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CREDIT MANAGEMENT ON LOAN DELINQUENCY AMONG SMES IN KAPSABET MUNICIPALITY NANDI COUNTY, KENYA

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***Abstract*: *SMEs contribute significantly to an economy's economic agenda by increasing jobs, supporting growth, and delivering essential services. They have an important role in economic growth at all levels, from global to regional to local. Small and medium-sized businesses provide for around 60% of employment in developing economies. In addition, they contribute approximately 40 percent of national income in these countries. Despite the crucial role played by SMEs in economic development, they face serious challenges in their activities, loan default is a significant obstacle. SMEs' loan default has been attributed to a number of factors. These include a lack of desire to repay loans, the diversion of funds to other purposes, deliberate indifference, and inappropriate financial management. Absence of a prudent credit management system hurts the cash flow, affects the returns, risk management and growth. The purpose of the study was to establish the effect of credit management on loan delinquency among small and medium enterprises in Kapsabet Municipality, Nandi County. The specific objective of the study was to determine the effect of Credit approval procedures practices on loan delinquency among small and medium enterprises in Kapsabet Municipality. The study adopted explanatory research design. The target population was 7719 managers/owners of SMEs in Kapsabet Municipality out of which a sample of 380 was drawn. Both descriptive and inferential statistics were used for data analysis. The study findings indicated that Credit approval procedure practices had a negative and significant effect on loan delinquency of (β=-1.481, $p < 0.05$). The study concluded that credit approval procedures practices have a significant effect on loan delinquency among Small and Medium Enterprises. The study recommended that when considering factors that might affect loan repayment, Owners or managers of Small and Medium Enterprises should consider collection and analysis of information, terms of the Loan, keeping business records and indicating cash flow sources.*

Keywords: *Credit Management, Loan Delinquency, Small and Medium Enterprises*

1.0 Introduction

The universe of small and midsize businesses is extremely diverse. Small and Medium Enterprises largely contribute to an economy's economic agenda by expanding employment, fostering growth and providing crucial services (Howorth & Westhead, 2013). Despite, the crucial role played by SMEs in economic development, they face serious challenges loan defaults in their operations. Loan delinquency is the incidence in a loan portfolio where payments are in arrears (Siaw, Oteng, & Opoku, 2014). According to Owusu, Oppong, Agyeiwea, and Abruquah (2015), a variety of factors have been listed as the causes of SME loan delinquency. These include a lack of motivation to repay loans, the diversion of funds to other purposes, intentional indifference, and poor financial management. Exchange rate depreciation, delay in time of loan delivery, small farm size, high interest rate, age of SMEs, poor supervision, non-profitability of business enterprises, and excessive government intervention in the operations of government-sponsored credit programs affects loan delinquency. Therefore, firms need effective credit management.

World Bank (2017) reports that SMEs are facing several challenges as they struggle to register favourable growth. Bowen, Morara and Mureithi (2009), found that most SMEs in Kenya have a sluggish growth rate and sixty percent of all SMEs will fail in their first year of existence. KNBS (Kenya National Bureau of Statistics) (2016) indicate that approximately 500,000 SMEs in Kenya close doors every year. Further the KNBS report observed that approximately 2.2 million SMEs collapsed between the year 2012 and 2016. Imprudent credit decisions have been highlighted in literature as among the principal causes of SMEs stagnation and decline in growth (Agyei-Mensah, 2017). Howorth and Westhead (2013) highlight that most have not established a formal working capital management system and make arbitrary decisions regarding their working capital levels. Bhalla (2010) assert that absence of a prudent credit management system hurts the cash flow, affects the returns, risk management and growth. According to Singh (2018), firms that implement a prudential credit management process have the potential to register a growth in their sales, earnings, and assets growth. Therefore, it is clear that credit management influence the loan performance of SMEs.

Credit management is a crucial procedure for any company involved in the credit market. When executed properly, the process assures that the customer pays for the services rendered. According to Myers and Berkley (2013), credit management techniques are the strategies an organization use to ensure that its credit level is appropriate and is managed efficiently. It is a component of financial management that includes credit research, credit rating, credit classification, and credit reporting. Nelson (2012) defines credit management as the processes a business does to manage the credit sales it makes. It is a necessary practice for all firms that engage in credit transactions, since some have effectively managed their credit activities to the point where there is no credit risk.

Credit management is the collection and management of credit payments from clients. These practices are defined by Myers and Berkley (2013) as the tactics firms employ to maintain an appropriate level of credit and effectively manage this level. It is a component of financial management that includes credit research, credit rating, credit classification, and credit reporting. When credit management is performed properly, both the capital held by borrowers and the likelihood of bad debts decrease. Edwards (2013) argues that if you are a firm and you have not included in your selling price any expenses connected with late payment, or if you do not have a mechanism to recoup the costs by charging interest, then such costs will inevitably impact your profit (Howorth &Westhead, 2013). Some businesses are tempted to extend credit when they consider the possibilities of expanding their operations. To avoid losses, firms must be certain that the increased revenue from increased sales will exceed the cost of borrowing (Myers & Berkley, 2013).

With the increased level of unemployment globally, many individuals have engaged in SMEs as source of employment. Given the status of the business environment where the competition is intense, SMEs need adequate financial resources to survive (Ahmed & Malik, 2015). To stay highly competitive in the market place, research needs to be done to cater for the needs of the consumers. Any shortage in financial resources may hinder SMEs from growing (Ntiamoah, Egyiri, Fiaklou, & Kwamega, 2014). To meet their financial needs, SMEs have sought financial leverage from financial institutions such as commercial banks, SACCOs, micro financial institutions, self-help groups, mobile money and others (Financial Sector Deepening, 2016). Despite these efforts most of these SMEs have challenges such as loss of property due to loan repayment default.

Delinquent loans by the SMEs had risen from 6.1 per cent of total loans in 2017 to 12.36 per cent in 2020. Businesses had struggled to pay loans at the expenses of their working capital, some falling apart and closing shops resulting in elevated defaults and listing by credit reference bureau. (Central Bank of Kenya, 2020). Various studies conducted in Kenya have focused on loan repayment among SMEs. For instance, Ahmed and Malik (2015) in their empirical investigation on credit risk management and delinquent loan of SME banks of Pakistan. A methodological gap exists as the study had not provided justification for the research design adopted. A contextual gap exists as the study had been conducted in a different geographical setting. A conceptual gap exists as credit administration activities were not within the scope of their study which the current study seeks to incorporate. Wekesa (2018) investigated the effect of debtors' management methods on the expansion of the hire purchase sector for SMEs in Kenya. A conceptual gap exists as credit approval procedures practices had not been considered in the study which the current study seeks to add. The current study therefore sought to find out how credit management affects loan delinquency among small and medium-sized businesses in Kapsabet Municipality, Nandi County. The specific objective was to establish the effect of Credit approval procedures practices on loan delinquency among small and medium enterprises in Kapsabet Municipality, Nandi County. The sub-sections of the remainder of the article are as follows; section 2 covers literature review, section 3, research methodology, section 4 results & discussions and section 5 conclusion and recommendations.

2.0 Literature Review

2.1 Credit Approval Procedures Practices and Loan Delinquency

Chilukuri and Rao (2015) investigated the effectiveness of assessment and credit approval, as well as loan review, in commercial banks. According to the survey, credit risk is the most significant risk faced by many commercial banks around the world. According to the study, many banks are concerned that some of their customers will fail to pay on time or at all. As a result, many banks are required to monitor and appraise each and every loan on a regular basis to determine the borrower's current and future ability to repay interest and principal. According to the findings, the loan review process should attempt to improve the level of unpaid interest and non-performing loans in the books of account. Many borrowers in the country require a smooth and predictable application, processing, and payout process. Banks with a high number of non-performing loans should focus more on debt recovery.

Liang, Chih-FengLiao and Yu-TingGao (2017) using the stochastic frontier approach on 14 banks from 2001 to 2010, investigated how SMEs' lending and credit guarantee affect Korean banks' efficiency. The data show that as lending to SMEs grows, banks' cost efficiency falls due to knowledge asymmetry. However, increasing the proportion of loan guarantees can help them save money. This demonstrates that South Korea's credit guarantee system can effectively share SMEs' credit risk in order to assist banks become more efficient.

Gakure, Ngugi, Ndwiga, and Waithaka (2012) examined the impact of credit risk management strategies on the performance of unsecured loans by Kenyan commercial banks. The top-level managers, medium level managers, and lower-level managers were the target population. Risk identification has a moderate impact on the performance of non-secured loans, according to the data. According to the findings, branch managers' inspection has a significant impact on the performance of unsecured loans in Kenya. The study found that branch manager inspection has a significant impact on unsecured loan performance, whereas risk identification processes have a small impact on non-secured loan performance. The study discovered that risk measurement has a significant impact on loan performance, and risk analysis and evaluation have a small impact on unsecured loan performance.

Mwangangi (2014) investigated the relationship between the borrower credit score and its credit repayment performance. The study used a correlational research approach, using all corporate clients as the target group. 100 corporate clients had been given loans by the Agricultural Finance Corporation (AFC) over a period of 5 years. Data was captured and analyzed using regression analysis to examine the relationship between a borrower's credit score and repayment behavior. According to the findings, the use of credit scoring of a particular 26 borrower positively and significantly influenced the repayment performance in AFC as it facilitates quick loan turnaround, consistency in lending, and basis for risk pricing. The study recommended that AFC should cooperate with other credit institutions to ensure that they get in depth information on clients before advancing loans to them. Literature reviewed led to development of the following hypothesis statement.

***$H0_1$*:** *Credit approval procedures practices have no significant effect on loan delinquency among small and medium enterprises in Kapsabet Municipality, Nandi County.*

3.0 Research Methodology

The study adopted a cross sectional study design as it is concerned primarily in establishing whether there is a relationship among the variables by comparing the particular characteristics of a specific population of subjects, either at a fixed point in time or at varying times for comparative purposes. The design was chosen since it was deemed to be the most effective to significantly contribute to the depth and specificity of the study (Gupta & Gupta, 2022). Once the sample is representative of the relevant population, cross sectional study design ensured that any subsequent assessments of the attributes of that population are accurate and the findings are generalizable in other words, they have population validity (Pandey & Pandey, 2021). The study population for this investigation was all the 7719 managers/owners of the registered SMEs in Kapsabet Municipality between 1st July 2020 to 19th April 2021. The sample size was 380 respondents calculated based on Yamane 's 1967 formulae and selected using simple random sampling technique. The study used questionnaires to collect data. Pilot study was done among 38 SMEs in Mosoriot Town. Cronbach 's alpha (α) was used to assess reliability of the questionnaire. The study adopted content validity which was tested using experts (supervisors) opinion. The data for the study was analyzed using both descriptive statistics and inferential statistics.

4.0 Results & Discussions

4.1 Background Information

This section covers information on age of the respondents, gender of the respondents, years in business, type of business and level of education.

Table 1: Background information of the respondents

n=319		**Frequency**	**Percent**
Age bracket	18-24	3	0.9
	25-29	25	7.8
	30-34	3	0.9
	35-39	87	27.3
	40-44	130	40.8
	45-49	42	13.2
	50 and above	29	9.1
Gender	Male	194	60.8
	Female	125	39.2
Years in business	1-5 years	28	8.8
	6-10 years	101	31.7

	11-15years	134	42.0
	16 years & above	36	17.6
Type of Business	Farming	53	16.6
	Trade	178	55.8
	Manufacturing	15	4.7
	Service	73	22.9
Level of education	Certificate	91	28.5
	Diploma	138	43.3
	Undergraduate	67	21.0
	Postgraduate degree	23	7.2

All the respondents who participated in the study were willing to disclose their age bracket. Age is most cases is associated with the ability of the respondents to understand a given subject matter, i.e., credit management and loan delinquency among Small and Medium Enterprises in Kapsabet Municipality in Nandi County. Age diversity presents different opinions on a certain subject matter which helps in the collection of comprehensive data that helps to improve of the quality of a study. In the current study, the age bracket is diverse and therefore it was expected that comprehensive data was collected on the subject matter. Out of the total respondents, the age bracket of the majority of the respondents 130(40.8%) was between 40 and 44 years, 87(27.3%) between 35 and 39 years, 42(13.2%) between 45 and 49 years, 29(9.1%) 50 and above years, 3(0.9%) between 25 and 29 years and 3(0.9%) between 18 and 24 years. The findings implied that majority of the owners or managers of Small and Medium Enterprises in Kapsabet Municipality in Nandi County are aged between 40 and 44 years. The findings revealed that 194 (60.8%) respondents were male while 125(39.2%) were female. This implied that there was a significant gender disparity among managers/owners of Small and Medium Enterprises in Kapsabet Municipality in Nandi County. In regards to years in business, majority of the respondents 134(42.0%) were in business for a period of between 11 and 15 years, 101(31.7%) between 6 and 10 years, 56(17.6%) 16 and above and 28(8.8%) between 1 and 5 years. This implied that all the respondents were in business long enough and therefore issues that concerns credit management and loan delinquency among Small and Medium Enterprises in Kapsabet Municipality in Nandi County were not new to them. The period was long enough for them to either encounter the aspects or for them to hear about them from other Small and Medium Enterprises in the Municipality. The type of business for majority of the respondents 178(55.8%) was trade, 73(22.9%) service, 53(16.6%) farming and 15(4.7%) manufacturing. This implied that most of the respondents type of business was trade. Findings revealed that 91(28.5%) were certificate holders, 138 (43.3%) diploma, 67(21.0%) undergraduate and 23(7.2%) postgraduate degree. This implied that majority of the respondents were diploma holders.

4.2 Descriptive Statistics

The specific objective of the study was to establish the effect of Credit approval procedures practices on loan delinquency among small and medium enterprises. The respondents were first of all asked to state whether credit approval affects loan delinquency. Findings are presented in Figure 1.

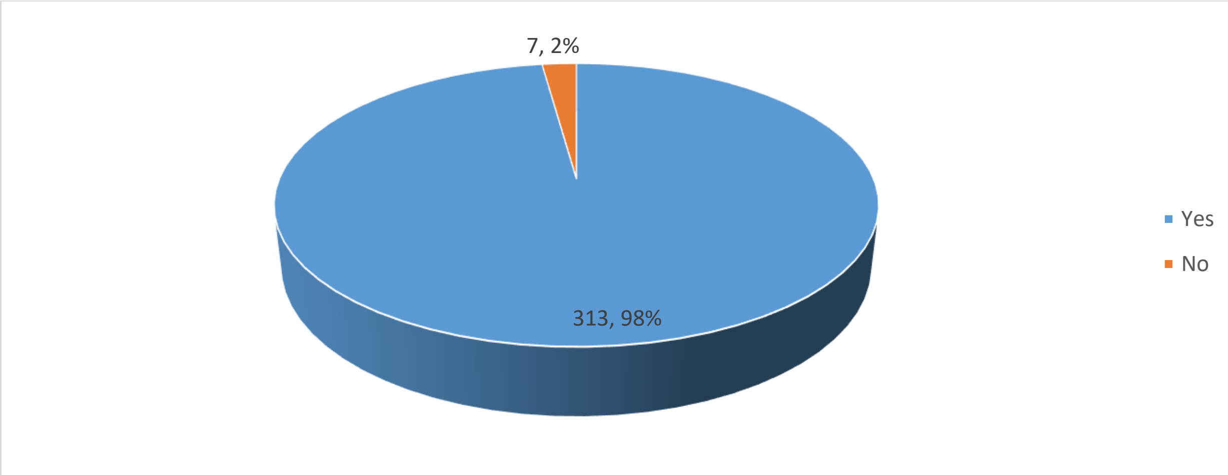

Fig 1: Credit approval procedures practices

The respondents were requested to state whether credit approval procedure practices affect loan delinquency, out of the total respondents, 313(98%) stated that credit approval procedure practices affect loan delinquency while 7(2%) held a contrary opinion that credit approval procedure practices do not affect loan delinquency. The respondents were further asked to state whether they agreed with the following statement on how credit approval procedure practices affect loan delinquency. The study focused on collection and analysis of information, assessing terms of the Loan, keeping business records and indicating cash flow sources. The researcher was interested on the opinion of respondents on the extent to which the indicators affect loan delinquency among Small and Medium Enterprises. The descriptive findings were as presented in Table 2;

Table 2: Credit Approval Procedure Practices

n=319		SA	A	U	D	SD	Mean	Std. dev
Collection and analysis of credit information affects loan repayment.	F	228	49	14	14	14	1.5486	1.06251
	%	71.5	15.4	4.4	4.4	4.4		
Assessment of terms of the loan affects loan repayment.	F	117	146	13	10	33	2.0470	1.21092
	%	36.7	45.8	4.1	3.1	10.3		
Keeping business records affects loan repayment.	F	184	66	28	29	12	1.8056	1.15463
	%	57.7	20.7	8.8	9.1	3.8		
Indicating cash flow sources at the business affects loan repayment.	F	230	87	2	0	0	1.9137	1.75019
	%	72.1	27.3	0.6	0.0	0.0		
Composite							1.8287	

The respondents were asked to give their opinions in regard to whether collection and analysis of credit information affects loan repayment, 277 (86.8%) of respondents agreed that length of credit approval has an effect on repayment while 28(8.8%) disagreed with the statement. Collection and analysis of credit information was further established to affect loan delinquency of Small and Medium Enterprises with (mean= 1.5486, std.

Dev. = 1.06251). Findings resemble that of Liang, et al., (2017) that collection and analysis of credit information affects loan delinquency. In relation to whether assessment of terms of the loan affects loan repayment, 263(82.4%) agreed that available information has an effect on loan repayment while 23(7.2%) disagreed with the statement. Assessment of terms of the loan was further established to affect loan delinquency of Small and Medium Enterprises with (mean= 2.0470, std. Dev. = 1.21092). Findings are in agreement with that of Chilukuri and Rao (2015) that assessment of terms of the loan affects loan repayment.

The study also sought to determine whether keeping business records affects loan repayment, 250 (78.4%) agreed that references from other banks and traders has an effect on loan repayment while 41(12.9%) disagreed with the statement. Keeping business records was further established to affect loan delinquency of Small and Medium Enterprises with (mean= 1.8056, std. Dev. = 1.15463). The study agrees with that of Mwangangi (2014) that keeping business records affect loan delinquency. In regards to whether indicating cash flow sources at the business affects loan repayment, 317 (99.4%) agreed that indicating cash flow sources at the business has an effect on loan repayment while 0(0.0%) disagreed with the statement. Indicating cash flow sources at the business was further established to affect loan delinquency of Small and Medium Enterprises with (mean= 1.9137, std. Dev. = 1.75019). The indicator recorded an aggregate mean of 1.8287, this implies that majority of the respondents revealed that credit approval procedure practices affect loan delinquency among Small and Medium Enterprises. The study is in agreement with that of Chilukuri and Rao (2015) that credit approval procedure practices affect loan delinquency.

4.3 Inferential statistics

The inferential statistics adopted were both correlation and regression analysis.

4.3.1 Correlation Analysis

Correlation analysis was adopted in the study to determine the nature of association that exist between the study variables. The correlation analysis results were presented in Table 3. Credit approval procedures practices were found to have a significantly strong negative relationship with loan delinquency of ($r = -0.758$, p-value < 0.05). This implies that credit approval procedures practices contribute to a decrease in loan delinquency. Findings resemble that of Chilukuri and Rao (2015); Liang *et al*., (2017) that credit approval procedures practices contribute to a decrease in loan delinquency.

Table 3: Correlation Analysis

n=319		L. Delinquency	Credit approval procedures practices
L. Delinquency	Pearson Correlation		
	Sig. (2-tailed)	1	
Credit approval procedures practices	Pearson Correlation		
	Sig. (2-tailed)	-.758*	1

*. Correlation is significant at the 0.05 level (2-tailed).

4.3.2 Simple Linear Regression Analysis

Simple linear regression analysis was used to predict loan delinquency from credit approval procedures practices. The results for the regression model summary were presented in Table 4;

Table 4: Regression Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.727[a]	.529	.523	1.77332

a. Predictors: (Constant), credit approval procedures

b. Dependent Variable: Loan Delinquency

From the table above, the value of adjusted R-square is 0.523 which indicates that the model explains 52.3% of loan delinquency from credit approval procedures practices. Analysis of variance (ANOVA) was adopted to assess the goodness of fit test of the regression model. The results are shown in Table 5;

Table 5: ANOVA

	Model	Sum of Squares	Df	Mean Square	F	Sig.
	Regression	1109.044	1	277.261	88.169	.000[b]
1	Residual	987.426	317	3.145		
	Total	2096.470	318			

a. Dependent Variable: Loan Delinquency

b. Predictors: (Constant), credit approval procedures practices

The F-ratio was 88.169 at 1 degree of freedom which is the variable factor. This represented the effect size of the regression model and the model is significant at 95% confidence level (p=0.000) indicating that loan delinquency can be predicted from credit approval procedure practices. Regression coefficient analysis was conducted in order to determine the beta that helped to show the extent to which credit approval procedures practices affect loan delinquency. Findings were as shown in Table 6.

Table 6: Regression Coefficients

		Unstandardized Coefficients		Standardized Coefficients	F	Sig.
		B	Std. Error	Beta		
1	(Constant)	2.145	.315		6.806	.000
	Credit approval procedures practices	-1.481	.161	-1.204	-9.180	.000

a. Dependent Variable: Loan Delinquency

Table 6 shows that credit approval procedure practices had a negative and significant effect on loan delinquency of (β=-1.481, $p < 0.05$). This implies that an increase in credit approval procedure practices by one unit decreases loan delinquency by 1.481 units when credit worthiness practices, credit administration activities and credit collection policy practices are kept constant. The study failed to accept the null hypothesis ($H0_1$) that Credit approval procedures practices have no significant effect on loan delinquency among small and medium enterprises in Kapsabet Municipality, Nandi County. Findings resemble that of Chilukuri and Rao (2015); Mwangangi (2014) that credit approval procedure practices have a negative and significant effect on loan delinquency.

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5.0 Conclusion and Recommendations

Credit approval procedures have a significant effect on loan delinquency among Small and Medium Enterprises. The study also concluded that collection and analysis of credit information affects loan repayment. Assessment of terms of the loan affects loan repayment. Keeping business records affects loan repayment. Indicating cash flow sources at the business affects loan repayment. Based on the study findings and conclusions the study recommended that when considering factors that might affect loan repayment, Small and Medium Enterprises should consider collection and analysis of information, assessment of terms of the Loan, keeping business records and indicating cash flow sources.

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