is still expanding across a wide range of organizations. The most popular strategies used by commercial banks to reduce risk involve inflating the rate of interest or creating various kinds of charges (commissions) to utilize the loan, which shifts credit risk onto trustworthy borrowers. The fact that risk managers do not view operational risks as a significant threat, aside from fraudulent activity by customers or bank employees, also contributes to the fact that many banks lack an adequate organization level for tracking and predicting operational risks.

Allen and Luciano (2019) conducted research on risk analysis and portfolio modelling with Australia being the target. A qualitative review of a financial institution's financial indicators provides the bank with the credit risk information it requires. The research presents an assumption regarding operational intentions, i.e., whether borrowers will be able to fulfill loan commitments to a bank, by showing exactly how well the financial institution performed in the prior period. The quality, accessibility, and sufficiency of loan collateral—which is necessary for a borrower to obtain credit funds—as well as the borrower's ability to repay the loan within a certain time are all factors taken into account by commercial banks when evaluating a borrower's credit risk.

In order to decrease non-performing loans among MFIs in Dar es Salaam, Moshi (2020) investigated credit risk management strategies. The design of the case study included 79 MFIs. According to the findings, a variety of things contributed to the occurrence of non-performing loans, including MFIs' poor credit record keeping and their failure to pay attention to applicants' financial data before approving credit or loans. The survey also found that MFIs employed a range of techniques to identify nonperforming loans. Investigating the borrowers' capacity to repay their debts was one of the tactics. Furthermore, comprehensive borrower screening and close borrower supervision were among the most effective ways to prevent nonperforming

loans. Despite using the aforementioned strategies, the bulk of MFIs continued to struggle with the issue of non-performing loans.

In Kenya's Nyeri County, Wachira (2017) investigated how commercial banks' loan performance was impacted by their credit risk management procedures. A census research was undertaken, and branch managers, credit managers, and credit officers made up the population of 86 respondents. According to the study's findings, each commercial bank had a credit policy that was carefully written and followed on a regular basis. Commercial banks rarely utilize credit rating models. The initial screening is done by a credit officer at every institution, and according to the amount, different steps of approval are done. The majority of financial institutions track the debtor's post-borrowing activity. In conclusion, managing credit risk has an effect on how well commercial banks do with their loans. Hence, managers should be more precise when determining a customer's capacity to pay back debts because better vetting leads to better results from commercial banks.

The identification, analysis, monitoring, and control of credit risks are all necessary for MFIs to operate financially, according to Kariuki's 2017 study conducted in Kenya. Credit risk management does not, however, enhance the financial performance of banks, according to other studies. The current study, however, contributes to the body of knowledge by exploring the relationship between the capital structures of MFIs and their approaches to managing credit risk. In their investigation of financial institutions in Juba City, Paulino et al. (2018) found no proof of a significant correlation between financial success and the management of credit risk factors of credit hazard identification, credit risk evaluation, and credit risk evaluation.

2.3.3 Terms and Condition of Credit and Financial Performance

Nikhade et al. (2019) investigated crop loan repayment behaviour in maize growers in Mexico with the goal of determining the role of time in the reasons of seasonal crop loan non-repayment. Due to the impact on project implementation, a relationship analysis revealed that when the loan application and distribution duration is protracted, the repayment term will increase. The time between when the loan is applied for and when it is disbursed determines whether a loan is problematic from the start or not.

Rahman, Belas, Kliestik, and Tyll (2017) conducted research on SME loan collateral requirements: empirical evidence from Visegrad nations. The findings also suggest that loans with longer terms are more likely to be collateralized than loans with shorter terms. They found evidence showing that bank-borrower proximity can lower collateral needs while bank concentration can raise them. By putting into practice policies that increase bank competition and reduce guaranties for female borrowers, regulators may consider these results into consideration. The study adds to the existing dialogue about collateral determinants.

With respect to credit information exchange and credit default in emerging countries, Fosu et al. (2020) examined the moderating impacts of banking market dominance and the standard of state institutions in 89 developing countries. The study employed regression analysis to make the observation that the danger of making loan repayments increased with loan size, therefore large borrowers would profit more than small-scale borrowers. A study gap results from the ambiguity of the net effect on loan repayment. The effect of installment reminders on loan collection efforts was not examined in the study.

According to Jote (2018), who carried a research in Ethiopia, loan size and repayment rate are negatively correlated. In other terms, the borrower repayment rate decreases the larger the loan amount the institution offers. Their regression findings strongly disagreed with this hypothesis. It said that the client would receive

a greater loan if the payback rate was higher. The money to be collected was significantly higher, and if the loan came from an innovation-based organization with limited chances of repeat loans and subsidized interest rates, such borrowers would likely feel pressured or motivated to put off repayment.

The effect of risk diversification on the financial statements of financial enterprises registered on Kenya's Nairobi Stock Exchange was assessed by Osewe (2020). Regression analysis was used in the study to show how loan fees ultimately raise the cost of the loan. The conditions of credit include any fees the borrower assesses to hasten the processing of loan documents. Large loan service charges may lead to default if the debtor tries to cover them with borrowings since they alter the project's overall cost, it was proposed.

2.3.4 Credit Collection Policy and Financial Performance

A well stated credit policy and credit management instruments for executing the policy are the foundation of an effective collection policy plan. Success is determined by how well the entire credit value chain performs overall. By utilizing chances to enhance the collection operations strategically successful, operationally efficient, and customer-focused, collection policies within financial institutions can create the difference between a good and great performance for the bank. A debt collection policy is a legitimate and required business practice that enables creditors and collectors to take reasonable action to obtain payment from clients who are contractually required to pay or repay the debt (Nabi et al., 2018).

In a study done in India by Khan, Ahmad and Shireen (2021), it was established that MFIs must use strict debt collection techniques to protect themselves from financial risk. Microfinance institutions must have full operational capability and develop risk management methods in order to function effectively. The findings suggested that MFIs implemented severe debt collection procedures, which may have reduced the probability of default and enhanced overall financial risk management. The presence of financial risk management measures may have had an impact on the rise of MFIs.

Sangwayire (2016) investigated the effects of credit risk management techniques on the financial performance of microfinance banks using a case study of the Urwego Opportunity Bank in Rwanda. The design was a descriptive case study. According to the study, banks used credit limitations as a strategy to reduce the exposure to credit risk resulting from new consumers who lacked any kind of collateral, had standard loan terms, had zero tolerance for delinquent, and were lent to in groups. The study's findings also made clear that credit limitations were influenced by the client's financial stability and credit history.

Modisagae and Ackermann (2018) used a probit regression method to examine the factors that contribute to collateral lending groups defaulting in microfinance. The internal strength of the banks was assessed based on interest revenue collected and reduced loan losses. The components of the loan repayment performance of microfinance institutions were examined using the logit model. Conclusions of the study show that insurance, especially third party loan security in situations of group lending, has a substantial impact on MFIs in Tanzania's ability to repay loans as evidenced by interest income collected.

Research on the foreign debt issue in Sub-Saharan Africa was done by Greene (2016). The study concludes that employing penalties and high interest rates to deter debtors from skipping or delaying payments is a risky strategy since it raises the possibility that the late-paying borrower may ultimately fail if the principal amount owed and fines are too high. The study also showed that fines for delayed payment frequently have an impact on repayment rates. This might be because penalties increase the cost of repaying current obligations, particularly if they are accrued continuously, like 2% of principal for each day of prolonged deferral.

According to Njenga (2019), credit risk management strategies may have contributed to the failure of Tanzania's Tala Company Limited and the financial difficulties Kenyan credit lending businesses are currently experiencing. According to the research, around 380,000 consumers have now defaulted on their loans as a result of the CRB listing. Tala is facing financial difficulties, and his report presents a bleak

picture of Kenya's faltering mobile lending business. Because of their incapacity to repay the debt, over 14 million Kenyans have been included in the CRB (CBK Report, 2019).

Ngondo (2018) investigated the impact of lending rates on loan performance at Kenyan commercial banks. According to the survey, financial institutions have implemented penalties for late debt payments as part of their debt recovery strategy during the last few decades. Furthermore, penalties are regarded as a proactive method because the borrower is made aware of the risks of incurring penalties in the event of default or late repayment. He also mentions that the waiving of interest and penalties is utilized to encourage payment. Finally, the strategy used by an institution is heavily influenced by its connection with the borrower. Debt recovery is very costly for lenders since they must incur additional fees.

To find out how the credit reference bureaus impacted the non-performing loans of Kenyan commercial banks, Kisengese (2014) conducted a study. The study's objective was to ascertain the impact of credit information sharing on nonperforming loans at Kenyan commercial banks. In this study, which employed a descriptive survey research method, the population of interest consisted of 43 financial institutions that are active in Nairobi, Kenya. According to the study, nonperforming loans are an issue for all banks. Sharing customer payment information helped commercial banks approve more credit, which reduced the amount of non-performing loans they made to chronic defaulters. Conversely, a low default rate and a rise in credit approval by commercial banks would result from lending to borrowers based only on the favourable information from all credit sources. The study found a negative correlation between credit information exchange and nonperforming loans at Kenyan commercial banks.

2.3.5 *Credit Management Process and Financial Performance of MFIs*

Micro-finance institutions (MFIs) in Bangladesh were evaluated by Parvin, Hossain, Mohiuddin, and Cao (2020) for their capital structure, financial performance, and sustainability. According to the study, micro-

finance institutions' (MFIs) funding sources, performance, and financial sustainability have become crucial issues for MFIs and initiatives to combat poverty in order to meet the UN's sustainable development goals.

Kalu, Shieler, and Amu looked into the credit risk management and financial performance of microfinance institutions in Kampala, Uganda (2018). Using frequencies and descriptive statistics, the population was examined. The Pearson linear correlation coefficient was utilized to analyze the connection between credit risk management strategies and financial performance. The results show that while credit hazard identification and credit risk assessment have a strong positive link with MFI financial performance, credit risk monitoring and debt mitigating risk have an only slightly significant beneficial association with MFI financial performance.

Otieno, Nyagol, and Onditi (2016) evaluated the connection between credit risk management and financial success in Kenyan microfinance banks. The researcher gathered information from 44 loan servicers and credit managers using both qualitative and quantitative techniques, such as surveys. The study's conclusions indicate that MFIs heavily rely on client appraisal while managing credit. Also, it demonstrated that customer appraisal is a practical method for reducing credit risk. The research additionally demonstrated a high correlation between MFI credit effectiveness and client evaluation. In order to improve their loan performance, the study advised MFIs to enhance their client appraisal procedures.

In their 2020 study, Paul and Musiega examined the impact that credit risk management practices had on the monetary performance of microfinance firms in Nairobi. The population of this study comprised of 1147 employees at Nairobi's microfinance institutions, hence the sample size was 96 responses. Questionnaires were used to target the bank managers and loan administrators in each branch in order to gather the primary information for this study. The study used first-hand information collected through questionnaires. The research's conclusions indicate that credit risk grading methods, viability assessment procedures, credit risk control procedures, and credit reminder procedures all significantly impacted the

financial success of Kenya's microfinance organizations. The report makes the recommendation that businesses should concentrate more on enhancing their credit risk mitigation procedures in order to gain an edge and be capable of handling increasingly fast changing conditions.

Bwoma, Muturi, and Mogwambo investigated the influence of loan management techniques on the financial performance of deposit-taking SACCOs in Kisii County (2017). The study's target group was 120 workers. The census approach was used for the investigation. Primary data was gathered using a questionnaire. To examine the data, both inferential and descriptive statistics were employed. The study discovered that the performance of deposit-taking SACCOs is highly impacted by nonperforming loans, handling credit risk, and debt collection methods. The study made a number of recommendations for SACCOs, including continuing to monitor past-due loans, fining clients for late payments, barring defaulters from receiving repeat loans, keeping track of the flow of debtors' business through the SACCO's account, routinely reviewing borrowers' reports, providing support to borrowers whenever they run into issues, keeping in touch with borrowers on a regular basis, and conducting online visits.

Barasa and Makokha (2018) assessed the impact that interest rates have on the income of microfinance firms in a case study in Kenya's Trans Nzoia County. The study found that the financial stability of microfinance institutions was positively impacted by debt management strategies. Debt collection tactics have a big impact on financial success. Policy criteria are established to make sure that borrowers may easily satisfy their obligations at a reasonable cost to the institution. The implementation of debt collection strategies is encouraged more in the study since it helps microfinance providers to set safe customer lending limits. The report also suggests that microfinance managers prioritize systems for internal control further since using customer credit registration forms improves credit management and monitoring. The report recommended further investigation into the challenges debt management systems in Kenyan microfinance firms face.

Atandi and Kirui (2022) looked on the financial viability and debt collection practices of mobile lending firms. Data were gathered from both primary as well as secondary sources, and descriptive and inferential statistics were used to examine them. The main conclusions of the study were that credit recovery efforts must be enhanced in order to ultimately increase firm earnings and prevent losses, that credit collection strategies should encourage debtors to pay back their loans rather than enrage them, and that ineffective financial planning provisions can invariably result in lack of effectiveness in financial products. The report suggests more investigation into how government regulations affect the functionality and feasibility of mobile lending businesses.

Research on the credit management practices and loan performance of Kenyan microfinance institutions was conducted by Karanja and Simiyu in 2022. Structured questionnaires were utilized to collect primary data. Financial information from microfinance organizations and regulation data as from Central Bank of Kenya will be used to collect secondary data (CBK). The study also found that reminding customers, especially recurrent defaulters, of their loan requirements on a regular basis can improve loan performance. The study found that credit policy, customer evaluation, terms of payment, loan terms, and credit controlling risks all had a 5% relative importance and a 95% confidence level impact on the advance presentation of microfinance banks in Kenya. The review's conclusions show that their companies evaluate their clients. The importance of customer reviews was also made clear by the study. The report claims that before approving a loan, the corporation looks into a customer's credit standing.

2.4 Conceptual Framework

The conceptual framework represents how the researcher conceptualizes the connection between the variables being investigated. The diagram in figure 2.1 represents the study's conceptualization of the relationship between debt collection process and financial performance.

Independent Variables **Dependent Variable**

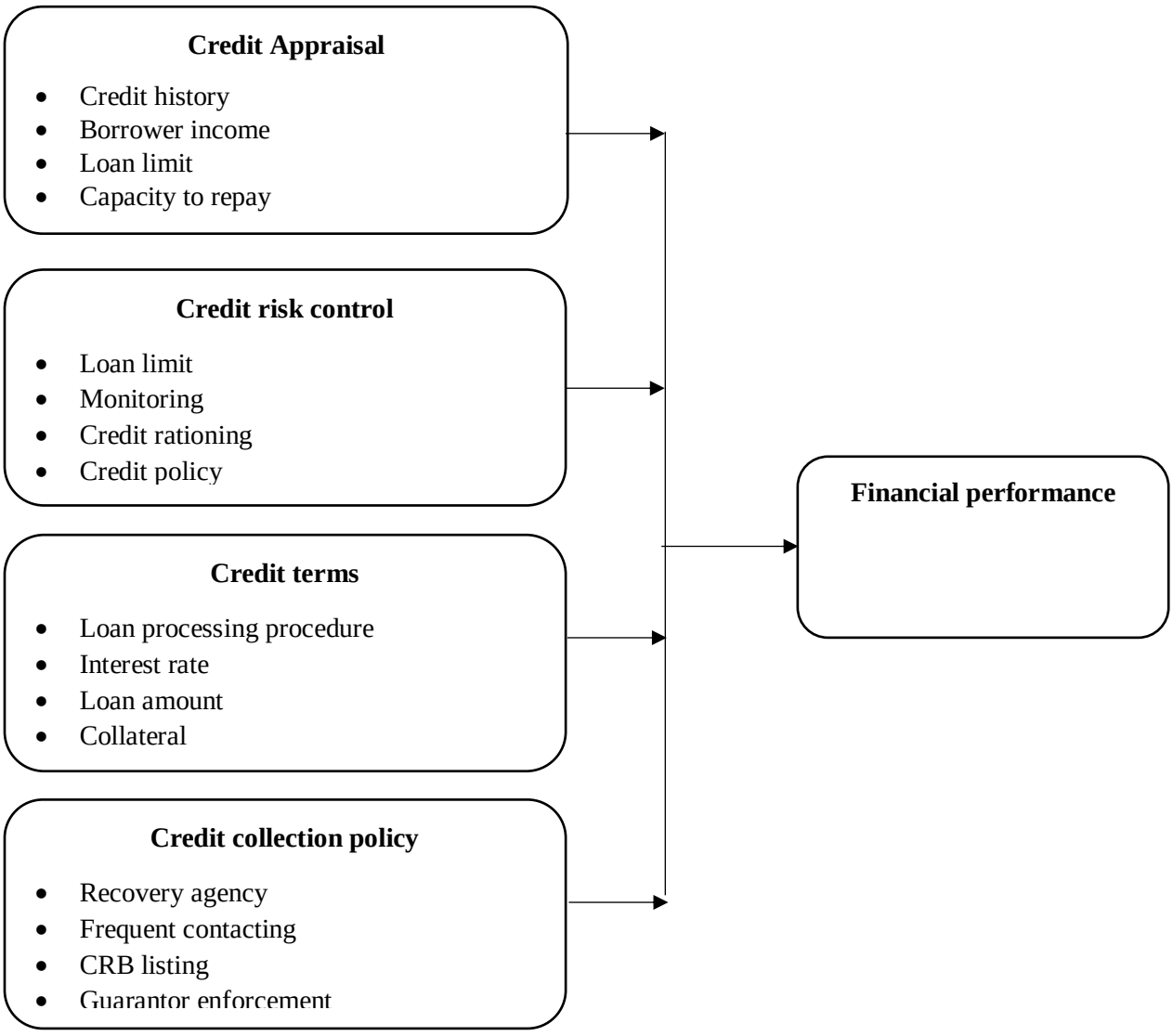

Figure 2.1: Conceptual Framework

Source: Author (2022)

2.5 Operational of Variables

TABLE 1

Operationalization of variables

Variable	Description	Measurement
Credit appraisal	The process through which an MFI assesses a potential borrower's creditworthiness, technical viability, and economic viability is called credit appraisal.	• Credit history • Borrower income • Loan limit • Capacity to repay
Credit risk control	By assessing the adequateness of an MFI's cash and credit loss reserves at any given time, credit risk control seeks to minimize losses.	• Loan limit • Monitoring • Credit rationing • Credit policy
Credit terms	Credit terms outline when payments for credit sales are due, along with any applicable discounts, interest rates, and late payment penalties.	• Loan processing procedure • Interest rate • Loan amount • Collateral • Loan processing procedure • Interest rate • Loan amount • Collateral
Credit collection policy	It is a process that outlines in clear, written rules the terms and circumstances for extending credit, the steps to be taken in the case of customer delinquency, and the methods for collection.	• Recovery agency • Frequent contacting • CRB listing • Guarantor enforcement
Financial performance	The ability to run businesses profitably, to endure, to grow, and to react to environmental opportunities and hazards.	ROE

2.6 Research Gap

There are various gaps that have been identified in the literature review that has been done. The first gap identified in the studies is that none of them has captured all the four variables at the same time which the current study is going to fill. Secondly, none of the studies done in Kenya have been done in Taita Taveta and thus warranting this study.

CHAPTER THREE

METHODOLOGY

3.0 Introduction

This section addresses various methodological approaches for completing the research. The chapter also discusses the methods adopted and the reasons for their adoption.

3.1 Research Design

A descriptive research design will be used for the investigation. Descriptive research designs, according to Sekaran and Bougie (2016), aim to present the current condition. In order to characterize what exists in connection to variables or circumstances in a situation, descriptive research is performed to acquire data on the current state of a phenomena (Sekaran & Bougie, 2016). The technique was acceptable since it entails a thorough investigation and analysis of the impact of credit management process and the financial performance of MFIs in coastal Region.

3.2 Population and Sampling Frame

3.2.1 Population

O'Gorman and MacIntosh (2015) characterize population as the complete set of objects to which a study seeks to make some references. Population is defined by Saunders et al. (2003) as the whole set of occurrences that are used when a sample is taken. The study will focus on 38 MFIs situated in coastal region i.e. Taita Taveta, Kilifi, Mombasa, Tana River & Kwale. The researcher will target 3 staff in each MFI and it will include the finance manager, loan appraisal officer and credit officer who handle issues to do with loans. Table 3.1 captures the population distribution.

TABLE 2

Population

Staff	Number	MFI	**TOTAL**
Finance Officer	1	38	38
Loan appraisal officer	1	38	38
Credit Officer	1	38	38
Total			**114**

3.2.2 Sampling and Sample Size

The main objective of a research study is to investigate the sample and develop conclusions because a sample is a group of people picked from a population to represent the actual population (Patten, 2017). Orodho (2004) defined sampling as the method through which a researcher chooses subjects or objects to study. The researcher specifically selects people or things from a population to reflect the traits shared by the entire group. The census sample approach will be used in this study to pick respondents from each of the MFIs chosen for the investigation. When the population is smaller than 100, Mugenda & Mugenda (2003) proposed that 100% of the target population be taken. As a result, the study will employ 114 MFI staff which is slightly higher than 100.

3.3 Data collection instruments

The study will use primary data. The only data collection tool for this study will be a questionnaire (Appendix II), which contains closed-ended questions. A questionnaire is preferred because it is a useful tool for gathering data and enables respondents to express many of their thoughts in relation to the study's problem (Krosnick, 2018). According to Kothari (2004), data received using a questionnaire is accurate and legitimate because it is free of bias and researcher interference.

There are two sections to the questionnaire. While the second section looks for information study objectives, the first section looks for background information. The surveys will be distributed utilizing the drop and pick later technique. A telephone follow-up was used in order to improve the response rate.

3.4 Pilot Study

A pilot test will be conducted to assess the correctness of the questions and the predicted reliability of the data which will be acquired. As per Gupta and Gupta (2022), a pilot test is conducted to find design and instrument defects and provide an alternative source of information for selecting a probability sample.

3.4.1 Reliability

Reliability assesses how consistently the research tool produces its results (Kombo & Tromp, 2006). The study will make sure that each question is phrased correctly to prevent pressuring respondents to provide a certain type of response. The most popular internal consistency metric, Cronbach's Alpha, will be used in the study and will be produced by SPSS. The study's dependability will be stopped at an acceptability value of ≥ 0.7.

3.4.2 Validity

Validity, according to Pandey and Pandey (2021) is the extent to which the findings accurately reflect the phenomenon under investigation. In order to find any unclear or inefficient questions, the instrument was pre-tested to ensure the validity of the study. Validity testing assisted in determining whether the questionnaire adequately covers the subject under research by replacing or removing any items that were unclear or irrelevant.

3.5 Data Analysis

Data processing and arrangement are steps in the data analysis process that result in findings that need to be interpreted by the research. The process of modifying data to extract pertinent information and facilitate conclusions is known as data analysis (Pandey & Pandey, 2021).

The questionnaire will be used to collect data for this study. After obtaining the respondents' questionnaires, the data will be reviewed and verified for accuracy, and then the responses will be categorized, coded, and tabulated to analyze qualitative data. SPSS will be used to analyze collected data. The descriptive analysis of the data will mostly use frequency, percentage, mean, and standard deviation.

The relationship between the dependent and independent variables will be established using the inferential statistical method known as multi linear regression, on the other hand. According to the following multiple regression analytical model, the relationship between the dependent and independent variables can be established:

$Y= \alpha +\beta 1x1 +\beta 2x2+\beta 3x3+ \beta 4x4+\varepsilon$

Y = Financial Performance

α =Constant term

β= Beta Coefficients

X_1 = Credit Appraisal

X_2= Credit risk control

X_3= Credit terms and conditions

X_4= Credit collection policy

ε= Standard Error

3.6 Diagnostic Tests

3.6.1 Normality Test

In this study, a number of diagnostic tests will be conducted to determine the applicability of the research structure. To ascertain whether the data is normal, normality tests were run on it. According to Creswell, the Kolmogorov-Smirnov test can be used to compute normality measures (2008).

3.6.2 Multicollinearity

Multi collinearity will be evaluated using tolerance statistics and the variable inflation factor (VIF). According to Woolsridge (2011), multi-collinearity happens when VIF is higher than 10 and Tolerance is lower than 0.2. When there is a strong correlation between the independent variables, multicollinearity occurs, which distorts the outcomes of the study models.

3.6.3 Auto Correlation Test

The relationship between a variable's current value and its historical values was determined using autocorrelation tests (Dunn, 2005). A result between 1.5 and 2.5 on the Durbin-Watson scale, which was used to measure autocorrelation, suggested that there is no autocorrelation (Khan, 2008).

3.6.4 Shapiro-Wilk, histogram, and Skewness and Kurtosis tests

Shapiro-Wilk, histogram, and skewness and kurtosis tests for linearity were performed in this study. A direct proportional relationship between the dependent and independent variables is indicated by linearity. As a result, each change in the independent variable will always be followed by an equivalent change in the dependent variable (Gall et al, 2006).

Predictor variables were found using the Durbin-Wu-Hausman (DWH) test in a regression model (Nakamura & Nakamura, 1981).

CHAPTER FOUR

DATA ANALYSIS, PRESENTANTION AND DISCUSSION

4.1 Introduction

This chapter discusses the analysis of the data, its interpretation, and presentation. Quantitative data was analysed using descriptive and inferential statistics while qualitative data was analysed using content analysis. Data was presented in frequency distributions, percentages, and frequency tables to easily understand and interpret it.

4.2 Response Rate

The sample population for this study was 114 respondents, out of which 106 completed the questionnaire, making a response rate of 9%. This was considered adequate since according to Mugenda & Mugenda (2012), a response rate of 50% is inadequate, 60% is good, while 70% is above excellent, for analysis and reporting. Table 3 below shows the response rate results.

TABLE 3

Response Rate

Responses	**Frequency**	**Percent**
Returned questionnaires	106	93
Unreturned questionnaires	8	7
Total	**114**	**100**

Source: Research data, (2023)

4.3 Reliability Statistics

The questionnaire was tested before actual data collection. Reliability was tested using the Cronbach's Alpha, which measured internal consistency. The acceptable reliability was set to be 0.70 and above. The results were as shown in Table 4.

TABLE 4

Reliability Statistics

Cronbach's Alpha	N of Items
.939	42

Source: Research data, (2023)

The Cronbach's Alpha was found to be 0.939, which was above the acceptable 0.7 hence there was a high level of internal consistency and reliability and was therefore considered suitable for this study.

4.4 Background Information

The results of the study on background information are aligned as per the study objectives and study questions.

4.4.1 Distribution by Gender

To ensure fair involvement of both male and female respondents, the participants were required to indicate their age category and the results were as shown.

TABLE 5

Distribution by Gender

	Frequency	**Percent**
Male	46	43.4
Female	60	56.6
Total	**106**	**100.0**

Source: Research data, (2023)

The findings revealed that 43.4% of the respondents were male, while 56.6% were female. This was therefore evidence that both genders were fairly involved in this study hence its findings did not suffer gender biasness.

4.4.2 Distribution by Age

The respondents were required to indicate their age group since individuals of different age groups are perceived to hold different opinions on different topics. The results were as presented below

TABLE 6

Distribution by Age

	Frequency	Percent
18-30years	12	11.3
31 -40 years	66	62.3
41 -50 years	18	17.0
50 years and above	10	9.4
Total	**106**	**100.0**

Source: Research data, (2023)

From the research findings, 11.3% of the respondents were aged between 18 to 30 years, 62.3% of the respondents were aged between 31 to 40 years, 17% of the respondents were aged between 41 to 50 years, and 9.4% of the repondents were aged above 50 years. This implied that individuals of different age groups were fairly involved in the study.

4.4.3 Number of years worked in MFIs

The repondents were required to indicate the number of years they had worked in MFIs and the results were as shown below.

TABLE 7

Working years with the MFI

	Frequency	Percent
Less than 1 year	26	24.5
1-3 Years	53	50.0
More than three years	27	25.5
Total	**106**	**100.0**

Source: Research data, (2023)

From the research findings, 24.5% of the respondents had worked in their respective MFIs for less than a year, 50% had worked for between 1 and 3 years, while 25.5% had worked for more than 3 years.

4.4.4. Period MFI has been in existence

Respondents were required to indicate the number of years that their respective MFIs had been in existence and the results were as depicted below.

TABLE 8

Period MFI had been in existence.

	Frequency	Percent
less 5 years	34	32.1
5-10 years	52	49.1
10-15 years	20	18.9
Total	**106**	**100.0**

Source: Research data, (2023)

From the research findings, 32.1% of the MFIs had been in existence for less than 5 years, 49.1% of them had been in existence for a period of between 5 and 10 years, while 18.9% had been in existence for 10 to 15 years.

4.4.5 Number of Clients

The respondents were required to indicate the number of clients in their respective MFIs and the results were as follows.

TABLE 9

Number of clients

	Frequency	Percent
100 clients	32	30.2
100-250 Client	56	52.8
250-500 clients	15	14.2
500 clients	3	2.8
Total	**106**	**100.0**

Source: Research data, (2023)

From the findings, 30.2% of the MFIs had 100 clients, 52.8% had between 100 and 250 clients, 14.2% had between 250 and 500 clients, while 2.8% had over 500 clients.

4.5 Descriptive Statistics

This section highlights the descriptive statistics outcome on effects of credit management processes on the financial performance of microfinance institutions in coastal region. The effects of credit management processes on the financial performance of microfinance institutions in coastal region was aligned in a five point's Likert scale. The range was between 'Strongly Disagree' (1) to 'Strongly Agree' (5). The scores of 'Disagree' and 'Agree' were denoted to represent variables which had a mean of score less than 2.5 on the continuous Likert scale. The score of 'Some extent' has been taken to represents a variable with mean score of 2.5 on the continuous Likert scale while the score of 'Agree' and 'Strongly agree ' had been take taken to represents a variable which had mean score of above 2.5 to 5 on the continuous Likert scale. Standard deviation (SD) more than 2 was considered to be high and this was an indication that the respondents' opinions were differing while on the other side a standard deviation of less than 2 meant that the respondents' opinions were in line.

4.5.1 Credit Appraisal and Financial Performance

How credit appraisal affects financial performance was the first objective of the study on the effects of credit management processes on the financial performance of microfinance institutions in coastal region. The respondents were required to indicate their level of agreement with the following statements on credit appraisal and financial performance. The results obtained were shown below.

TABLE 10

Credit Appraisal

	N	Minimum	Maximum	Mean	Std. Deviation
The credit history of the of the borrower is often looked at	106	2.00	5.00	4.3774	.73618
There is thorough business assessment to understand the performance and financial status	106	2.00	5.00	4.2642	0.75972

The credit officers assess the loan limits of the individual or business	106	2.00	5.00	4.1792	0.77824
The institution often assesses the borrower's capacity to repay the loan	106	1.00	5.00	3.7736	0.92873
Collateral capacity of the borrower is assessed for huge loans	106	1.00	5.00	3.7264	0.98109
The institution has competed staff who conduct credit appraisal	106	1.00	5.00	3.6604	1.03175

Source: Research data, (2023)

From the study findings, majority of the respondents agreed that the credit history of the of the borrower is often looked at (M=4.3774, SD= 0.73618), the credit officers assess the loan limits of the individual or business (M=4.1792, SD= 0.77824), and the institution often assesses the borrower's capacity to repay the loan (M=3.7736, SD= 0.92873). These study findings were in agreement with those by Njeru, Mohammed and Wachira (2016), credit history and credit referencing were employed more often in credit appraisal because lending substantially relied on prior knowledge.

Further, the study revealed that, collateral capacity of the borrower is assessed for huge loans (M= 3.7264, SD= 0.98109), there is thorough business assessment to understand the performance and financial status (M=4.2642, SD=0.75972), and the institution has competed staff who conduct credit appraisal (M= 3.6604, SD=1.03175). These study findings concur with those of Misati & Kamau (2015), the decision-making process that results in the granting of credit to a borrower centre on credit appraisal.

4.5.2 Credit Risk Control

The second objective of the study on the effects of credit management processes on the financial performance of microfinance institutions in coastal region was to establish the effect of credit risk control on financial performance of microfinance institutions in coastal region. The respondents were required to

indicate their level of agreement with the following statements on credit risk control and financial performance. The results obtained were shown in Table 11.

TABLE 11

Credit Risk Control

	N	Minimum	Maximum	Mean	Std. Deviation
The loan limit is considered as higher loans can be risky when it comes to some clients	106	1.00	5.00	4.3868	0.84595
The borrower is made to understand he loan terms to reduce risk of default	106	2.00	5.00	4.2453	0.74080
Collateral is demanded on loans that look riskier	106	2.00	5.00	4.1698	0.83349
There is constant review and updating of client's credit worthiness	106	2.00	5.00	4.0377	0.88290
The interest charges are reasonable based on the amount of loan to enhance payment	106	2.00	5.00	4.0189	0.79260
There are internal checks and audits that are used to monitor risks that might be associated with certain loans	106	1.00	5.00	4.0094	0.97096
Sometimes, the payment period is made flexible to lower the risks of non-payment	106	1.00	5.00	3.8585	0.83311

Source: Research data, (2023)

From the research findings, majority of the respondents agreed that the loan limit is considered as higher loans can be risky when it comes to some clients (M=4.3868, SD=0.84595), the borrower is made to understand the loan terms to reduce risk of default (M=4.2453, SD=0.74080), collateral is demanded on loans that look riskier (M=4.1698, SD=0.83349), and there is constant review and updating of client's credit worthiness (M=4.0377, SD=0.88290). These study findings agree with those of Allen and Luciano (2019), the quality, accessibility, and sufficiency of loan collateral, as well as the borrower's ability to repay the loan within a certain time are all factors considered by commercial banks when evaluating a borrower's credit risk.

Further, the study revealed that, the interest charges are reasonable based on the amount of loan to enhance payment (M=4.0189, SD=0.79260), there are internal checks and audits that are used to monitor risks that might be associated with certain loans (M=4.0094, SD=0.97096), sometimes, the payment period is made flexible to lower the risks of non-payment (M=3.8585, SD=0.83311). These study findings concur with those by Wachira (2017), managing credit risk has an effect on how well commercial banks do with their loans.

4.5.3 Credit Terms

The third objective was to assess the effects of credit terms on the financial performance of microfinance institutions in coastal region. Respondents were required to indicate their level of agreement with the following statements on credit terms and financial performance. The results obtained were presented in Table 12.

TABLE 12

Credit Terms

	N	Minimum	Maximum	Mean	Std. Deviation
The client is made to understand and agree with the interest rate and how it accumulates	106	1.00	5.00	4.3302	.80145

The credit officers assess the loan limits of the individual or business	106	1.00	5.00	4.3302	.86983
The grace period of the loan is well explained to the borrower	106	2.00	5.00	4.2642	.86522
The terms of repayment period are agreed upon with the borrower	106	1.00	5.00	4.2358	.83440
All necessary documents are kept safe and required copies are issued to the borrower	106	1.00	5.00	3.9623	.94541
The institution has a well written and document terms and conditions of its loans	106	1.00	5.00	3.8868	.96925
The borrowers are made to read, understand and sign the terms and conditions of the loan	106	1.00	5.00	3.8679	.95693

Source: Research data, (2023)

From the research findings, it was clear that the client is made to understand and agree with the interest rate and how it accumulates (M=4.3302, SD=0.80145), the credit officers assess the loan limits of the individual or business (M=4.3302, SD0.86983), the grace period of the loan is well explained to the borrower (M=4.2642, SD=0.86522), and the terms of repayment period are agreed upon with the borrower (M=4.2358, SD=0.83440).

The study further revealed that all necessary documents are kept safe and required copies are issued to the borrower (M=3.9623, SD=0.94541), the institutions have well written and document terms and conditions of their loans (M=3.8868, SD=0.96925), and the borrowers are made to read, understand and sign the terms and conditions of the loan (M=3.8679, SD=0.95693). These study findings concur with those of Mwangi

(2015), credit terms, which include loan cost, repayment time, and guarantee, are essential for controlling debt.

4.5.4 Credit Collection Policy

The last objective was to find out the effect of credit collection policy on the financial performance of microfinance institutions in coastal region. Respondents were required to indicate their level of agreement with the following statements on credit collection policy and financial performance. The findings were presented in Table 13.

TABLE 13

Credit Collection Policy

	N	Minimum	Maximum	Mean	Std. Deviation
Borrowers are often reminded through email, calls and SMS to pay their loans	106	1.00	5.00	4.3113	.88762
The institution has a credit collection policy	106	2.00	5.00	4.2642	.79644
The policy stipulates the use of credit incentives to encourage loan repayment	106	1.00	5.00	4.0189	1.04180
The policy stipulates situations when collateral can be used to recover the loan	106	1.00	5.00	3.9057	1.01913
If the borrower has not made attempt to repay the loan after various communication attempts, their details are forwarded to CRB	106	1.00	5.00	3.8113	1.12219

The credit collection policy indicates that there are avenues for legal actions should loan repayment be defaulted	106	1.00	5.00	3.7925	1.03018
The policy indicates that the institution can use debt collection agencies to hasten the process of debt recovery	106	1.00	5.00	3.7264	.98109
The policy captures situations where guarantors are contacted and how they assist with loan repayment	106	1.00	5.00	3.4151	1.22566

Source: Research data, (2023)

From the study findings, it was clear that borrowers are often reminded through email, calls and SMS to pay their loans (M=4.3113, SD=0.88762), the institutions have a credit collection policy (M=4.2642, SD=0.79644), the policy stipulates the use of credit incentives to encourage loan repayment (M=4.0189, SD=1.04180), and the policy stipulates situations when collateral can be used to recover the loan (M=3.9057, SD=1.01913). The study findings concur with those by Nabi et al (2018), a debt collection policy is a legitimate and required business practice that enables creditors and collectors to take reasonable action to obtain payment from clients who are contractually required to repay the debt.

The study further revealed that if the borrower has not made attempt to repay the loan after various communication attempts, their details are forwarded to CRB (M=3.8113, SD=1.12219), the credit collection policy indicates that there are avenues for legal actions should loan repayment be defaulted (M=3.7925, SD=1.03018), the policy indicates that the institution can use debt collection agencies to hasten the process of debt recovery (M=3.7264, SD=0.98109), and the policy captures situations where guarantors are contacted and how they assist with loan repayment (M=3.4151, SD=1.22566). These study findings agree with those of Wachira (2017), who investigated how commercial banks' loan performance was impacted by their credit risk management and found that all commercial bank had a credit policy that was carefully written and followed on a regular basis.

4.5.5 Financial Performance

The dependent variable in this study was financial performance of MFIs in coastal region. The respondents were requested to indicate their level of agreement on various statements pertaining financial performance of MFIs in coastal region. The findings were presented in table 14.

TABLE 14

Financial Performance

	N	Minimum	Maximum	Mean	Std. Deviation
The has been a surge in the gross profits of the institution	106	1.00	5.00	4.3868	.84595
The operating income of the institution has increased	106	2.00	5.00	4.3774	.73618
There has been a decrease in non-performing loans	106	2.00	5.00	4.2642	.75972
The return on equity of the institution has been positive over the years	106	1.00	5.00	4.2358	.83440
The return on assets of the institution has grown	106	2.00	5.00	4.1792	.77824
The return on investment has grown over the years	106	1.00	5.00	3.9623	.94541
There has been an increase in the deposits made by the clients	106	1.00	5.00	3.8679	.95693
The institution has experienced increase in profitability	106	1.00	5.00	3.7736	.92873
The policy indicates that the institution can use debt collection agencies to hasten the process of debt recovery	106	1.00	5.00	3.7264	.98109

Source: Research data, (2023)

From the research findings, it was clear that there has been a surge in the gross profits of the institutions (M=4.3868, SD=0.84595), the operating income of the institutions have increased (M=4.3774, SD=0.73618), there has been a decrease in non-performing loans (M=4.2642, SD=0.75972), the return on equity of the institution has been positive over the years (M=4.2358, SD=0.83440), and the return on assets of the institution has grown (M=4.1792, SD=0.77824).

Further, the study revealed that the return on investment has grown over the years (M=3.9623, SD=0.94541), there has been an increase in the deposits made by the clients (M=3.8679, SD=0.95693), the institution has experienced increase in profitability (M=3.7736, SD=0.92873), and the policy indicates that the institutions can use debt collection agencies to hasten the process of debt recovery (M=3.7264, SD=0.98109).

4.6 Diagnostic Test

The study completed diagnostic tests such as tests on normality, multicollinearity, autocorrelation and heteroskedasticity before engaging an ordinary least square regression model to evaluate the study hypothesis. The findings were as presented in the subcategories below.

4.6.1 Tests of Normality

A classical linear regression model undertakes that the data follows a normal curve (Normal distribution). To determine the dependent variable's normality, The Kolmogorov-Smirnova (K-S) test was done. In the Kolmogorov-Smirnova (K-S) test, the null hypothesis is that the data is normally distributed, whereas the alternative hypothesis is that the data is not normally distributed. Because the null hypothesis could not be rejected, a significance value greater than 0.05 indicated that the data was normally distributed. The Kolmogorov-Smirnova (K-S) test results are shown in Table 15.

TABLE 15

Normality Tests

	Kolmogorov-Smirnov[a]			Shapiro-Wilk		
	Statistic	df	Sig.	Statistic	df	Sig.
Credit appraisal	0.086	106	0.051	0.966	106	0.008
Credit risk control	0.142	106	0.000	0.946	106	0.000
Credit terms	0.127	106	0.000	0.943	106	0.000
Credit collection policy	0.082	106	0.074	0.965	106	0.007

Source: Research data, (2023)

Table 4.13 shows that the p values for the Kolmogorov-Smirnov and Shapiro Wilk tests of standardized residuals were 0.008 for credit appraisal, 0.000 for credit risk control, 0.000 for credit terms, and 0.007 for credit collection policy. This is an indication that all these variables were not normally distributed.

4.6.2 Autocorrelation

TABLE 16

Autocorrelation Test

Model	Durbin-Watson
1	1.860

Source: Research data, (2023)

The results on table 16 indicates that the Durbin-Watson statistic is 1.860, which lies between the recommended threshold of 1.5 and 2.5. The results thus designate the absence of autocorrelation.

4.6.3 Multicollinearity Test

The variance Inflation Factors (VIF) eas used to test multicollinearity and the results were presented in Table 17.

TABLE 17

Multicollinearity

Model		Collinearity Statistics	
		Tolerance	**VIF**
1	(Constant)		
	Credit appraisal	0.444	2.252
	Credit risk control	0.372	2.690
	Credit terms	0.324	3.083
	Credit collection policy	0.422	2.372
a. Dependent Variable: financial performance			

Source: Research data, (2023)

Table 4.15 displays the VIF results. According to the findings of the study, credit appraisal has a VIF value of 2.252, credit risk control has a VIF value of 2.690, credit terms has a VIF value of 3.083, and credit collection policy has a VIF value of 2.372. The tolerance values and VIF values for all the independent variables are less than 1 and less than 10, hence reveal the result of multicollinearity issue, showing that the independent variables in the study were within the normal range. The contemporary study's design and execution was therefore free from multicollinearity.

4.6.4 Heteroskedasticity Test

Homoscedasticity violation inhibits critical evaluation of forecast errors of standard deviation, which often leads to confidence intervals that are extremely wide or extremely narrow. In this study, Heteroscedasticity was assessed using the Breusch-Pagan test. The null hypothesis for this test was that the variance of the errors does not depend on the values of the independent variables. Homoscedasticity normally occurs when the p-value is more than the significance level (0.05)

TABLE 18

Breusch-Pagan Test for Heteroskedasticity

Chi-Square	df	Sig.
2.515	1	0.113

a. Dependent variable: financial performance

b. Tests the null hypothesis that the variance of the errors does not depend on the values of the independent variables.

c. Predicted values from design: Intercept + credit appraisal + credit risk control + credit terms + credit collection policy

As indicated in Table 18, the p-value was 0.113, which was greater than the significance level of 0.05. This implies that there was homoscedasticity in the regression model.

4.7 Correlation Results

To establish the relationship between the study variables, the study used Karl Pearson's product moment correlation analysis. The results were as shown in the table 4.17 below. Correlation is perceived to be significant when the probability value is below 0.05 (p-value less than 0.05). A correlation value (r) close to zero indicates a weak relationship while a r close to one indicates a very strongly correlations existing.

TABLE 19

Correlation Analysis

		Financial performance	**Credit appraisal**	**Credit risk control**	**Credit terms**	**Credit collection policy**
Financial performance	Pearson Correlation	1				
	Sig. (2-tailed)					
	N	106				
Credit appraisal	Pearson Correlation	.900**	1			
	Sig. (2-tailed)	.000				

	N	106	106			
Credit risk control	Pearson Correlation	.808**	.723**	1		
	Sig. (2-tailed)	.000	.000			
	N	106	106	106		
Credit terms	Pearson Correlation	.797**	.602**	.694**	1	
	Sig. (2-tailed)	.000	.000	.000		
	N	106	106	106	106	6
Credit collection policy	Pearson Correlation	.591**	.549**	.555**	.751**	1
	Sig. (2-tailed)	.000	.000	.000	.000	
	N	106	106	106	106	106
**. Correlation is significant at the 0.01 level (2-tailed).						

Source: Research data, (2023)

The study found a strong positive correlation between credit appraisal and financial performance in microfinance institutions in coastal regions which was shown by a correlation factor of 0.900. This positive relationship was found to be statistically significant since the significance value was 0.000, which was less than 0.005. The relationship was fully supported by the study findings by Thisika and Muturi (2017), there is a positive, significant, and statistically significant correlation between credit assessment and non-performing loans.

The findings also revealed that credit risk control and financial performance were positively and significantly related (r=0.808, p=0.000). This relationship was also supported by Wachira (2017), managing credit risk has an effect on how well commercial banks do with their loans.

Credit terms were also observed to have a strong significant relationship with financial performance of MFIs in coastal region (r=0.797, p=0.000). These study findings concurred with those by Mwangi (2021) credit terms and conditions are essential for controlling debt.

Credit collection policy was discovered to have a positive significant impact on financial performance in MFIs in coastal region (r=0.591, p=0.000). These findings were in line with Ogoro and Onditi (2016), commercial bank's loan lending policies and financial performance are positively correlated.

4.8 Regression Analysis

To test the influence among predictor variables, multiple regression was used. The research used Statistical Package for Social Sciences (SPSS V21.0) to code, enter and compute the measurements of the multiple regression. The model summaru is presented in table 20.

TABLE 20

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.965[a]	0.931	0.928	0.15248
a. Predictors: (Constant), credit collection policy, credit appraisal, credit risk control, credit terms				

Source: Research data, (2023)

Table 4.18 shows that the R squared (coefficient of determination) value is 0.931, which indicates that 93.1% of the variation in financial performance in coastal region is explained by the independent variables (credit collection policy, credit appraisal, credit risk control, and credit terms). Thus, 6.9% is accounted for by the error term and other factors not considered in the study. The correlation coefficient (r=0.965) value indicates a joint strong correlation among the variables.

The study further tested the significance of the model using the ANOVA technique

TABLE 21

ANOVA

ANOVA[a]						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	31.507	4	7.877	338.768	.000[b]
	Residual	2.348	101	.023		
	Total	33.856	105			
a. Dependent Variable: financial performance						

b. Predictors: (Constant), credit collection policy, credit appraisal, credit risk control, credit terms.

Source: Research data, (2023)

From the ANOVA statics, the study recognized the regression model had a significance level of 0.000%, which is an indication that the data was supreme for making a conclusion on the population parameters since the value of significance (p-value) was less than 0.005.

The study also used the coefficient table to determine the study model and findings were as presented in Table 4.19.

TABLE 22

Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	0.213	0.111		1.908	0.059
	Credit appraisal	0.544	0.035	0.617	15.677	0.000
	Credit risk control	0.127	0.039	0.140	3.247	0.002
	Credit terms	0.422	0.043	0.452	9.825	0.000
	Credit collection policy	-0.132	0.032	-0.164	-4.069	0.000

a. Dependent Variable: financial performance

Source: Research data, (2023)

As per the SPSS generated output, the equation ($Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \varepsilon$) becomes:

$Y= 0.213 + 0.544X_1 +0.127X_2+0.422X_3-0.132X_4$

Where;

Y=Financial Performance

X_1= Credit Appraisal

X_2 =Credit Risk Control

X_3=Credit Terms

X_4=Credit Collection Policy

The results obtained indicate that if credit appraisal, credit risk control, credit terms, and credit collection policy remain unchanged, or have a value of 0, then financial performance of MFIs in coastal region will increase by a value of 0.213 units.

Also, if credit appraisal is increased by 1 unit while holding credit risk control, credit terms, and credit collection policy constant, then financial performance of MFIs in coastal region will increase by a value of 0.544 units. There is therefore a positive (B=0.544) and insignificant (p=0.000) relationship between credit appraisal and financial performance of MFIs in coastal region. Similar findings are with Aliia and Muhangi (2017), who concluded that using client appraisal to lower credit risk was a viable strategy and that to improve credit performance, MFIs needed to increase their client appraisal procedures.

Secondly, if credit risk control is increased by 1 unit while holding credit appraisal, credit terms, and credit collection policy constant, then financial performance of MFIs in coastal region will increase by a value of 0.127 units. There is therefore a positive (B=0.127) and significant (p=0.002) relationship between credit risk control and financial performance of MFIs in coastal region. Similar findings are with Kalu, Shieler, and Amu (2018), who found credit risk assessment to have a strong positive link with MFI financial performance.

If credit terms were increased by 1 unit while holding credit appraisal, credit risk, and credit collection policy constant, then financial performance of MFIs in coastal region will increase by a value of 0.422 units. There is therefore a positive (B=0.422) and significant (p=0.000) relationship between credit terms and financial performance of MFIs in coastal region. Similar findings are with (Mwangi, 2021), credit terms and conditions are essential for controlling debt.

Lastly, if credit collection policy is increased by 1 unit while holding credit appraisal, credit terms, and credit risk control constant, then financial performance of MFIs in coastal region will decrease by a value of 0.132 units. There is therefore a negative (B=0.132) and significant (p=0.000) relationship between and financial performance of MFIs in coastal region. These findings contradict those by Khan, Ahmad and Shireen (2021), MFIs that implemented severe debt collection procedures may have reduced the probability of default and enhanced overall financial risk management.

In conclusion, the inferential statistic indicted that the financial performance of MFIs in Coastal Region. was explained by independent variable Credit appraisal, Credit control, credit terms and therefore appreciating that all the regressor variables were the good predictor of the financial performance of MFIs in Coastal Region .

4.9. Hypothesis testing using multiple regression Analysis.

Hypothesis one H_{01}: *Credit appraisal is statistically insignificant to financial performance of MFIs in Coastal Region.*

The study therefore failed to reject the research hypothesis **H_{01}** at 5% level and observe that Credit appraisal is statistically insignificant to financial performance of MFIs in Coastal Region. Effect as shown in table 4.19

Hypothesis one H_{02} *Credit risk control is statistically insignificant to financial performance of MFIs in Coastal Region*

The study therefore failed to reject the research hypothesis **H_{02}** at 5% level and observe that Credit control is statistically insignificant to financial performance of MFIs in Coastal Region. Effect as shown in table 4.19

Hypothesis one H_{03} *Credit terms is statistically insignificant to financial performance of MFIs in Coastal Region.*

The study therefore failed to reject the research hypothesis $\mathbf{H_{03}}$ at 5% level and observe that Credit terms appraisal is statistically insignificant to financial performance of MFIs in Coastal Region. Effect as shown in table 4.19

Hypothesis one $\boldsymbol{H_{04}}$ *Credit collection is statistically insignificant to financial performance of MFIs in Coastal Region.*

The study therefore failed to reject the research hypothesis $\mathbf{H_{04}}$ at 5% level and observe that Credit collection is statistically insignificant to financial performance of MFIs in Coastal Region. Effect as shown in table 4.19

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter relied on reports on the summary of the findings, conclusions of the study and recommendations on policy and further research in line with the study objectives.

5.2 Summary of Findings

This provides a summary of the analysis of all the findings in line with study objectives.

5.2.1 Credit Appraisal and Financial Performance

The first objective sought to examine the effects of credit management processes on the financial performance of microfinance institutions in the coastal region. Results revealed that Credit appraisal had a direct and statistical impact on the financial performance of Micro Finance Institutions in coastal region, Kenya. The credit history of the borrower is often looked at and thorough business assessment is done to well understand the performance and financial status of the MFIs. The study also revealed that the credit officers assess the loan limits of the individual or business as well as their capacity to repay the advanced loans.

Research findings agree with those of Sharma and Kalra (2015) who conducted a study in Saudi Arabia and results revealed that the core of a microfinance institution's high-quality loan portfolio is the credit application appraisal which aims at determining whether microloan borrowers are creditworthy.

The findings of the study in question also agrees with those of Kemboi (2018) that Career planning practices include elements such as top management support, alignment with organizational objectives, career centers, communication, and feedback. The study findings concur with that of Ahmed and Malik

(2015) who conducted a study in Pakistan that revealed that a microfinance institution must assess the borrower's company income to decide whether he can make on-time repayments.

Lastly the study findings agree with that of Mumbi and Omagwa (2017) who looked into how some Kenyan commercial banks' financial. The study found that lending criteria, credit standards, and loan appraisal procedures all had a major effect on bank performance. According to the study, banks must limit their exposure to credit risk to acceptable levels in order to achieve the highest risk-adjusted rate of return.

5.2.2 Credit Risk Control and Financial Performance

The second objective sought to examine effect of credit risk control and financial performance of MFIs in coastal region, Kenya.

Results revealed that there is constant review and updating of client's credit worthiness and that the borrower is made to understand the terms of the loan which helps in reducing the risk of default. Findings of the study in question also revealed that there are internal checks and audits that are used to monitor risks that might be associated with certain loans & collateral is a must especially for loans that the MFIs have classified as risky.

These study findings agree with those of Wachira (2017) which revealed that managing credit risk has an effect on how commercial banks loans perform thus affecting the financial performance of the finance institution.

5.2.3 Credit Terms and conditions on Financial Performance

The third objective sought to establish the effect of credit terms and conditions on financial performance of microfinance institutions in coastal region, Kenya. The results revealed the client is usually taken through all the terms and conditions of a given loan before he/she agrees with the interest rate and how it accumulates over a given period. The results also revealed that MFIs had a well written and document terms and conditions of its loans.

The findings of this study agrees with that of Osewe (2020) that the conditions of credit include any fees the borrower assesses to hasten the processing of loan documents. Large loan service charges may lead to default if the debtor tries to cover them with borrowings since they alter the project's overall cost, it was proposed.

5.2.4 Credit Policy and Financial Performance of MFIs

The 4th objective sought to establish the effect of credit policy and the financial performance of MFIs in coastal region, Kenya. The study revealed that Borrowers are often reminded through email, calls and SMS to pay their loans and that the MFIs had a credit policy which stipulated the use of credit incentives to encourage loan repayment and when the collateral can be used to recover the loan advanced to individuals or businesses. The findings of the study also revealed that the institution can effectively recover outstanding loans while treating clients fairly and adhering to regulatory requirements.

The findings of the study were in line with those by (Nabi et al., 2018) that a debt collection policy is a legitimate and required business practice that enables creditors and collectors to take reasonable action to obtain payment from clients who are contractually required to pay or repay the debt.

The findings of this study agrees with that of Greene (2016) that concluded that employing penalties and high interest rates to deter debtors from skipping or delaying payments is a risky strategy since it raises the possibility that the late-paying borrower may ultimately fail if the principal amount owed and fines are too high.

5.3 Conclusions

The interest rates charged on loans by microfinance institutions play a crucial role in determining the MFI's income. High-interest rates can increase revenue but may also deter borrowers, while low-interest rates can

make loans more accessible but may reduce income. Striking the right balance is key for financial performance.

The size of loans offered by the MFI affects the average loan portfolio size and the level of risk associated with each borrower. Smaller loans can diversify risk but may require more resources to manage. Larger loans can increase the MFI's income but may also increase credit risk and therefore a balance needs to be maintained between the number of small loans and big loans.

As credit risk control measures are put in place, the quality of an MFI's loan portfolio improves. Which in turn improves the financial performance of the MFIs.

The study concludes that a well-implemented debt collection policy enables MFIs to recover the overdue loans but also supports the institution's reputation and its mission to promote financial inclusion while treating clients with respect and fairness.

The quality of credit management processes directly influences the financial performance of MFIs. Effective credit management results in lower credit risk, higher interest income, efficient operations, and sustainable portfolio growth, all of which contribute to the institution's financial health and long-term viability.

5.4 Recommendations

The study recommends that the MFIs that are performing well financially should invest in improved credit risk control measures such as increased profits can be reinvested in staff training, technology, and other resources to enhance credit risk management.

The study also recommends that Microfinance Institutions should work closely with their clients, providing not just financial services but also financial education and business support since can improve the credit

risk control process by increasing borrowers' financial literacy and their ability to manage their loans effectively**.**

The study also recommends that MFIs should ensure that they serve their social mission of financial inclusion while also achieving financial sustainability since well-designed credit product portfolio can help MFIs reach their objectives and improve their overall financial performance.

5.6 Areas for Further Studies

The study sought to examine the effect of credit management processes on financial performance of microfinance institutions in coastal region, Kenya. Further research may look at similar research in other sectors since the current study focused on MFIs. Balancing financial sustainability with the social mission of financial inclusion is a constant challenge for MFIs and the researcher recommends further a research in this area.

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APPENDICES

Appendix I: Introduction Letter

Dear Sir/Madam,

My name is Amon Mwashighadi Msagha, a graduate student at KCA University. As part of the degree requirements, I am required to undertake a research project involving data collection for academic purposes. The research is titled: **Effect of credit management processes on financial performance of microfinance institutions in coastal region.** The questionnaire below is designed to obtain basic and expert information to support the analysis and report for this study. The information collected will be used for academic purposes only and any information given will be treated with utmost confientiality. Your response to the questions presented in this questionnaire will be highly appreciated.

I am readily available to offer any further information if needed.

Yours Sincerely,

Amon Mwashighadi Msagha

Appendix II: Research Questionnaire

Section I: General Information

1. Gender Male [ ] Female [ ]
2. Age 18-30years [ ] 31 -40 years [ ] 41 -50 years [ ] 50 years and above [ ]
3. Highest level of education? Certificate [ ] Diploma [ ] Bachelors Degree [ ]
   Post-Graduate Degree [ ]
4. Working years with the MFI? <1 [ ] 1-3 [ ] >3 [ ]
5. Period of MFI been in existence? <5 years [ ] 5-10 years [ ] 10-15 years [ ] >15 years [ ]
6. Number of clients? <100 [ ] 100-250 Client [ ] 250-500 clients [ ] >5000 [ ]

Section II: Client Credit Appraisal

The following statements relate to credit appraisal. Answer by putting a tick where appropriate. Key: Strongly Agree=5, Agree=4, Neutral =3, Disagree =2 and Strongly Disagree =1

Statements	**5**	**4**	**3**	**2**	**1**
The institution has competed staff who conduct credit appraisal					
Collateral capacity of the borrower is assessed for huge loans					
The institution often assesses the borrower's capacity to repay the loan					
The credit history of the of the borrower is often looked at					
The credit officers assess the loan limits of the individual or business					
There is thorough business assessment to understand the performance and financial status					

Section III: Client Risk Control

The following statements relate to credit risk control. Answer by putting a tick where appropriate. Key: Strongly Agree=5, Agree=4, Neutral =3, Disagree =2 and Strongly Disagree =1

Statements	**5**	**4**	**3**	**2**	**1**
The loan limit is considered as higher loans can be risky when it comes to some clients					
There are internal checks and audits that are used to monitor risks that might be associated with certain loans					
Sometimes, the payment period is made flexible to lower the risks of non-payment					
Penalty for late payment is imposed to motivate borrowers to pay					
The interest charges are reasonable based on the amount of loan to enhance payment					
Collateral is demanded on loans that look riskier					
The borrower is made to understand he loan terms to reduce risk of default					
There is constant review and updating of client's credit worthiness					

Section IV: Credit Terms and Conditions

The following statements relate to credit terms and conditions. Answer by putting a tick where appropriate.

Key: Strongly Agree=5, Agree=4, Neutral =3, Disagree =2 and Strongly Disagree =1

Statements	**5**	**4**	**3**	**2**	**1**
The institution has a well written and document terms and conditions of its loans					
The borrowers are made to read, understand and sign the terms and conditions of the loan					
All necessary documents are kept safe and required copies are issued to the borrower					
The terms of repayment period are agreed upon with the borrower					
The credit officers assess the loan limits of the individual or business					
The client is made to understand and agree with the interest rate and how it accumulates					
The grace period of the loan is well explained to the borrower					

Section V: Credit Collection Policy

The following statements relate to credit collection policy. Answer by putting a tick where appropriate. Key: Strongly Agree=5, Agree=4, Neutral =3, Disagree =2 and Strongly Disagree =1

Statements	**5**	**4**	**3**	**2**	**1**
The institution has a credit collection policy					
Borrowers are often reminded through email, calls and SMS to pay their loans					
If the borrower has not made attempt to repay the loan after various communication attempts, their details are forwarded to CRB					
The policy stipulates situations when collateral can be used to recover the loan					
The policy captures situations where guarantors are contacted and how they assist with loan repayment					
The credit collection policy indicates that there are avenues for legal actions should loan repayment be defaulted					
The policy stipulates the use of credit incentives to encourage loan repayment					
The policy indicates that the institution can use debt collection agencies to hasten the process of debt recovery					

Section VI: Financial Performance

The following statements relate to financial performance of MFIs. Answer by putting a tick where appropriate. Key: Strongly Agree=5, Agree=4, Neutral =3, Disagree =2 and Strongly Disagree =1

Statements	**5**	**4**	**3**	**2**	**1**
The institution has experienced increase in profitability					
The operating income of the institution has increased					
The return on assets of the institution has grown					
There has been a decrease in non-performing loans					
The has been a surge in the gross profits of the institution					
There has been an increase in the deposits made by the clients					
The return on investment has grown over the years					
The return on equity of the institution has been positive over the years					

Appendix III: Work Plan

ACTIVITIES	September 2022-March 2023	April 2023	May 2023	June 2023
Proposal Development				
Data Collection				
Data Analysis and Implementation				
Report Writing				
Report Dissemination				

Appendix IV: Research Budget

Budget Items	**KES**
Stationaries	2,000
Printing	4,000
Data collection	
Field materials	3,000
Questionnaire Printing	5,000
Research Assistants	10,000
Data Analysis Interpretation	
Analysis of data	16,000
Total Cost	40,000

APPENDIX V

1. SMEP Bank Microfinance
2. KWFT Microfinance
3. ECLOF Kenya Mombasa Branch
4. Yehu Microfinance Services Limited
5. Rafiki Microfinance Bank
6. Kenya Women Microfinance Bank
7. The - LadyBoss Micro-Lending LTD
8. KCB Mtaani Drivers/Conductors/Turnbuys/Welfare Group
9. Kismat Credit Ltd
10. Faulu Kenya-Mombasa
11. Izwe Loans Mombasa
12. Cladfy Financial Services
13. Smart Micro Investments Limited
14. Fina Bank-Nyali
15. Together as one Mombasa
16. Vision Fund KENYA, MOMBASA BRANCH
17. Memsap
18. FSI Capital Ltd
19. The Promise Rehani Enterprise
20. ONEkey Micro-Hand

21. Real People Business Finance-Mtwapa

22. Co-op Kwa Jirani Mintsoft Systems Ltd

23. Platinum Credit-Mombasa

24. First Community-Mombasa

25. Diamond Trust Bank - Likoni

26. Fadhili Enterprises

27. Jubilant Kenya Ltd

28. Taita Taveta Non-teaching staff Sacco Wundanyi

29. Jirani Smart Ltd Head Office

30. Maisha Microfinance Bank
31. Musoni Kenya

32. M-pesa Kenya Women Microfinance Bank ltd

33. U & I MicroFinance Bank

34. MUUNGANO Microfinance BANK

35. Rosky Credit Ltd

36. Agricultural Finance Corporation-Kilifi

37. KEY Microfinance Bank Limited

38. Qwetu Sacco Taita Taveta