Effect of Group Lending on Management of Loan Default Rates among Microfinance Institutions in Nakuru Town, Kenya

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Abstract: ***Microfinance Institutions (MFIs) in Kenya currently provide significant financial services including microcredit facilities particularly to the low income persons in both rural and urban areas across the country. The object of this study was to determine how loan defaults in MFIs have been minimized by the use of group lending to members of groups. This research, therefore, tried to examine effectiveness of group guarantee systems by examining Group administration in relation to loan default rate management. The research employed descriptive research design and survey research method. The scope of the study was Nakuru town with target population of 119 drawn from staff members of 18 MFIs operating within the town. Sample of 85 officers were chosen through simple random sampling, response rate was 84.7%. The findings were presented in form of descriptive statistics (mean, percentages and standard deviation) and inferential statistics (Pearson's correlation). It was generally established that the respondents agreed that group administration influenced management of loan default rates. In general, group administration was conspicuously strongly and positively related to loan default rate management.***

Keywords: Loan default rate, Self help group, Group lending and Group Guarantee

1. Introduction

Microfinance has been in existence for many years, advancing credit to low income earners. One of the earlier and longer-lived micro credit organizations providing small loans to rural poor with no collateral was the Irish Loan Fund System, initiated in the early 1700s by the author and nationalist Jonathan Swift. The emergence of innovative group lending models in the field of microfinance is celebrated as a contractual innovation that has achieved the perceptible miracle of enabling previously unbankable or marginalized borrowers to lift themselves up by their own bootstraps by creating "social collateral" to replace the missing physical collateral that excluded them from access to more traditional forms of financial services, like credit, savings, and so on [2]. Groups are formed around shared characteristics and needs such as economic interests, shared production and marketing needs, common residential or production location or shared ethnic background [10].

Microenterprise credit was based on solidarity group lending in which every member of a group guaranteed the repayment of all members. These "microenterprise lending" programs had an almost exclusive focus on credit for income generating activities (in some cases accompanied by forced savings schemes) targeting very poor borrowers [15]. The concept of micro lending to development of Grameen Bank was pioneered in Bangladesh by Mohammed Yunus to assist low-income women and men through micro-enterprises for their economic development.

In Kenya's local self-help development efforts are predicated on the spirit of Harambee, a Swahili word that connotes community efforts for a common goal [1]. Some women in Kenya already demonstrate competence through the use of "informal networks" frequently known as "'women's self-help groups" as observed by Bichanga and Aseyo [1]. Their actions also complement efforts of various agencies to reduce poverty and improve the lives of rural people. Modern women's groups' objectives now focus more on income-generating projects rather than solely welfare activities.

2. Statement of the Problem

In Kenya there is a growing concern on the loan default among microfinance and other non banking financial institutions. This has created problems to both the MFIs in Kenya and their clientele. This is caused by existence of high levels of loan delinquency problem in microfinance industry which negatively affect the level of private investment and constrain the scope of MFI credit to borrowers as these firms have to compensate for loan delinquency losses. Loans given out end up become non-performing loans which adversely affect the profitability and overall financial performance of the lending institutions [15]. Many lending institutions in Kenya are confronted by the challenge of rising non-performing loan portfolios, which eventually end up as defaulted loans. Loan default will affect the microfinance's maximization of returns and portfolio growth.

3. Objectives of the Study

3.1 General Objective

The general objective of the research was to establish the effect of group lending on management of loan default rates in MFIs in Nakuru town, Kenya.

3.2 Specific Objective

The research study also addressed the following specific objectives:

To determine how group administration contribute to minimization of loan default rates in MFIs in Kenya.

4. Research Question

The research sought to answer the following questions:

Does the group administration assist in minimization of loan default rates in MFIs in Nakuru?

5. Conceptual Framework

The conceptual framework have been build on the causes of loan default and group lending as a strategy to reduce loan defaults management.

Independent Intervening Dependent

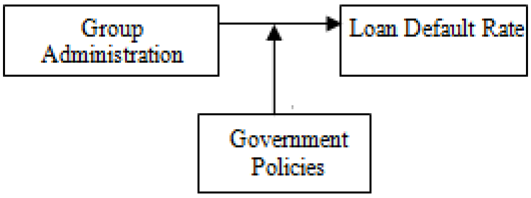

Figure 1: Conceptual Framework

6. Literature Review

This section will also review both theoretical and empirical studies that touches on the objectives of the study in relation to group administration in reducing loan default rates in groups (SHG`s) .

6.1 Theoretical Literature Review

This research was guided by two major theories which includes; Theory of group lending and Social Psychological Theory.

6.1.1Theory of Group Lending

The theory of group lending which essentially looks into ex ante moral hazard and the role of joint responsibility was first put across by Varian, [14]. This theory set out an ante moral hazard approach to group lending. Their main argument was that the group-lending contract circumvents ex ante moral hazard approach by inducing borrowers to monitor each other's choice of projects and to inflict penalties upon borrowers who have chosen excessively risky projects. Laffont & Rey [6], input their assertion regarding this theory when they opined that, due to the fact that group members are affected by the actions and inactions of other members meant that they would take steps to punish anyone who happened to put in little effort and as such burdens the group with excessive risk. The joint liability contract relies on the group's capacity to sanction individual members who may try to shirk. Granted the contract, in principle both group members will never shirk. As such, it turns out that the sanctions are never actually affected.

6.1.2 Social Psychological Theory

Social psychology, as noted by Kraut [4], has developed a rich theoretical base for understanding and predicting group behavior. It is further asserted that this theory attempts to analyze the nature of groups with the intent of understanding the group behavior and how the theory could contribute to the design of collaborative systems. There is substantial agreement among social psychologists about the classes of factors that influence group outcome. Among the most useful frameworks for thinking about groups and their effectiveness are the input-process-output models [8] & [9]. These theories hold that the success of a group depends upon inputs or resources which the group has to work with and the interaction among the group or team members. Social psychological theory brings to the fore the fact that groups on average perform better than the average of their members or than a member selected at random. For instance, they produce more and better ideas than a single individual when brainstorming, or solve problems more accurately than the typical person in the group [5]. Groups are argued to do better through two basic mechanisms: aggregation and synergy. Essentially, the different individuals who make up a group bring unique resources to it. It is said that the way group members interact with each other could directly influence the group outcomes and could mediate the impact of inputs to the group. Factors which could influence the group's outcomes in terms of production, maintenance and member support include: communication, conflict, conformity, socialization, leadership, status, and in-group-out-group differentiation.

6.2 Empirical Literature Review

The researcher reviewed hitherto studies that touched on group lending and loan default rates among MFIs globally, regionally and in Kenya.

6.2.1 Group Administration of Self Help Groups

In microfinance group lending model is one of the best practices in Africa [12]. The MFIs lends to self help groups (SHGs) which in return lends to the group members. This suggests that group governance including self internal regulations and screening process for members for loan qualifications, may affect loan delinquency levels of the lending MFI.

MFIs and SHGs operate under the influence of external factors such as macroeconomic factors which are beyond their control. This implies that in absence of quality governance and strategic plans aimed at mitigating adverse effect of external factors on credit risk, may contribute to high levels of delinquent loans and subsequent loan default in MFIs in Kenya [15]. Specific measures to discourage default can be incorporated in credit schemes, but viable project design and good administration are the most important safe guards [6]. Efficient administration of a group play a crucial role in management of loan defaults in self help groups [15]. It is observed that training of group members in administration and financial management is a vital part of managing default in loan repayment. The more group members understand and participate in group administration, the fewer the chances of errors of accountability.

7. Research Methodology

The research employed descriptive research design and survey research method. The scope of the study was Nakuru town with target population of 119 drawn from staff members of 18 MFI, Operating within the town. Sample of 85 officers were chosen through simple random sampling.

The researcher employed structured questionnaires which contained close-ended questions to collect primary data. According to Peil [11], the survey method if well used, could provide reliable, valid and theoretically meaningful information. The research instruments for all categories of respondents were pre-tested. The researcher employed the Principle Axis Factoring (PAF) method and Cronbach's alpha to test validity and reliability of research instruments.

7.1 Research Findings

The study involved a sample of 85 respondents and there was 84.7% response rate. The response rate enhanced the credibility of the data collected relative to the objectives of the study. High response rate is particularly fundamental in descriptive studies since their usefulness lies in their capacity to generalize their findings to a population with high confidence levels [13]

7.1.2 Self Help Group Administration

The researcher sought to examine the extent of the effect of group administration on management of loan default rate in MFIs. This was accomplished by analyzing the data using descriptive statistics to illustrate both the measures of central tendencies (mean) and variability as shown in table 1.

Table I: Frequency Distribution on SGH

Group Administration	*SD %*	*D %*	*N %*	*A %*	*SA %*	*Σ %*	*$\bar{X}$*	*Std Dev*
i) Groups that are democratically managed have low loan default rates.	12	3	6	27	52	100	4	1.4
ii)Education and experience plays a major role in management of the group affairs, which leads to reduced loan default rate.	3	6	12	39	40	100	4	1
iii) Good governance is mandatory for group to be successful.	3	3	-	9	85	100	5	0.9
iv) Participation of members in running group improves its performance and accountability to financial lenders.	-	3	6	24	67	100	5	0.8
v) Group leaders who organize workshops, seminars and training to members helps in improving members' solidarity and trust.	-	3	6	6	85	100	5	0.7
vi) Leaders who strictly follow group bylaws and constitution will impliedly enforce peer pressure among group members.	-	3	3	21	73	100	5	0.7

Sample size (n) =72
Key
SD = Strongly Disagree. **D=** Disagree **N=** Neutral
A =Agree **SA=** Strongly Agree
STD DEV = Standard Deviations

According to the descriptive statistic findings, it is clear that most of the statements returned means inclined towards 5.00 (strongly agree). Only two propositions returned means inclined towards 4.00 (agree). Moreover, the statements that returned "strongly agree" responses had standard deviations less than 1.00 (STD DEV < 1.00). Explicably, the study findings illustrated that administration of self help groups was a very important factor in influencing management of default rates among the group members. It is, therefore, rational to assert that democracy in groups, education and experience, good governance, members' participation in group administration, organizing of workshops and seminars by the group leaders, and following of group by-laws and constitution by the group leaders are very key in the management of loan default rates among group members.

7.3 Correlation Analysis

The researcher sought to establish the effects of independent variables (Group administration) on the management of loan default rates among members of self-help groups.

7.3.1.Relationship between Group Administration and Loan Default Rate

The study aimed at establishing whether or not the administration of a given Self-Help Group bore any ramifications on the rates of loan default rates of individual members. The results of the findings are as indicated in Table2,

Table 2: Relationship between Group Administration and Loan Default Rate

S.No	*Group Administration Factors*		*DRM*
i	Democratically Managed Groups have Low Loan Default Rates	Pearson Correlation	.654**
		Sig. (2-tailed)	0.001
ii	Education and Experience of Members Plays a Major Role in Management of the Group's Affairs hence low Loan Default Rate	Pearson Correlation	.619**
		Sig. (2-tailed)	0.002
iii	Good Governance is Mandatory for Group to be Successful	Pearson Correlation	.853**
		Sig. (2-tailed)	0
iv	Participation of Members in Running the Group Improves its Performance and Accountability to Financial Lenders	Pearson Correlation	.568**
		Sig. (2-tailed)	0.004
v	Group Leaders who Organize Workshops, Seminars and Training of Members Help to Improve Members' Solidarity and Trust	Pearson Correlation	.692**
		Sig. (2-tailed)	0.001
vi	Leaders who Strictly Follow Group By-Laws and Constitution Impliedly Enforce Peer Pressure among Group Members	Pearson Correlation	.719**
		Sig. (2-tailed)	0

**. Correlation is significant at the 0.01 level (2-tailed).
LDRM = Loan Default Rate Management
Sample size (n) =72

"Good governance is mandatory for group to be successful" returned the strongest correlation ($r = 0.853^{**}$) when related against management of loan default rates. This meant that respondents who believed that good governance and administration was essential in success of a self-help group were also of the view that the same enhances the management of loan default rates amongst MFIs. It was also established that, all the factors bordering on group administration were strongly related to loan default rates management since they returned correlations greater than 0.500 ($r > 0.500$).

8. Summary, Conclusion and Recommendation

Group administration was observed to highly determine management of loan default rates in groups and amongst their members. The mean of all factors, was lying between 4.00 (agree) and 5.00 (strongly agree) which furthered the proposition that group administration contributed to loan default rate management amongst MFIs. The statement "good governance is mandatory for group to be successful" returned the strongest correlation ($r = 0.853$) when related against management of loan default rates. It was also established that, all the factors bordering on group administration were strongly related to loan default rates management since they returned correlations greater than 0.619 ($r > 0.619$). Interpretatively, it was inferred that administration of a self-help group largely affects how the group members repay the loans advanced to them and as such boosts the management of loan default rates amongst MFIs.

8.1 Conclusions

There are a number of conclusions that were drawn relative to effect of group lending on loan default rate management. The conclusions touched on a single variable (Group administration) and how it relates to management of loan default rate amongst various groups that are offered credit facilities by MFIs in Kenya.

8.1.1 Effect of Group Administration in Self-Help Groups on Loan Default Rates Management

Group administration was inferred to highly determine management of loan default rates in groups and amongst their members. Encouraging democracy in the administration of self-help groups was concluded to reduce rates of default in loan repayment. It would, therefore, be advisable to encourage self-help groups to promote democratic and participatory management as a way of curtailing loan default rates among their members. Moreover, it was inferred that the groups that promoted good governance in their leadership and administration would enhance management of loan default rates amongst their members.

8.2 Recommendations

From the findings of the study and the subsequent inferences drawn, the researcher put across the following recommendations in line with the variable of the study.

8.2.1 Group Administration

Self-Help Groups should encourage participatory leadership and/or administration in order to promote good governance. This is very likely bound to better manage rates of loan default rates. MFIs are also recommended to organize seminars, workshops and/or conferences for self help groups. In such functions, MFIs can enlighten groups' members on how to inculcate these aspects as a way of smoothly repaying any credit facilities advanced to them, hence reducing chance high chances of loan default rate. The researcher also recommends that the community members willing to form a Self Help Group should try as much as possible, that group administration that is democratic and enhance members' leadership skill. This will enable the group to remain cohesive, thus reducing chances of loan default rate.

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