



THE 2ND ICPAK RESEARCH

CONFERENCE 2021

THEME: BUILDING A RESILIENT ACCOUNTANCY PROFESSION
AND ECONOMY IN A DISRUPTIVE ENVIRONMENT

DATES
7th - 8th
Dec/2021

VENUE
Kenya School of
Government - Nairobi



Analysis of Third Party Loan Guarantee and Performance of Non-Prime Household Loans in Microfinance Banks in Kenya

THEMANTIC AREA: **ACCOUNTING AND TAXATION**

MAIN AUTHOR- CPA, Dr. Bernard Ndirangu Wachira

OTHERS -Humphrey Opiyo Omondi¹, Josphat K. Kinyanjui² ¹Department of Business Management and Entrepreneurship, Karatina University, Karatina, Kenya. ²Department of Mathematics and Actuarial Sciences, Karatina

University, Karatina, Kenya

OUTLINE



Background



Problem statement



Objectives



Findings



Conclusion

Background



- Non-prime household loans- Are the credits to people with no collateral as security.(World Bank report ,2016b).its based on Grameen microfinance banks model.
- Grameen Microfinance banks model-It was introduced by Mohammed Yunus in 1976 in the village of Jobra in Bangladesh.
-
- THE MODEL- Has gained popularity globally for offering social cohesion by availing opportunity to Citizens acquire credit without collateral as opposed to commercial banks who ask for collaterals(Global competitiveness report,2013-2014).





- Guarantorship-Its where a person undertakes to repay loan when the borrower fails to repay.
- Its common in microfinance banks where non prime household loans are granted(Altman,2012).
- Microfinance credit promote inclusion and social cohesion because there would be a marginalized group among others due to failure to access credit, but microfinance banks model has bridged that gap.





Non-prime Household Loan sustainability-

- Despite the popularity of this type of loan, credit risk factor has threatened its success as confirmed by central bank of Kenya.
- Thus many world economies has taken non prime household loans as a global agenda and they are concerned about their survival.(World Bank Report 2016a)
- Credit risk management mechanisms remain the single most determinant of sustainability and survival of microfinance banks globally.
- Non performance of these loans have brought down reputable institutions eg Lehman brothers in America(Dell'Aricca et al,2012).

Figure 2.1 shows that household loan non performance is the highest being at 36.4 per cent while the lowest is education at 1.2 per cent.

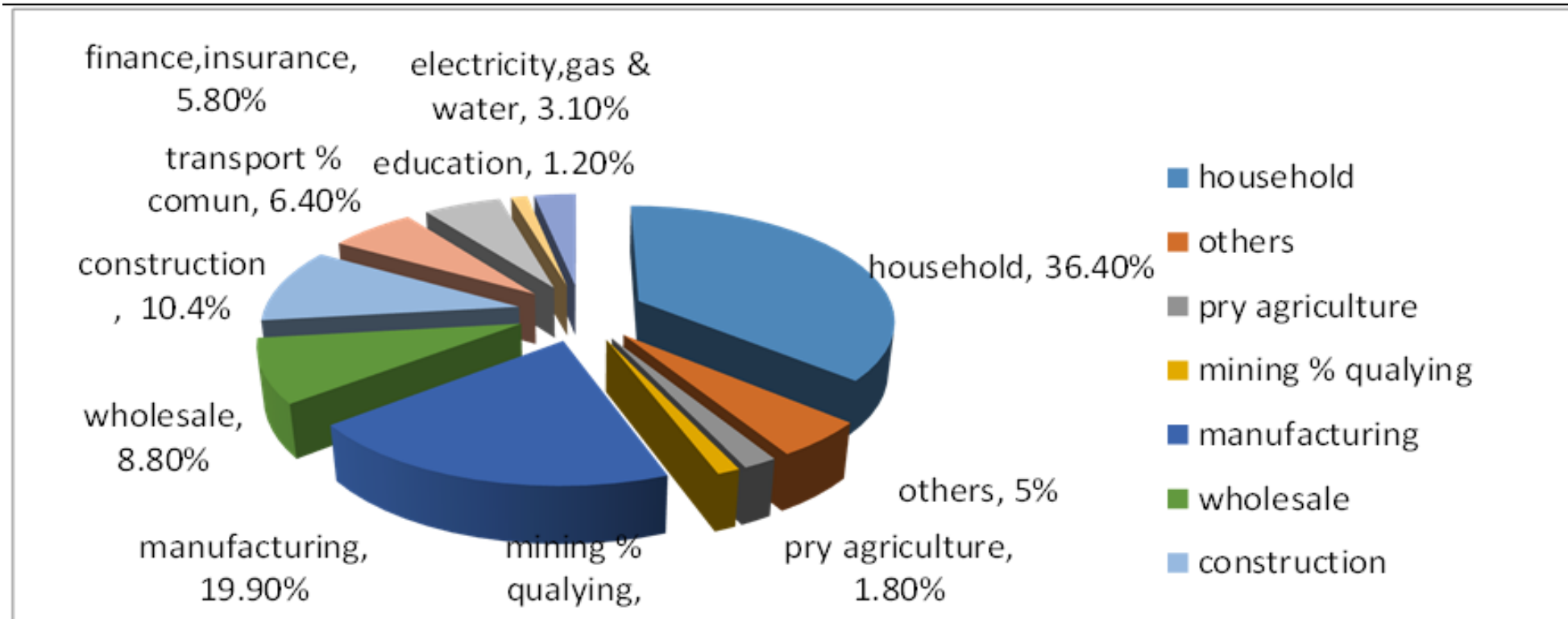


Figure 2. 1 Global Compositions of Non Performing Loans.

Source: BNM: 2014 - Source Global Economic Outlook (2014)



Africa perspective

- Approximately 90% of African citizens did not seem to have access to reasonable credit due to lack of collaterals(United Nation,2006).
- **Morocco** microfinance bank sector was one of the fastest growing globally in year 2007 growing at between 20-30% p.a
- But non performing loans grew by 35% by year 2015 p.a thus hampering this growth
- South Africa ranked 1st in Africa as having well established MFB.
- But ranked 4th in non performing loans globally.
- This is attributed to high credit risk

Kenya perspective

- Kenya has also adopted Grameen microfinance bank model ,however its faced with the credit risk challenges of non performance in non prime household loans
- Kenya ranked the -
- 1st in having the most advanced microfinance sector in sub Sahara Africa in branch network and service to the poor.
- *However it is ranked the*
- *1st in household loans non performance in East and Southern Africa and*
- *3rd Globally in household loans default behind Ghana and Egypt*
.(Africa competitiveness report,2015).



Kenya perspective cont.....

- Total default of non prime household in 2014 was 26.3billion out of 32.9 billion which is 80% of total household loans defaulted (CBK,2014).

Kenya intended to generate employment opportunities of more than 400,000 youth at a cost of \$1.5 billion(shs150 billion), Empower 800,000 women annually, through granting of non prime household loans

But poor performance has slowed down this initiative .



Problem statement..

- The success of Grameen Bank Model in Bangladesh was believed to offer an opportunity to poor households in accessing non-prime household loans without collaterals both globally and in Kenya.
- In Kenya, only 1% of the land titles are owned by women, youth, and disabled, and this hinders them from accessing credits from main stream banks (FinAcess, 2016).
- Non-prime household loans were considered as the alternative but this has not worked as expected (Mutia, 2014; Mwangi and Sichei, 2011; Warue, 2012).

Problem statement..

- The government introduced revolving funds in form of non prime household loans of
 - Youth fund \$0.059 billion (shs 5.9 billion)
 - Women fund of \$0.038 billion, -(shs 3.8 billion)
 - Uwezo fund of \$0.06 billion, (shs 6.0 billion)
- But more than 50% of these loans have since been defaulted.
- The default rate continues increasing despite the pressure put on loan recovery.
- This affects negatively on vision 2030 flagship of job creation by the government of Kenya. This may also lead to collapse of banks, economic crises, and less funds for country for other projects if no action is taken (World Bank, 2016b).



OBJECTIVES



General objective

To determine the level at which the third party loan guarantee affects the performance of non prime household loans in microfinance banks in Kenya

Specific objectives

- To determine how the *amount secured by guarantee* influences the performance of non prime household loans in microfinance banks in Kenya
- To establish how *recoveries from guarantors* influences the performance of non prime household loans in microfinance banks in Kenya
- To determine how *percentage of loan secured by guarantee* influences the performance of non prime household loans in microfinance banks in Kenya
- To determine how *percentage recoveries from guarantors* relate to the performance of nonprime household loans in the Microfinance Banks in Kenya

Research Methodology

- The positivism philosophy was adopted in this study.
- The research design adopted was descriptive survey.
- POPULATION - 516 employees of 13 MICROFINANCE BANKS
- SAMPLE SIZE – 150 comprising of senior managers
- **Data collection instruments**
 - Primary and secondary data were used
 - Questioners were used in primary data collection
- **Data analysis method**

Spss was used in analyzing the data

Regression Model

$$Y = B_0 + B_1 X_1 + B_2 X_2 + B_3 X_3 + \epsilon$$

FINDINGS



- The problem of the poor performance of non-prime household loans in Microfinance Banks is a global issue, and it is still a global agenda (Owusu et al., 2015).due to high amount and percentage granted using guarantors.
- Less recoveries from guarantors in terms of amount and percentage leads to poor performance of non prime household loans in MFBs. The problems of the poor performance of non-prime household loans in Microfinance Banks persist in Kenya despite adoption of credit risk mitigation innovations in non-prime household loans. (World Bank, 2016a).Even after Kenya being ranked number 47 out of 148 in best innovations, it appeared not to have obtained reliable innovations that can reduce non prime household loans default.



- The problem of the poor performance of non-prime household loans still exists in Kenya.
- This seems to have caused a high level of unemployment, increased level of poverty, and slow economic growth in Kenya
- The behavior in the Microfinance Banks in Kenya is granting non-prime household loans using guarantors as security.
- The banks are not keen on various aspects of risk mitigations. This study showed that credit risks exist in all the Microfinance Banks in Kenya



FINDINGS cont....



- World Bank (2016b) stated that the future of banking globally will be determined by how well credit risk mitigations are undertaken in the banks.
- The risks in the Microfinance Banks in Kenya ought to have been controlled for the performance of the non-prime household loans to improve.
- Credit risk takes approximately 70% of all the risks in banking industry; whereas, all the other risks combined takes only 30% (Fernando, 2006)
- . Microfinance Banks sector's financial statement (CBK, 2016), shows a loss of 128.3 million Kenyan shillings in 2016.its attributed to poor Credit risk management in Microfinance Banks particularly on the mode of guarantorship.

credit risk is higher than the other types of risks that include market and liquidity risk and it has a greater contribution in hampering the growth of microfinance banks globally.

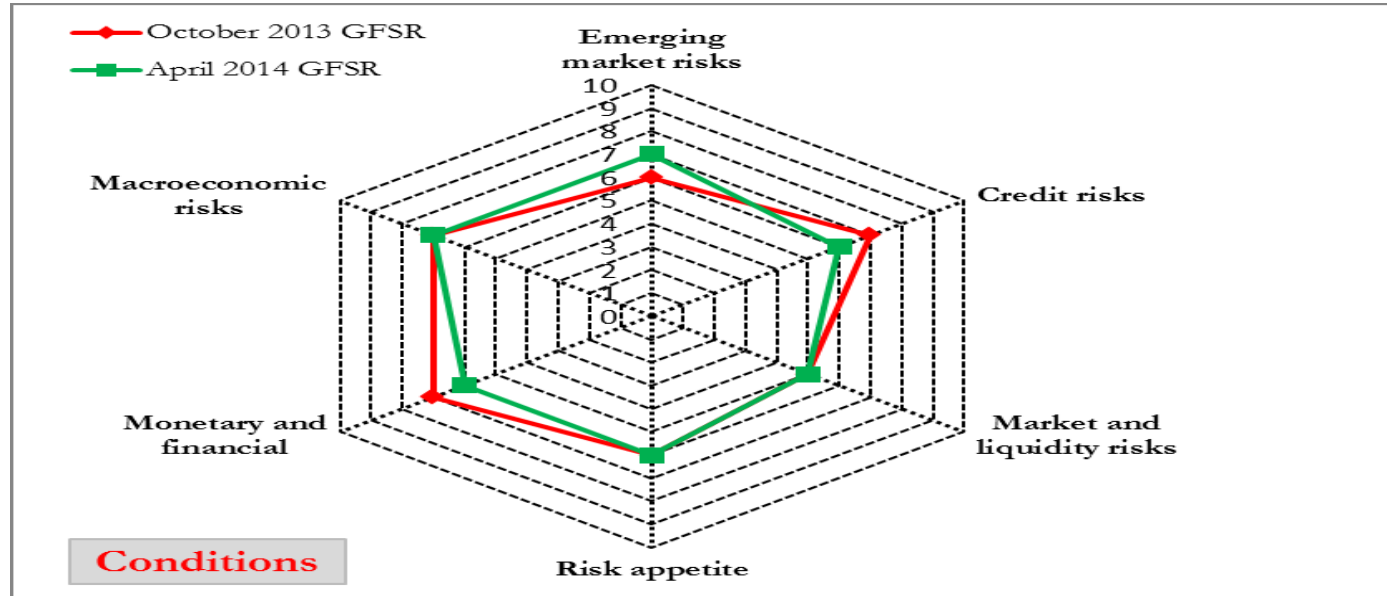


Figure 2. 1. Global Financial Stability Map

Source: Global financial stability report, April 2014



- The proportion of loan that has been secured by guarantee against the total loans in Microfinance Banks is not well thought.
- Although the loan secured through guarantorship is of much help to those without collaterals, if not well enhanced it can have negative effects on performance of microfinance banks in Kenya.
- Poor performance of non-prime household loans in the Microfinance Banks and in government revolving funds including youth fund, women fund and Uwezo fund, in Kenya appear to have caused a high level of unemployment in Kenya and a low gross domestic product (GDP).

FINDINGS cont.....



- In 2014, Kenya changed its status from poor countries to a lower-middle-income economy when the economy grew by approximately 25%(FinAccess 2016).
-
- Despite this categorization, Kenya is still grouped among 25% of the countries that are poorest in the world.
-
- This is evidenced by having 40% of the Kenyan population earning below the poverty line (World Bank Report, 2016a) despite emphasis of granting to youth and women non prime household loans in form of revolving fund for self employment.

FINDINGS CONT.....

- Thus the target of creating 400,000 jobs for youth and 800,000 opportunities for women has not yet been achieved.
- The higher the non prime household loans, the higher the default.
- When the loan default goes up the performance of non-prime household loans whose measure is profitability becomes poor





© CanStockPhoto.com - csp10140246

Dilemma

- If the Microfinance Banks reduce the amount and percentage of loan granted against guarantee, they will miss a market segment that they rely on thus affecting the performance of non-prime household loans further and even the general performance of Microfinance Banks,
- The job creation goal by the government will not be achieved, if this fund is not availed to youth, women and other citizens who cannot afford the collaterals.
- THE MAIN QUESTION THUS IS- WHICH WAY IS THE BEST WAY?.

Conclusion



- A lasting solution is yet to be established on reduction of loan default
- Credit reference bureau in Kenya has not yet offered a lasting solution to this problem.
- Microfinance Banks though at an early stage of implementation of serious risk mitigation mechanism recommended by the Central Bank of Kenya through Microfinance Bank Act, the pace of putting them into practice is low.



- As the Microfinance Banks continue to have their loan being secured by guarantorship, there is a need to consider more elaborate recoveries mechanism to ensure that a higher percentage is recovered.
- This worrying situation calls for more elaborate approaches of loan granting and recoveries.
-
- The Grameen Bank Model by Mohammed Yunus of credit granting without collateral was a well thought idea, but granting loans using guarantors as a security seems to be contributing to poor performance of non-prime household loans in the Microfinance Banks in Kenya.



- The outcome of this research may be applied in re-evaluating the accounting policies in the banking and public sector particularly in the government revolving funds.
- The central bank of Kenya need to be strict on implementation of credit risks mechanisms by the Microfinance banks.
- .Where the government is providing the revolving fund to the youth and women in terms of microfinances credit, more research need to be done on how to enhance the loan guarantorship among the beneficiaries and the parents of the youth to ensure that the fund granted is recovered at least 80%.

References



Africa Competitiveness Report. (2015). Committed to Improving the State of the World. World Economic Forum: Cologny, Switzerland.

Altman EI. (2012). “Altman Z-Score Plus” Offers Enhancements to Assess Credit Risk in Global Environment. The Altman Z-Score Plus. Available at: <http://altmanzscoreplus.com/> •

Central Bank of Kenya report. (2016). Central Bank of Kenya (CBK) credit officer survey. July-September 2016. Available at: [www. centrabank.go.ke/downloads](http://www.centrabank.go.ke/downloads)

Dell’Ariccia G, Iga D, Laeven L. (2012). Credit booms and lending. IMF Working paper 11/58, (Washington, March). Available at: <http://www.imf.org/external/pubs/cat/longres.aspx?sk524707.0> •

Fernando NA. (2006). Understanding and dealing with high interest rates on micro credit. A note to policy makers in the Asia and Pacific Region. Asian Development Bank. Available at: <http://www.adb.org/documents/books/interest> on [30th April 2009].

FinAcess. (2016). National Survey. Profiling Developments in Financial Access and Usage in Kenya. Central Bank of Kenya and Financial Deepening Publication: Kenya

Global Competitiveness Report. (2013-2014). Committed to Improving the State of the World. World Economic Forum:

Geneva. Global Economic Report. (2016). A World Bank Group Flagship Report. World Bank: Washington, DC. International Finance Corporation World Bank Group. 2016. Voices of Women Entrepreneurs in Kenya. Washington, DC. Available at: www.ifc.org

Mutia MT. (2014). Study on Mainstreaming Equity and Poverty in Reduction in Policies Strategies and Programmes in Kenya (with Special Focus on Youth and Women). United Nation Development Programme: Kenya.

Mwangi I.W, Sichei MM. 2011. Determinants of Access to credit by individuals in Kenya: a comparative analysis of Kenya national FinAccess Surveys of 2006 and 2009. European Journal of Business and Management 3(3): 206-227.

Owusu AD,

United Nation report. (2006). Building Inclusive Financial Sector for Development. UN: New York.

Warue B.N. (2012). Factors affecting loan delinquency in microfinance in Kenya. International Journal of Management Sciences and Business Research 1(12): 226-236

World Bank Report. (2016a). International Development Association Project Appraisal Document on a Proposed Credit. Social Protection and Labor Global Practice Africa Region. Report No: PAD1654. World Bank Report. (2016b). Kenya Country Economic Memorandum. From Economic Growth to Jobs and Shared Prosperity. The World Bank: Washington, D

