E-ISSN: 2469-4339

Management and Economics Research Journal, Vol. 3, Pages 55–66, 2017

Original Research Article

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Wachira *et al.*

HATASO, USA

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

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Received: Jun 28, 2017; Accepted: Aug 10, 2017

Abstract

Household loans remain the engine to productivity and economic growth globally. Non-prime household loan is essential, because it enables the borrowers with no collateral to access credit from Microfinance Banks. The survival and sustainability of non-prime household loans globally is therefore significant. Credit risk however remains the main deterrent of the soundness of Microfinance Banks. This leads to the poor performance of microfinance institutions in many economies in the world. Several countries globally are making inroad in reducing the credit risks, which lead to the poor performance of Microfinance Banks. It is still unknown why the credit risk affects the performance of non-prime household loans in the Microfinance Banks domiciled in Kenya. The reason for conducting this study is to determine the level at which the third party loan guarantee and the performance of non-prime household loans relate to the Microfinance Banks in Kenya. Particularly, this study is to determine how the amount secured by guarantee, recoveries from guarantors, percentage of loan secured, and percentage recoveries from guarantors relate to the performance of non-prime household loans in the Microfinance Banks in Kenya. The population was 516 senior management employees of the banks. The researcher conducted a multiple regression analysis for determining the relationship between the amount secured by guarantee—recoveries from guarantors, percentage granted, and percentage recoveries—and the performance of non-prime household loans. The R and R^2 were used for determining the strength of the relationship and the coefficient of determination at 0.05 level of significance of variables. The result of this study reveals that there exists a strong relationship between the dependent and independent variables, thereby contradicting the null hypothesis, which states that the relationship does not exist. The percentage of the recoveries from the guarantors over the total recoveries did not have a strong relationship and was not significant. This study recommends the enhancement of the loan guarantee processes to reduce high loan default geared toward good performance of this loan so that it can be accessible to many people.

Keywords: Household loans; Microfinance Banks; Collaterals; Non-prime household loan; Credit risk.

1. INTRODUCTION

Non-prime household loans, which are considered as subprime loan, near prime, or second chance lending, are the credits to people who may have difficulties in maintaining the repayment schedule with no emphasis to collateral as security (World Bank Report, 2016b). Globally, the model of Microfinance Banks by Mohammed Yunus in 1976 in the village of Jobra in USA, which is associated with the origin of household non-prime loans, has gained popularity in the granting of household non-prime loans (Warue, 2012). It is an opportunity for the disadvantaged group in the society who could not afford collateral to access credit (IMF, 2014). Every citizen globally is supposed to be a part of inclusion within the economies they belong. An inclusive social system ensures that all citizens contribute to and benefit from the economic prosperity of their country (Global Competitiveness Report, 2013-2014). Global Competitiveness Report (2013-2014) from a World Economic Forum held in Geneva indicates that inclusion is a prerequisite for social cohesion, because the society will lack the necessary coherence of goals to accomplish common purposes if some members of the community are marginalized. This has seen many world economies to take non-prime household loans as a global concern, and many countries are concerned about its survival (World Bank Report, 2016a).

The survival of non-prime household loans appears to be the most important means of achieving inclusion. The citizens without collaterals are also able to access credits, which enable them to have investment. This is a method of creating self-employment for mainly women and youth. However, the sustainability of the household non-prime loan is threatened by credit risks. Moreover, according to the report of Central Bank of Kenya (2016), Global Competitiveness Report (2013-2014) states that credit risk mechanisms remain the single most determinant of sustainability and survival of Microfinance Banks globally. Gestel and Baessens (2009) in a study, Credit Risk Management: Basic Concepts: Financial Risk Components, indicates that the credit risk management appears to be one of the important matters and main agenda within the financial institutions in many global economies. The recent financial challenges and the regulatory framework being brought by Basel II, credit risk analysis and risk assessment, in general, are being allocated more time in financial institutions and banking industry deliberations (Gestel and Baessens, 2009). In the mid-1996, the total number of microfinance institutions offering micro loans in the form of non-prime household loans was found to be one thousand in excess of 100 economies. Moreover, each of them was considered to have at least one thousand members (World Economic Outlook Report, 2014). There are approximately three billion people globally, which is half of the world population. They have challenges in earning income to an extent so that they receive an income of as low as one dollar in a day (World Bank, 2016b). Granting non-prime household loans is considered as a solution to uplift their standard of living through self-sustainability programs (Global Economic Report, 2016). Globally, household nonperforming loan is the highest in the world accounting for approximately 36.4%, where more than 50% of the nonperformance is on non-prime household loans overtaking prime household loans default (World Bank, 2015). Nonperformance of these loans is a global issue, because it has led to shutting down of renowned world class businesses such as Lehman brothers, Bearstearns, and American International Group incorporation in America owing to subprime loans, which are non-prime household loans (Dell'Ariccia *et al.*, 2012). Non-prime house hold loans if well harnessed appear to remain the engine of productivity globally (CBK, 2016). Many economies in the world are considerably interested in the reduction of credit risks that may hinder the growth of non-prime household loans (IMF, 2014).

The focus of non-prime household loans in African countries has as well been considered with similar interest owing to its importance in uplifting the standard of living of their respective citizens. Above 90% of the residence did not seem to have access to reasonable credits over the last 10 years owing to lack of collaterals to secure loans (United Nation, 2006). Morocco Microfinance Banks sector was one of the fastest growing in the world in year 2007, with a growth rate of between 20% and 30% per year. However, further growth appears to have been hampered by increasing the nonperformance of non-prime household loans that grew by more than 35% per year (WEO, 2015). The Africa Competitiveness Report (2015) indicates that South Africa ranked first in Africa and twenty fourth globally owing to the presence of well-established Microfinance Banks. However, the country ranked fourth behind Ghana, Egypt, and Kenya in household nonperforming loans. This has made many African countries to focus on this issue and try to determine the best credit risks mechanism that can reverse this trend of poor performance of non-prime household loans.

Kenya is not exceptional in executing this global agenda of reducing poor performance of non-prime household loans. Kenya microfinance sector is among the most celebrated sections of the economy in sub-Saharan Africa in branch network and service to the poor. However, it ranks the first in household loans nonperformance in East and Southern Africa and third globally after Ghana and Egypt (Africa Competitiveness Report, 2015). The total default in 2014 was 26.3% out of 32.9 billion making a default of 80%, and this is a worrying situation in Kenya economy (CBK, 2014). The Microfinance Banks in Kenya have made an effort of increasing the performance of non-prime household loans through enhancement of application of monetary policy and information sharing, which has worked well in other countries but has not yielded good results in Kenya (Central Bank of Kenya, 2016). Kenya intends to generate employment opportunities of more than 400,000 youth at a cost of $1.5 billion and empower 800,000 women annually to initiate self-investment. However, this initiative has been frustrated by the poor performance of non-prime household loans. World Bank (2016b) in their report at Washington DC on the economic growth and job creation of Kenya indicates that the pronounced emphasis and advocacy on the performance of non-prime household loans are its importance and effectiveness in empowering the Kenyan citizen financially. This will enable them to become self-reliant, reduce poverty, and lead to household loan growth and investments (World Bank, 2016b). The Kenya government has been very keen on granting of loans without collaterals particularly to the youth and women who are not able to provide securities on loans.

The Microfinance Banks grant non-prime household loans through the security of guarantorship. This will empower them economically to an extent of starting their own investments. Several researchers have emphasized the need for loans without collaterals that will enable the group who has no securities to offer to get credit for self-sustainability. This will subsequently lead to reduction of unemployment among youth and women as well as general poverty (Mwangi and Sichei, 2011; Owusu *et al.,* 2015; Warue, 2012; Waweru and Kalani, 2009). Availability of non-prime household loans has not alleviated the poverty, or created jobs for the youth and women to the probably expected level. Despite the effort by the microfinance banks and government in providing this credit, the level of default has slowed down this initiative. The microfinance banks are hesitant in providing this credit owing to the high level of credit risk. This appears to have resulted from the failure by the borrowers to repay back the loan (FinAcess, 2016; Warue, 2012; World Bank, 2016b). Even if the poverty level seem to have lowered from the previous 47% to approximately 42% according to World Bank (2016b) as indicated in the report on the prosperity of Kenya, this level is still high compared to the government target of reducing it by a figure below 10%. Global Competitiveness Report (2013-2014) indicates that the innovative capacity of Kenya was ranked an impressive 46th out of 148 economies with excessive spending on research and development and good research institutions that collaborate well with the business and financial sector in research activities. However, even after being Kenya being ranked highly in innovations, the Microfinance Banks in Kenya and the government have not comprehensively been sufficiently innovative to be able to address the poor performance of non-prime household credits.

The reason for undertaking this research is to determine the relationship between the loan guaranteed by a third party and the performance of non-prime household loans in the Microfinance Banks in Kenya.

1.1. Problem Statement

Globally, 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. In Kenya, only 1% of the land titles are owned by women, youth, and disabled, and this hinders them from accessing credits from mainstream 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). The government introduced revolving funds of $0.059 billion for youth, women fund of $0.038 billion, and Uwezo fund of $0.06 billion, but approximately half of these loans have since been defaulted. A worrying situation is that the government is allocating more money; Microfinance Banks consider this product as essential. However, the default rate continues increasing despite the pressure put on loan recovery compared to prime household loans whose default is decreasing. 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). This study was for the establishment of the relationship between the third party loan guarantee and the performance of non-prime household loans in the Microfinance Banks in Kenya.

1.2. Objective of the Study

To determine how the third party guaranteed loans and the performance of non-prime household loans are related in the Microfinance Banks in Kenya.

1.3. Theoretical and Literature Review

Bank risk management theory holds that banks and similar financial institutions should meet the regulatory requirement for risk measurement and capital (Pyle, 1997). The risk management in this theory is considered as the process by which the managers satisfy the risk-related processes through identification of key risks by obtaining understandable, consistent, as well as operational risk measures (Pyle, 1997). This is performed by selecting the risks to reduce or increase and the required methods. The procedures aimed at monitoring the resulting risks in the banks are established. The methods by which the loan is secured or guaranteed expose the Microfinance Banks to risks, which may lead to loss of funds through default. According to this theory, a bank or similar financial institution management perception that compliances to regulator needs is the only or even the most important factor for establishing a sound risk management system. This notion is one of the reasons by which the non-prime household loans may experience poor performance. The consideration that the loans must be secured even if it is through guarantorship only requires considerable deliberation by

the Microfinance Banks. This view is in line with the theory of the bank risk management. This is because the theory indicates that there should be risk mechanisms in banks so as to reduce the losses of loan default. As an approach of reducing the loan default and improving the performance of non-prime household loans, the credits should be secured even if it is through guarantorship. However, this form of securing loan is not an assurance that the loan must be repaid (Warue, 2012). This shows that the bank risk management is a broad concept that requires further enhancement.

The theory stresses that the management team of the banks requires a more reliable risk mitigation measure that aims at reducing credit risks. This is to direct the capital to functions with the best risk returns or reward ratios particularly in financial institutions (Gestel and Baessens, 2009). Therefore, the managers should assess whether the loans secured by the guarantorship reduce or increase the risks of fund loss. The theory emphasizes that there is a need to estimate the potential losses for the banks to stay within limits that are imposed by creditors, readily liquidity, regulators, or customers.

Interventions of Institutions and individuals in credit risk management are necessary if the loss of funds through default is to be minimized (Gestel and Baessens, 2009). This is similar to monitoring the loan granted using guarantorship as the security so as to minimize the risk of losing the funds. Macionis and John (2012) show that the provision of loan guarantees that can be considered as the risk management mechanism is an effective method to promote emerging, growing, and high-risk enterprises. However, Nguta (2013) indicates that the household loans third party guarantorship may not be of any use if not well enhanced. Several researchers, Owusu *et al*. (2015), Warue (2012), and Gestel and Baessens (2009), support this theory and state that an efficient credit risk management system, which relates well with loan risk mitigation mechanisms, can be of much help to the banks if well applied.

The performance of non-prime household loan requires prudent bank risk management mechanisms that will safeguard banks against default, which causes loss to banks (Gestel and Baessens, 2009). It has been indicated that more reliance on third party guarantorship as security affects the future financial decision in risk management. The guarantorship as a loan security appears to be unreliable owing to the loan portfolio defaulted even after being secured by guarantors (FinAcess, 2016). When a loan is secured by third party guarantee, the performance of non-prime household is poor, because the default rate increases owing to difficulty in loan recoveries.

2. METHODS

2.1. Research Methodology

The positivism philosophy was adopted in this study. The research design adopted was descriptive survey.

2.2. Data Analysis Presentation and Interpretation

2.2.1. Response Rates and Respondents Characteristics

The total number of questionnaires distributed was one hundred and fifty only (150). However, the response rate was 93%, after one hundred and forty questionnaires were filled. On gender, males were at 57.1%; whereas, females were at 42.9%. The findings of the study respondents who were 56.1% of the total number of respondents were of age limit between 31 and 40 years. The majority of the respondents work in the credit department, representing 40.67%. The study showed that 55% of the respondents stated that they had experience within a range of 1-5 years. The study showed that the credit related matters are well understood by the credit department, and they have worked for relatively few years supporting the argument that the majority of the employees of Microfinance Banks are young people.

2.2.2. Descriptive Statistics of Third Party Loan Guarantee

In evaluating the third party guarantee, the researcher had four variables. They include the amount secured by guarantee, recoveries from guarantors, percentage of loan granted through guarantee, and percentage recoveries from guarantors. Concerning the amount of loan granted and secured by guarantors, the majority of respondents or 42% stated that over 51 million Kenyan shilling was granted. Further analysis showed that the mean score was 0.932 out of 1, with an overall standard deviation of 1.387.

Table 1. KMO and Bartlett's Test for Third Party Guaranteed Loan.

Kaiser–Meyer–Olkin measure of sampling adequacy		0.811
Bartlett's test of sphericity	Approx chi-square	1776.327
	Df	28
	Sig	0.000

On the loan recoveries from the guarantors, the respondents were asked to indicate the range in which the loan was recovered from the guarantors when the borrower failed to repay the loan. The ranges involved were 10 million and below, 11-20 million, 21-50 million, 51-100 million, and then 100 million and above, all in Kenyan shillings. The question was aimed at determining the extent to which the range in which the recovery is performed affects the performance of non-prime household loans in the Microfinance Banks in Kenya. The study showed that 44% of the respondents stated that the recovery was below 10 million Kenyan shillings, thereby indicating that the recoveries were very low.

The other variable was the percentage of loan secured by guarantors. The study showed that 44.3% of the respondents indicated that the percentage secured by guarantee was 81% and above. The mean score was 0.3218, and the standard deviation was 0.4421. On the percentage of loan recovered from guarantors after defaulting by the borrowers, the study showed 45% of the respondents stated that it was 20% and below. Moreover, another group of respondents who were 30.3% stated that it was between 21 and 40%. This is an indication that the percentage of loan recovered from guarantors after the borrower have defaulted in the Microfinance Banks in Kenya is below 50%.

The testing for sample adequacy was conducted to ensure that the data that was collected was adequate for further analysis, which included multiple linear regression and Pearson correlation. This sample testing was performed by using SPSS version 21 software, and the test for multicollinearity was the first to be conducted. The determinants from the correlation matrix were computed. The results were 0.012, and it was greater than the recommended figure of 0.00001. This indicated that there was no multicollinearity in between the variables that were applied in the study. The testing method of the Kaiser–Meyer–Olkin measure of sampling adequacy is shown in Table 1. The results for the Kaiser–Meyer–Olkin test for sampling adequacy is 0.811. The Bartlett's test of sphericity was highly significant, because $p < 0.0001$.

The Kaiser–Meyer–Olkin measure obtained from the analysis, which was 0.811, being above 0.5 indicated that the collected data was acceptable for the multiple regression analysis method applied in this variable. The Bartlett's test for sphericity, which was significant, implied that the multiple regression data analysis method was suitable for this study.

2.3. Relationship between Third Part Guarantee and Performance of Non-Prime Household Loans in Microfinance Banks in Kenya

The study showed that there was a correlation between the amount of loan secured by guarantorship and the performance of non-prime household loans in the Microfinance Banks in Kenya. The correlation coefficient was 0.876, and a *p*-value of 0.0132 (<0.05) indicated a strong relationship. The correlation coefficient for recoveries from guarantors was 0.765, and a *p*-value of 0.0213 demonstrated that the relationship was strong. On the percentage of loan secured by guarantors, the correlation coefficient was 0.867, and a *p*-value of 0.0312 indicated a strong relationship. For the three variables, they indicated a significant level below 0.05, thereby showing that the level of confidence was greater than 95%. However, the correlation coefficient of the percentage of loan recovered from guarantors was 0.459, and a *p*-value of 0.0708 demonstrated a weak relationship. Moreover, it was not statistically significant.

Multiple regression analysis was conducted using the equation

$$Y = B_0 + B_1X_1 + B_2X_2 + B_3X_3 + B_4X_4 + \varepsilon$$

The equation has the respective X, representing different variables. The X_1, X_2, X_3, and X_4 variables represent the amount secured by guarantee, recoveries from guarantors, percentage granted, and percentage recoveries, respectively. Y represents the performance of non-prime household loans. B_1, B_2, B_3, and B_4 represent the coefficients, while ε is the error term.

The indicators of the Model Fitness are shown in Table 2, and the coefficients indicate that the correlation coefficient (R) between the independent variable, third party guarantee, and non-prime household loan performance representing dependent variable was 0.862, which is an average of all the parameters showing a positive strong relationship. The coefficient of determination being (R-Square) 0.743 shows that the model can explain 74.3% of the variations or can explain the changes in the dependent variable of non-prime loan performance. The Durbin–Watson statistic test was used for detecting the presence of autocorrelation or a relationship between values separated from one another owing to time difference. The predictor error was 1.675. As it was not more than two ($d < 2$), it implied that there was a positive correlation of the independent and dependent variables, and thus null hypothesis was rejected. This indicates that the extent of amount of loan secured through guarantee, the loan recoveries from guarantors, the percentage of loan secured by guarantee, and the percentage of loan recoveries from guarantors representing third party guarantee, which is an independent variable, is able to explain 74.3% of the changes in non-prime household loan performance representing a dependent variable.

Table 3 represents the Analysis Of Variance (ANOVA) on the influence of third part guarantee on non-prime household loan performance in Microfinance Banks whose indicator is profitability. The results illustrate that the model is statistically significant in explaining the impact made by third party guarantee on non-prime household loan performance in the Microfinance Banks in Kenya. The findings in the ANOVA table show that the effect from all the variables of third party guarantee combined is statistically significant in explaining the variations of non-prime household loan performance in the Microfinance Banks in Kenya. This was at a level of significance of 0.013 (<0.05). As a result, the null hypothesis was rejected. Moreover, it was concluded that third party guarantee has a positive influence on non-prime household loan performance in the Microfinance Banks in Kenya.

The positive Beta coefficients illustrate that a unit change in the independent variable results in a positive change in the performance of non-prime household loans in the Microfinance Banks in Kenya. Therefore, from Table 4, the amount secured (2517.795), recoveries (969.02), and percentage secured by guarantors (926.617) indicate a positive change in non-prime household loans in the Microfinance Banks in Kenya. The percentage of loan recoveries (-975.01) indicates a negative change in the performance of non-prime household loans in the Microfinance Banks in Kenya.

Table 2. Model Fitness—Third Party Guaranteed Loans and Non-Prime Household Loan Performance (Primary Data).

Indicator	Coefficient
R	0.862
R-Square	0.743
Std. Error of the estimate	7365.464
Durbin –Watson	1.675

Table 3. ANOVA—Third Party Guarantee and Non-Prime Household Loan Performance (Primary Data).

Indicators	Sum of the squares	Degree of freedom	Mean square	*F*	Significance level
Regression	1.616E + 11	6	32280000000	21.005	0.013
Residual	1.406E + 11	86			
Total	3.022E11b	92			

Table 4. Regression Coefficients—Third Party Guarantee and Non-prime Household Loan Performance (Primary Data).

Indicator	Beta	Std. Error	*t*	df	Sig.
Amount secured by guarantee	2517.795	1728.637	1.456	6	0.0211
Recoveries from guarantors	969.02	2313.13	0.418	7	0.0315
Percentage secured by guarantors	926.617	2637.338	−0.351	6	0.0118
Percentage of loan recoveries	−975.01	2636.21	0.419	6	0.069

3. RESULTS AND DISCUSSION

The Microfinance Banks sector of Kenya has adopted credit risk mitigation innovations in non-prime household loans. However, the problems of the poor performance of non-prime household loans in Microfinance Banks persist (AMFI, 2014; World Bank, 2016a). The Global Competitiveness Report (2013-2014) indicates that Kenya takes the position 47 out of 148 economies in innovations. However, even after being ranked highly in innovations, Kenya appears not to have obtained innovations that can improve the performance of non-prime household loans in Microfinance Banks. This created a need for a study that can assist in determining a solution for the problem of non-prime household loans that can be addressed in Kenya. This study showed that 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.

In Microfinance Banks, the mode of increasing profitability depends on how borrowers and facility risks can be mitigated (Altman, 2012). Fernado (2006) from India, in a study, states that risk is the fundamental element that drives the financial behavior in banks. The credit risk appears to be a threat in many Microfinance Banks worldwide and in Kenya. The behavior in the Microfinance Banks in Kenya is granting non-prime household loans using guarantors as security. This shows that this financial behavior needs to be well enhanced to avoid loss of funds by the Microfinance Banks in Kenya. Fernado (2006) states that the risk is real in all global economies and in banks. Therefore, the banks should be keen on various aspects of risk mitigations. This study showed that credit risks exist in all the Microfinance Banks in Kenya similar to that occurring in all economies worldwide. As indicated by Fernado (2006), credit risk is a reality in banking industry worldwide.

World Bank (2016b) stated that the future of banking globally will be determined on how well credit risk mitigations are undertaken in the banks. As shown by the findings of this study, the risks in the Microfinance Banks in Kenya should be controlled for the performance of the non-prime household loans to be improved. This can be performed by enhancing the granting of loans using guarantors as a security. This is in consideration of the amount granted and secured by guarantors, and the percentage granted and secured by guarantors to the total loan portfolio. Another consideration is the recovered amount and the percentage of loan recovered from guarantors when loan is defaulted.

Fernado (2006) and Owusu *et al*. (2015) state that the sustainability of banks will depend on the way they handle credit risks and conduct their marketing. Credit risk takes approximately 70% of all the risks in banking industry; whereas, all the other risks combined takes only 30% (Fernado, 2006). The findings of Fernado (2006) are in good agreement with the findings of this study, which shows that the credit risk control should be prioritized and provided considerable attention for the performance of non-prime household loans to be good in Microfinance Banks. This study showed that granting loans through guarantorship as a security should be enhanced to ensure that no fund is lost through nonpayment of the loan granted.

In Association of Microfinance Institution in Kenya report (AMFI) (2014), 2014 Sector report on microfinance sector in Kenya, it notes that the Microfinance Banks in Kenya profitability has not been impressive, because it shows a decline trend. This is also reflected in the Microfinance Banks sector's financial statement (CBK, 2016), which shows a loss of 128.3 million Kenyan shillings in 2016. Credit risk management in Microfinance Banks plays a great role in reducing the loan default (Arunkumar, 2015). However, this seems to be lacking in the Microfinance Banks in Kenya. It appears that owing to poor credit risk control such as lack of

enhancement of guarantorship when granting non-prime household loans, the loss has been reported in the Microfinance Banks in Kenya sector.

The proportion of loan that has been secured by guarantee against the total loans in Microfinance Banks should be reconsidered. World Bank (2016) in their report, International development association project appraisal document on a proposed credit, Social Protection and Labor Global Practice Africa Region indicates that the profitability of Microfinance Banks depends on how best it can recover funds from the loan granted at the lowest cost, buy money by offering high deposits rates, and invest the same money to earn high returns while applying credit risk reduction mechanism. This agrees with the findings of this study that shows that, although the loan secured through guarantorship is of much help to those without collaterals, if not well enhanced it can have negative effects on the performance of non-prime household loans in the Microfinance Banks in Kenya. The Kenyan Microfinance Banks sector reported a deficit of 128.3 million Kenyan shillings in 2016. This is an indication that their loan granting model should be reconsidered. This poor performance of non-prime household loans in the Microfinance Banks in Kenya appear to have caused a high level of unemployment in Kenya and a low gross domestic product (GDP).

The performance of non-prime household loans has been reported to be improving and helping those without collaterals in some global economies. However, according to World Bank (2016a) report, this remains to be attained in Kenya. In 2014, Kenya changed its status from poor countries to a lower-middle-income economy. This occurred when the economy grew by approximately 25%. 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). The percentage of youth who are in the range of 15 years and 35 years of age increased from 62.7 to 66.9% in 2009 and then to approximately 71.1% in 2015 (World Bank Report, 2016a). Therefore, the level of unemployment still remains high in Kenya especially among the youth. This has made the government to set a goal of creating jobs for more than 400,000 youth annually, which is difficult to be achieved. The Microfinance Banks fund and the government revolving fund were assumed to be a solution to the unemployment problem in Kenya. This was through accessing non-prime household loans without collaterals to the youth and women, but this initiative seems not to have worked well yet.

The Microfinance Market Outlook Report (2014) on growth driven by vast market potential indicates that the global microfinance market was expected within a range of between 15 and 20% in the year 2015. However, this growth appears not to have been achieved owing to credit risk issues. This failure of achieving the intended growth seems to have resulted to the poor performance of non-prime household loans in Microfinance Banks. This corresponds with the findings of this study. Moreover, it shows that the performance of non-prime household loans become poor when the third party guarantorship dominates the loan as security in the Microfinance Banks in Kenya. A study by Microfinance Market Outlook Report (2014) indicates that Asia is displaying the strongest growth momentum in Microfinance Banks. However, this report also noted that the momentum would be better if the credit risk in Microfinance Banks in Asia was minimized.

A particularly impressive development in this region was the revival of India's microfinance market, although Russian slowed it down to economic crisis (Microfinance Market Outlook, 2015). This indicates that the growth of the Microfinance Banks globally is still hampered by many impediments both internal and external. This study showed that the problem of the poor performance of non-prime household loans in Microfinance Banks is a global issue, and it appears to be a global agenda. The access to non-prime household loans in the Microfinance Banks in Kenya and the government revolving fund does not seem to play a great role in the alleviation of poverty or creation of jobs for the youth and women. Despite the effort by Microfinance Banks and government in providing this credit, the level of default has slowed down this initiative. The level of unemployment is still high, because it has not been possible to create over 400,000 jobs annually as per the projections.

In a study by Feller and Kristin (2010), in an article exploring the circumstances that lead to guarantor becoming liable on a personal guaranty, the researcher noted that the guarantor is faced with a situation where one has personal liability to repay the loan when the borrower fails to honor the agreement of loan repayment. This study finding showed that the reliance of guarantors, as security for the loan, appears to have resulted to the poor performance of non-prime household loans in the Microfinance Banks in Kenya. The performance measure is the profitability. The profitability of the Microfinance Banks in Kenya was

negative in two years. The (CBK, 2014) report shows a loss of 1.004 billion Kenyan shillings. In 2015, the profit was temporarily high being 492 million, but the Central Bank of Kenya report (2016) indicates that the Microfinance Bank sector in Kenya had a loss of 128.3 million Kenyan shillings.

The report of Earnst and Young (2008) on accounting for guaranteed debt indicates the third party loan guarantee act as an enhancement of loan security. This showed that when granting credit, there is a lot of consideration for the guarantorship as a security. However, the loan guarantee as a security for loan seems to not to work effectively such that the default rate increases. When the loan default goes up from the findings of this study, the performance of non-prime household loans whose measure is profitability becomes poor. In some instances, the Microfinance Banks report deficit in their financial statements. This study showed that the Microfinance Banks in Kenya were not able to recover loans from some guarantors when the loan was defaulted. The recoveries done were less than the loan defaulted. Additionally, this study showed that increasing the amount and percentage of the loan secured through guarantorship is proportional to increasing the credit risk by having more default and less profit. The lowering of loan delinquency level would lead to high profitability, which depicts good performance of non-prime household loans. This study showed that even if there are other credit risk factors in Microfinance Banks that need to be mitigated, the third party guarantorship appears to be a higher risk because it sometimes becomes difficult to recover loans from the guarantors if it is defaulted.

Proper loan guarantee mechanism may assist Microfinance Banks to reduce the default and loan delinquency level. This may be through loan recovery methods, which would boost the profitability in Microfinance Banks (Addae-Korankye, 2014; Macionis and John, 2012; World Bank, 2016b). This indicated that reducing the percentage of the loan secured by guarantee to total loan may be even better as a risk reduction strategy compared to others. However, these Microfinance Banks attract customers who have difficulties of getting other loan securities since they do not have title deeds and other categories of collaterals. This implies that if the Microfinance Banks reduce the 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, because only fewer funds will be available for leading.

According to Addae-Korankye (2014), in the study on Causes and Control of Loan Default/Delinquency in Microfinance Institutions, some Microfinance Banks fail to articulate the proportion of third party guaranteed loans to total loans, and thus high loan delinquency leading to reduction of profit. This finding agrees with the finding of this study although the study results of Addae-Korankye (2014) had no proper indication of how guarantor affects the performance of non-prime household loans, which is well outlined in the results of this study. Third party guarantee needs a lot of consideration in regards to the percentage of the third party guaranteed loan recovery to the total loan recovery, because if not well handled the percentage of loan recovery from the guarantors can continue lowering as it is indicated in this study.

Bergstresser *et al*. (2010) in a study on Financial Guarantors and the 2007-2009 Credit Crisis note that some economies have both the credit rating industry and the financial guarantors, providing some measure of pooling in the production of information about underlying borrowers. Moreover, the study shows that the rating agencies investigate the condition and circumstances of the borrowers in order to construct their ratings. It continues and states that the financial guarantors perform a similar service before accepting a certain guarantor to guarantee loan. The findings of this study are that this effort of having those processes was aimed at reducing the credit risk related to loan guarantorship. However, this study showed that, even with these measures of reducing credit risk, the non-prime household loan performance in the Microfinance Banks worldwide still remains poor. In Kenya, there is credit reference bureau, which relates to the identification of those failing to repay loan. However, it has not yet reversed the situation of the poor performance of non-prime household loans in the Microfinance Banks in Kenya. As shown in this study, the loan guarantorship should be enhanced worldwide to enhance the performance of non-prime household loans.

International Finance Corporation World Bank group report (2016a) in their document on Voices of Women Entrepreneurs in Kenya indicates that there is inequality in both opportunities and assets access in women compared to men. The government introduced women fund to supplement the non-prime household loans granted by the Microfinance Banks in Kenya. This initiative appears to have been slowed down by high default of this fund and loan resulting to poor performance of non-prime household loans in the Microfinance Banks in Kenya. The measure for the poor performance of non-prime household loans is profitability.

The poor recovery from guarantors is also considered as a risk factor in affecting the performance of non-prime household loans in the Microfinance Banks in Kenya.

The findings in a study by Owusu *et al*. (2015) on Reducing Loan Default Rate Among Microfinance Banks reveal that if the microfinance banks are well managed and credit risk reduced, then it leads to the economic growth of that economy. Nguta (2013) in a study conducted in Imenti North District in Kenya so as to establish the causes of repayment defaults in the area indicates that banks have realized high loan default thus low profit and less employment opportunities. Yunus (2003) projected a reduction of poverty globally by 2015 by 35%, but it was not achieved. This study showed that the level of poverty globally has increased instead of decreasing, thus differing with the projected results in Yunus (2003). The poor performance of non-prime household loan appears to have hindered this intended reduction. This seems to have caused discomfort to Microfinance Banks, the government and individual who have since taken away their lives owing to poverty and stress. In Kenya Akiba bank, microfinance was closed by the Central Bank owing to malpractice. In India, the governments closed down two large MFIs after the death of customers who committed suicide after being pressurized to repay their loan (Fernando, 2006). This was after the Microfinance Banks effort to recover loan from guarantors without success.

This study showed that Microfinance Banks appear to have done little in alleviation of poverty globally and in Kenya. This may be attributed to the poor performance of non-prime household loans in the Microfinance Banks in Kenya. The measure for the performance was the profitability in the Microfinance Banks in Kenya. The sector reported a loss of 128.3 million Kenyan shilling (CBK, 2016) after another loss of 1.004 billion was reported in 2014.

Microfinance institutions globally are the hope of poverty alleviation through job creation. However, this goal is yet to be achieved (Owusu *et al*., 2015). World Bank Report (2016a) and Owusu *et al*. (2015) state that the goal of Microfinance Banks is to avail chap credit without collateral to those who cannot get access to mainstream commercial banks.

This study showed that in Kenya the government is making an effort of availing funds to youth and women for own investment and poverty reduction. These funds include youth fund, women fund, and Uwezo funds. However, the payment of the non-prime household loans provided by the government and the Microfinance Banks in Kenya is still a problem.

The findings of the study by Dell'Ariccia and Marquez (2006) and Keys *et al*. (2010) correspond with the results of this research, which showed that when there is poor performance of non-prime household loans in the Microfinance Banks in Kenya, the level of unemployment declines and it appears to lead to poverty of the Kenyan population. This subsequently may lead to a slow economic growth.

The influence of third party guarantee on the performance of household loans is also statistically significant as supported by the findings in this study. Thus, a lot of emphasis has been put by the Microfinance Banks in this area although a lasting solution is yet to be established. The Microfinance Banks in Kenya were using loan guarantee as a risk mitigation measure. This is in consideration of the amount granted, the percentage of loan granted, and secured through guarantorship. Other considerations involved the amount recovered from guarantors and the percentage of loan recoveries from guarantors when loan is defaulted. However, failures to be more prudent on proper guarantorship enhancement subsequently appear to have results to low profit, which is an indicator of the performance of non-prime household loans in the Microfinance Banks in Kenya.

The findings of this study reveal that the Microfinance Banks are at an early stage of implementation of serious risk mitigation mechanism, which is recommended by the Central Bank of Kenya through supervision under Microfinance Bank Act. Thus, the method they used to operate is different from the new methods. They consider it a challenge to meet all the requirements of risk mitigations. Nevertheless, this should not be an excuse, because the prudent risk mitigation is necessary if the Microfinance Banks are to continue operating prudently. The Microfinance Banks sustainability and survival appear to greatly depend on the good performance of non-prime household loans. The measure for the performance of non-prime household loans is the profitability.

4. CONCLUSION AND RECOMMENDATION

The study showed that, as the Microfinance Banks continue to have their loan portfolio being secured by guarantorship, there is a need to consider more elaborate recoveries mechanism to ensure that it is

recovered. This will avoid loss in the bank as witnessed by the final accounts results for 2016 that have shown a loss of shs 128 million in the Microfinance Banks sector in Kenya. This is in addition to the loss of 1.004 billion in 2014. 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 contributing to poor performance of non-prime household loans in the Microfinance Banks in Kenya. The Microfinance Banks however is also found to be at a cross road, because the largest market segment is the borrowers without collaterals, which correspond with their main goals of assisting those customers who would not otherwise get credit from mainstream banks. However, at the same time, Microfinance Banks were formed with an intention of making profit. This is to make the owners and customers to have returns on their investments. As a method of enhancing the performance of non-prime household loans, the study recommends enhancement of loan guarantorship in the Microfinance Banks in Kenya and worldwide. This may lead to positive results in the Microfinance Banks profitability, which is a measure of non-prime household loans. It may reverse the current situation of reporting deficit in the microfinance sector in Kenya.

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Citation: Wachira BN, Omondi HO, Kinyanjui JK. 2017. Analysis of third party loan guarantee and performance of non-prime household loans in Microfinance Banks in Kenya. Management and Economics Research Journal 3: 55-66.