International
Journal
Of Advanced Research in Engineering & Management (IJAREM)
ISSN: 2456-2033 || PP. 49-52

Short-Term Loans Performance and Financial Sustainability of Micro-Finance Institutions in Imenti North Sub-County, Kenya

Agnes Kamba[1], Dr. Rita Kagwiria Lyria [2], Alexander Wachira[3], Justus Nderitu Maina[4]

1. School of Business & Economics, Meru University of Science & Technology, agnes.
2. Dean School of Business & Economics, Meru University of Science & Technology
3. School of Business, Meru University of Science & Technology,
4. School of Business, Karatina University,

Abstract : The study aimed at assessing the influence of short-term loans performance on financial sustainability of Microfinance Institutions in Imenti North Sub-county, Kenya. The study adopted a descriptive research design. The target population consisted of 33 respondents. Self administered structured questionnaires were administered by the researcher. Descriptive statistics and correlation analysis were used to analyse the data. It was established that MFIs offer short term loans such as emergency loans, education loans, farming loans, micro loans, salary advance and insurance premium financing. It was also established that MFIs carry out thorough analysis of the potential borrowers prior to disbursing the loans. It was further established that returns on short term loans are significantly correlated to the total short term loans.

Key words: Short-term loans, Performance, Microfinance Institutions, Financial Sustainability, Imenti North sub-county.

Introduction

A microfinance institution is a financial institution that is involved in provision of small scale financial services to low income clientele who have no access to conventional banks. Poverty has highly contributed to the 2 billion unbanked populations where we have 767 million individuals worldwide living below US$1.90 per person per day (WorldBank, 2016). Internationnally, 59% of adults did cite lack of adequate funds as the major reason to their financially exclusion. This is a clear indication that financial services aren't yet affordable or designed to fit the low income earners. Additionally, poor individuals are ignored by commercial banks and are regarded as "unbankables" (WorldBank, 2016). However, Professor Muhammad Yunus, The Nobel Prize winner in 2006, using Grameen bank model attested that poor people are viable customers. Since then the micro finance market has grown at a high rate and has enlarged its portfolio of financial services beyond pure microcredit (Schmidt, 2008).

In Africa 350 million adults are financially excluded with significant opportunities to expand affordability, accessibility and usage of formal financial services (Lewis, Villasenor, & West, 2016). Kenya's Micro-finance institutions has faced many reforms since the late 1990s with an aim of improving profitability, efficiency and productivity of institutions in the finance sector. Commercial banks' had left a substantial gap in service delivery to financial services users particularly low income earners. MFIs have registered remarkable growth as the unbanked population expanded and started patronizing their services. The use of MFIs products has increased from 3.5% in 2013 to 3.6% in 2016 but its frequency in use is as low as 12.5% (FinAccess, 2016). This affect the profit of MFIs which in the long run threatens its survival. Profitable microfinance industry is vital in maintaining the stability of the micro-banking system. Low profitability weakens the capacity of microfinance institutions to absorb negative shocks, which subsequently affect solvency. Profitability reflects how MFIs are run given the environment in which they operate, which should epitomize efficiency, risk management capabilities, their competitive strategies, quality of their management and levels of capitalization (Warue, 2015)

There exists a disjoint on the literature of short-term loans towards financial sustainability of MFIs. For example Umar, Tanveer, Aslam, and Sajid (2012) viewed MFIs as primary instruments of social change and their sustainability is often measured by non-financial parameters such as poverty eradication and provision of social amenities to the poor. In contrast, Pierantozzi & Krell, (2014) indicated that MFIs short term loans attract high interest rates to make profit, and this conflict with the goal of poverty reduction. Greed 'for-profit' in MFIs is exploiting the poor to make large profits and poor people are considered as the only beneficiaries of microfinance. This study therefore sought to assess the influence of short term loans performance on financial sustainability of micro-finance institutions in Imenti North Sub-County, Kenya.

Literature Review

Short Term Loans

The concept of credit can be traced back in history and it was not appreciated until and after the Second World War when it was largely appreciated in Europe and later to Africa (Kiiru, 2004). Banks in USA gave credit to customers with high interest rates which sometimes discouraged borrowers hence the concept of credit didn't become popular until the economic boom in USA in 1885 when the banks had excess liquidity and wanted to lend the excess cash (Ditcher, 2003). In Africa the concept of credit was largely appreciated in the 50's when most banks started opening the credit sections and departments to give loans to white settlers. In Kenya credit was initially given to the rich people and big companies and was not popular to the poor.

In 1990s loans given to customers did not perform which called for an intervention. Most suggestions were for the evaluation of customer's ability to repay the loan, but this didn't work as loan defaults continued (Morduch, 1999). The concept of credit management became widely appreciated by Microfinance Institutions (MFI's) in the late 90s, but again this did not stop loan defaults to this date (Modurch, 1999). Thus, loan defaults increases the cost of loans generally. Consequently, most MFIs charge higher interest rates to cover for this risk of defaults. It is therefore, not true that the higher interest rates charged by MFIs are a reflection of the profitability of MFIs. Thus, there is need to investigate the relationship between loans given out by MFIs and sustainability of MFIs.

Transaction Cost Theory

The transaction cost theory is credited to Williamson (1981) the Nobel Prize winner in 2009. It states that there is a cost incurred in participating in any market or making a financial exchange of goods and services. Transaction cost occurs when a microfinance institution lender financial services to micro-entrepreneurs and low income clients who have no access to conventional banks (Williamson, 1981). The theory makes an assumption that a firm would make an attempt to reduce the cost of exchanging goods and services within its environment and technical costs within the organisation. Financial intermediators therefore, weighs the alternatives between earning money from lending large loans compared to micro loans. This would be in favour of the going concern concept, which advocates for operational continuity of an organisation for foreseeable future. Micro finance institutions are structured to offer micro loans to the population regarded as "unbankables". The commercial banks view offering small loans to low income earners as being costly and this deviates from the profit maximization goal of an organisation (World Bank, 2016). Default risk is the main determinants for the transaction costs involved in lending. The lender may not have sufficent knowledge about the borrower, thus creating information assymetry. On the other hand, information assymetry increases the cost for lending as the organisation has to carry out loan evaluation, loan disbursement, loan recovery and loan protection (Olando, Mbewa, & Jagongo, 2012). Offering small and short term loan have been seen to attract many micro entreprenuers and hence leading to the vigourous growth of microfinance providers. Short-term micro loans disbursement and loan evaluation leads to growth of financial service provider (Olando, Mbewa, & Jagongo, 2012).

Research Methodology

This study adopted a descriptive research design. The study was carried out in Imenti North Sub-County, Kenya due to its recent increase in the number microfinance institutions. However, the influence of various revenue products of these MFIs on their sustainability had not yet been elucidated. Thus, this study sought to provide empirical data to fill this research gap by investigating the influence of short-term loans revenue on sustainability of MFIs in Imenti North Sub-County. The target population consisted of 33 respondents i.e. branch managers, operational managers and credit managers of the five deposit taking microfinance institutions and the six non-deposit taking institutions operating in Imenti North Sub-County. Census method and purposive sampling was used in obtaining the respondents. Self administered structured questionnaire were used. Descriptive statistics and Pearson correlation were also be used to analyze the data

Data Analysis And Results

Type of Short Term Loans

The respondents were first required to state the kinds of short term loans offered to clients. It was established that MFIs offer short-term loans namely emergency loans, education loans, farming loans, salary advance and insurance premium financing. Additionally, majority of their loans were found to be for a short period.

Security for Short Term Loans

The respondents were also requested to state how their institution ensured that loans were being paid. The study established that MFIs carry out thorough analysis of the potential borrowers prior to disbursing the loans. Other respondents indicated that some MFIs rely on CRB reports to extend loans to clients. In addition, MFIs do carry out business assessment in case of business loans and require potential borrowers to provide collaterals and have sufficient savings in their accounts prior to being given any loan. It also emerged that some MFIs which offer loans to group use groups as guarantors to the loans to reduce cases of defaulting.

Relationship between and Financial Sustainability

The study sought to establish the relationship between short term loans performance on financial sustainability. The results revealed that in 2015, the total short term loans performance of the MFIs was strong and significantly related to the financial sustainability of MFIs (r =0.992 at p = 0.01). This implies that an increase in total short term loans performance in 2015 was strongly associated financial sustainability of MFIs. Similar strong significant relationship was also recorded in the year 2014 (r =0.873 at p = 0.01), 2013 (r =0.676 at p = 0.01), 2012 (r =0.764 at p = 0.01) and the year 2011 (r =0.854 at p = 0.01). These results are an indication that short term loans performances are significantly correlated to the financial sustainability. Thus, any MFI in need of increasing its short term loans performance will also lead have to increase its financial sustainability.

Conclusion

The researcher winds up by stating that MFIs offer short-term loans which seem to favour the "unbankables". Further, there are policies guiding short-term loan management. The MFIs have adopted the latest technology of credit management i.e. uses of CRB reports. This differs with Maina and Kinyariro (2015) who found out credit management guidelines are not strictly followed by financial institutions. The researcher concludes that short term loans performance is significantly correlated to the financial sustainability. This in agreement with the study carried out by Umar, Tanveer, Aslam, and Sajid, (2012) who viewed MFIs as primary instruments of social change and their sustainability is often measured by non-financial parameters such as poverty eradication and provision of social amenities to the poor. In contrast, Pierantozzi and Krell (2014) indicated that MFIs short term loans attract high higher interest rates to make profit, and this conflict with the goal of poverty reduction. Greed 'for-profit' in MFIs is exploiting the poor to make large profits and poor people are considered as the only beneficiaries of microfinance.

Recommendations

Based on the results the following recommendations were made:

i) MFIs should create awareness on short-term loans in order to increase their uptake and profitability

ii) MFIs should work towards financial innovation like mobile banking to increase uptake of short-term loans that would ultimately contribute positively to financial performance of the firms and hence financial sustainability.

References

[1]. FinAccess. (2016). *2016 FinAccess Household Survey.* Nairobi, Kenya: FinAccess.

[2]. Lewis, R., Villasenor, J., & West, D. (2016). *Assessing financial inclusion advances in sub-Saharan Africa.* Espanol: Africa in Focus.

[3]. Maina, J. N., & Kinyariro, D. K. (2015). Influence of Credit Risk Management Practices on Loan Delinquency in Savings and Credits Cooperative. *African Journal of Co-operative Development and Technology* , 108-115.

[4]. Morduch, J. (1999). The Microfinance Promise. *Journal of Economic Literature* .

[5]. Myers, S. (1984). The capital structure puzzle. *Journal of Finance , 39*, 575-92.
[6]. Olando, C. O., Mbewa, M. O., & Jagongo, A. (2012). Financial Practice as a Determinant of Growth of Savings and Credit Co-Operative. *International Journal of Business and Social Science , 3* (24), 204-219.
[7]. Pierantozzi, A., & Krell, M. W. (2014). Social Performance Data Quality at MFIs in India. *The Mix.*
[8]. Schmidt, R. (2008). Microfinance, Commercialisation and Ethics. *Working Paper Series: Finance & Accounting* .
[9]. Umar, M., Tanveer, Z., Aslam, S., & Sajid, M. (2012). Impact of Capital Structure on Firms' Financial Performance: Evidence from Pakistan. *Research Journal of Finance and Accounting , 3* (9).
[10]. Warue, B. N. (2015). *Principles and Practices of Microfinance in Kenya*. Nairobi, Kenya: Initial Technologies.
[11]. Williamson, O. E. (1981). The Economics of organisation: The transaction cost approach. *American Journal of Sociology , 87* (3), 548-577.
[12]. WorldBank. (2016). *Poverty and shared Prosperity: Taking on Inequality*. Washington, DC: World Bank Publication.