

# Chama Loan Default in Faulu Bank of Kenya-Bungoma County

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## ARTICLE INFO

## ABSTRACT

CHAMA in Faulu bank of Kenya means Group. The study aimed at investigating CHAMA loan default at Faulu Bank, a private owned Micro Finance Institution in Kenya. Faulu Bank was formed in the early 1980s, and its main role was to assist in the development of small and medium enterprises (SMs) by providing loans to individuals, businessmen, Chama, private companies, public bodies, local authorities and other persons engaged in business activities. Faulu began lending to CHAMA around 2006 with its Bungoma Branch of Bungoma County being one of its pioneer branches. The performance of the CHAMA loans was good with an initial default rate of 1% but in the subsequent years the performance of the Chama loans in the Bungoma branch became very poor, recording the highest rate of 80% default in 2009. The findings of the study done in 2013 suggest that the amount of loan has no effect on default; size of the CHAMA has a significant positive effect on CHAMA loan default, while age of the CHAMA, profitability and loans turnover all produced significant negative effect on CHAMA loan default. The findings of the study are useful in designing of credit scoring systems by Faulu Bank and other lending institutions embracing the Chama lending model.

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**KEYWORDS:** *Micro credit, Chama lending, Loan default, Grameen, Faulu Bank of Kenya.*

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## 1.0. BACKGROUND/ INTRODUCTION

The major goal of microfinance is the provision of micro loans to the low-income and the poor households. The chance that a microfinance institution (MFI) may not receive its money back from borrowers (plus interest) is the most common and often the most serious vulnerability in a microfinance institution. Since most microloans are unsecured, delinquency can quickly spread from a handful of loans to a significant portion of the portfolio. This contagious effect is exacerbated by the fact that microfinance portfolios often have a high concentration in certain business sectors.

International organizations are coming to the realization that MFIs are veritable and effective channels to ensure programme implementation effectiveness, particularly in poverty alleviation projects and firsthand knowledge of the needs and interest of the poor (CGAP, 1999).

According to Waithera (2008), Micro Finance is way of supplying loans and small credits to finance small projects to help the poor have an income through forming their own small scale business to earn their daily bread and better their living. Micro finance is the provision of credit to the poor and low-income earners to enable engage

them in productive activities. Technically, micro finance is a business in which the person conducting the business holds himself out as accepting deposits on a day to day basis and any other activity of the business which is financed, wholly or to a material extent, by lending or extending credit for the account and at the risk of the person accepting the deposit, including the provision of short term loans to small or micro enterprises or low income households and characterized by the use of collateral substitutes (GoK, 2006).

According to (Cotler & Woodruff, 2008; Mel et al., 2007; Tambunan, 2007; Schoombee, 2000; Kurwijila & Due, 1991), most challenges faced by MEs around the world are lack of access to credit. Schoombee (2000) found out that lack of access to formal bank credit is one of the important problems faced by South African micro entrepreneurs in the informal sector. Mel et al. (2007) confirm that missing credit markets is the main limitation for small businesses to grow. Lending is risky to a micro enterprise because repayment of loans can seldom be fully guaranteed. The failure of a large number of privately-sponsored Micro Finance institutions in many developing countries was due, among other things, to their inability to ensure good repayment rates among their borrowers (Adams et al., 1984; Yaron, 1994).

Poverty alleviation through provision of subsidized credit was embraced by many countries in the 1950's through the 1980's, but these experiences were nearly all disasters. Loan repayment rates often dropped well below 50 percent. In 2005, for example, government regulators in Kenya closed Akiba micro finance on grounds that it had unlawfully taken customers deposits and reneged on payments Mulleti (1999). In 2006, the Indian governments cracked down on two large MFIs following suicides of at least sixty of their customers who were under pressure to repay loans at prohibitively high interest rates

Fernando et al (2006). Poverty alleviation through provision of subsidized credit was embraced by many countries in the 1950's through the 1980's, but these experiences were nearly all disasters. Loan repayment rates often dropped well below 50 percent Morduch (1999). Kenya rural enterprise programme suffered default in two of its schemes while Benin, Ghana, Guinea and Tanzania have also suffered a bad portfolio due to non repayment of loan issued out. According to (Schreiner, 2003), the World Bank Sustainable Banking with the Poor project (SBP) in mid-1996 estimated that there were more than 1,000 microfinance institutions in over 100 countries, each having a minimum of 1,000 members and with 3 years of experience. In a survey of 2006 of such institutions, 73 per cent were NGOs, 13.6 per cent credit unions, 7.8 per cent banks and the rest savings unions. An overwhelming majority of the world's poor live in the third world countries. Various approaches have been employed in alleviating poverty of which provision of credit that targets the poor is one. Many are now of the opinion that allowing the poor to have command over resources through credit can contribute towards poverty alleviation.

Throughout Asia, Africa, and Latin America, the last decade has witnessed substantial efforts that aim at opening the poor's access to credit and at the same time improve their incentives to meet repayment obligations. One distinguishing feature of these efforts has been the formation of borrower Chama and the use of Chama responsibility and peer monitoring as the core principles guiding financial transactions. The low incomes Chama are usually excluded from credit facilities because of many reasons. These include insufficient collateral to support their loans, high transaction costs, unstable income, lower literacy and high monitoring costs. The rapid proliferation of MFIs has drawn some criticism. Some observers fear that it has outpaced the capacity of developing

world governments to implement sensible regulatory measures Howard et al (2006). While this has contributed to the industry's flexibility and propelled its fast growth, it has also created a wild environment in which borrowers with limited financial experience may be exploited by incompetent or unscrupulous lenders Howard et al (2006).

The Inter-American Development Bank (1997) reported that micro enterprise makes a major contribution to aggregate employment, production, and national income in Latin America and the Caribbean. Budiantoro (2004) found out that 30 percent of GDP in Indonesia was contributed by MEs. MEs provide income and employment for significant workers in the rural and urban areas by producing basic goods and services such as traditional foods, craft, barber and hair salon and hawkers for the needs of rapidly growing populations.

Since the founding of the Grameen Bank in 1976 and following its success in rural Bangladesh, the group lending model has been adopted in over 40 low-income countries (Pitt and Khandker, 1998). The Faulu Bank which is a privately owned Micro Finance institution in Kenya started offering Chama credit to small and medium businesses in Bungoma County in 2006 and by the beginning of 2007, the program had expanded more than twofold to include 100 Chama groups which received loans in excess of Ksh. 50million the beneficiaries being approximately 1,440 business units. Currently, Faulu Bank-Bungoma County has financed 120 Chama a total of over Ksh. 64 million. Faulu Bank requires the Chama to sign a joint liability clause, which means that the group members are responsible for repayment of not just their own loans, but also loans taken by all members in their Chama. The primary purpose of Faulu Bank of Kenya loans is to enable those who do not own land which was used as collateral to access loans. The target Chama have been mainly women and the youth but the product has been

extended to include men. However, the wanting performance of Chama loans in Faulu Bank calls for a research on the causes of the increasing default rate in Chama loans schemes. Other main stream privately owned financial institutions and banks have also adopted group loans model.

## 2.0. RESEARCH PROBLEM

Despite the recent growth in the Micro-finance sector, the sector is faced with challenges of loan defaults by clients. Individual groups have tried using groups' equity for collaterals which is expected to ensure that funds revolve and benefit other individual members of the group but this has ended up in futility. High levels of default have caused increased amounts of non-performing loans in the books of many financial institutions. Faulu Bank has in the recent past experienced poor loan repayment patterns of its Chama based loan product. According to Peters, (2003), 25% of borrowers in microfinance institutions take loans from six or more different financial institutions which eventually lead to repayment crisis in the microfinance industry. Repayment crisis subsequently lead to liquidity problems which negatively influence the operational performance of microfinance institutions.

Loan default is one of the critical issues of Micro finance institutions (MFIs) that concern all stakeholders (Sharma & Zeller, 1997; Marr, 2002; Maata, 2004; Godquin, 2004). Whereas the high loan default rate is the primary cause of the failure of MFIs (Yaron, 1994; Woolcock, 1999; Marr, 2002; Maata, 2004), the findings of this study can be used by micro financing institutions to manipulate their credit programs for the better. This study determines whether age of the CHAMA, size of CHAMA, profitability, amount of loan and loans turnover have significant influence on repayment of Chama based loans. Competition among MFIs has not only brought benefits such as better access and lower interest-rates, but has also introduced problems Saloner

(2007). These adverse effects fall back not only on the MFIs, which are struggling to maintain their performance level, but also on the clients. Borrowers are facing serious problems from paying back their loans.

### 3.0. OBJECTIVES OF THE STUDY

#### 3.1. General objective

The research aimed at Analysis of Chama Loan Default in Faulu Bank of Kenya-Bungoma County.

#### 3.2. Specific objective

- i) To determine the effect of age of Chama on loan repayment patterns
- ii) To determine the effect of loan size on Chama loan repayment patterns
- iii) To establish the effect of education level of Chama members on Chama loan repayment
- iv) To establish the effect of experience in loan taking on loan repayment by Chama
- v) To establish the effect of Chama size on group loan repayment

### 4.0. HYPOTHESES

1. **H<sub>0</sub>**: The age of a Chama has no significant effects on loan repayment
2. **H<sub>0</sub>**: The size of loan has no significant effects on loan repayment.
3. **H<sub>0</sub>**: The number of years in formal education for Chama members has no significant effects on Chama loan repayment.
4. **H<sub>0</sub>**: Experience in loan taking has no significant effects on loan repayment.
5. **H<sub>0</sub>**: The size of the Chama has no significant effects on loan repayment.

### 5.0. REVIEW OF LITERATURE

According to Ledgerwood (1999), microfinance is a provision of a broad range of financial services such as savings, credit, insurance and payment services to the poor or low-income group who are

excluded from the normal banking sectors. Gonzalez-Vega (2008) documented that Microfinance refers to the provision of financial services to low-income clients, including consumers and the self-employed, who traditionally lack access to banking and related services. Microfinance is a place for the poor and near poor clients to get access to high quality financial services, which include not just credit but also savings, insurance and fund transfer. The World Bank defines microfinance as "... Small-scale financial services – primarily credit and savings – provided to people who farm or fish and who operate small enterprises or microenterprises where goods are produced, recycled, repaired, or sold; who provide services; who work for wages or commissions; who gain income from renting out small amounts of land, vehicles, draft animals, or machinery and tools; and to other individuals and groups at the local levels of developing countries, both rural and urban" (Robinson, 2001). Bank Negara Malaysia (BNM) defined microfinance as the provision of small loans/financing up to RM50, 000 to microenterprises or self-employed individuals, for their business activities not just for income generating activities. Woller & Parsons (2002) submitted that microfinance is the second evolution in credit theory and policy where the first revolution is microcredit. The Grameen Bank defined microcredit as small loans given to the poor for undertaking self-employment projects that would generate income and enable them to provide for themselves and their families. According to Waithera (2008), Micro Finance is way of supplying loans and small credits to finance small projects to help the poor have an income through forming their own small scale business to earn their daily bread and better their living. Micro finance is the provision of credit to the poor and low-income earners to enable engage them in productive activities.

Micro-financial institution that offers savings and credit services is facing realities of market competition due to the liberalization of the economy, excess liquidity in big commercial banks, inadequate financial resources resulting to low liquidity in lending institutions among other factors (Dinos et al, 2010).

Bayang (2009) observed that at the time of loan disbursement, the poor borrowers are pre-occupied with pressing economic problems ranging from shortage of food, lack of seeds for planting and paying medical bills among others, a practice which makes micro finances repayment difficult. In order to overcome challenges of loan defaults, micro finance institutions use various credit lending models such as the Grameen (village) Bank in India founded by professor Yunus (Yunus, 2003). The bank adopted a methodology where a bank unit is set up with a field manager and a number of bank workers covering an area of about 15 to 22 villages. The managers and the workers start by visiting villages to familiarize themselves with local milieu in which they will be operating and identify prospective clientele, as well as explain the purpose, functions and mode of operation of the bank to local population. Lending started with formation of groups of five prospective borrowers. The group is observed for a month to see if the members are conforming to the rules of the bank. Only if the first two borrowers repay the principal plus interest over a period of fifty weeks (50) do other members of the group become eligible for an additional loan. This mechanism ensured that collective responsibility of the group served as collateral on the loan. Against the advice of banks and government, Professor Muhammad Yunus a Bangladeshi economist gave out 'micro-loans' to 17 to 42 poor basket weavers from his pocket. He found out that it was possible with this tiny amount not only to help them survive, but also to create the spark of personal initiative and enterprise necessary to pull themselves out of poverty and in 1983 he formed

the Grameen Bank, meaning 'village bank' founded on principles of trust and solidarity. In Bangladesh today, Grameen has 2,564 branches, with 19,800 staff serving 8.29 million borrowers in 81,367 villages. On any working day Grameen collects an average of \$1.5 million in weekly installments.

The Grameen model emerged from the poor-focused grassroots institution, Grameen Bank, started by Prof. Mohammed Yunus in Bangladesh. It essentially adopts a methodology where bank unit is set up with a Field Manager and a number of bank workers, covering an area of about 15 to 22 villages. The manager and workers start by visiting villages to familiarize themselves with the local environment in which they will be operating and identify prospective clientele, as well as explain the purpose, functions, and mode of operation of the bank to the local population. Groups of five prospective borrowers are formed; in the first stage, only two of them are eligible for, and receive, a loan. The group is observed for a month to see if the members are conforming to rules of the bank. Only if the first two borrowers repay the principal plus interest over a period of fifty weeks do other members of the group become eligible themselves for a loan. Because of these restrictions, there is substantial group pressure to keep individual records clear. In this sense, collective responsibility of the group serves as collateral on the loan. The microfinance institutions have now become a household-name as millions of Kenyans rely on them, almost entirely for their basic needs of food, shelter and clothing and even school fees and medical expenses. They exist as viable and credible alternatives to formal banking institutions which to a large extent are beyond the reach of ordinary Kenyans. They provide the financial support and advantage which lies in the strong structure and shared values of trust mutual and development. They have mobilized funds over ksh.150 billion making them one of the major contributors to

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national economy. The Micro financial Act 2008 required that loans policy and procedures manual specifying the criteria and procedures applicable in the evaluation, processing, Assessing Institutional Factors Contributing to Loan Defaulting in Microfinance Institutions in Kenya be in place.

Another popular model in micro finance is rotating savings and credit associations (ROSCA). ROSCAs form groups of individuals who pay into an account on a monthly basis. Each individual then earns an opportunity to receive a relatively large loan which to invest. The group decides who receives the loan each term, often based on rotating schedule. The initial money is either accumulation of the group members' individual deposits or more frequently, by an outside donation. Loan repayment is ensured through peer pressure. Anyone who does not repay the loan amount risks the privilege to borrow in the future. In microfinance institutions, the loanee pays high interest rates because of the high cost in running microcredit program. Microcredit is also used as the extension of very small loans to those who are in poverty that is designed to spur entrepreneurship and help them out from poverty group. These individuals lack collateral, steady employment and verifiable credit history, which therefore, cannot even meet the most minimal qualifications to gain access to traditional credit. The target population comprising women microenterprises from the low-income households and the loans have no collateral.

In Nepal, the repayment performance of groups formed under the Small Farmers Development Program (SFDP) exhibit a mixed results (Sharma, 1993; Desai and Mellor, 1993) and Bratto (1986) gives examples from Zimbabwe of how group repayment rates can fluctuate according to changing external circumstances. However, not all group loans have low default rates. In order to increase loan repayment most

of the micro financing schemes in Ethiopia provide loans to organized members, who are not required to put up physical collateral but operate in a group mechanism in which risks of non-repayment are transferred to the group. Essentially, most micro financing schemes in Ethiopia have, with slight modifications, adopted the Grameen Bank micro credit mechanisms (Fantahun, 2000).

Even if Chama liability claims to improve repayment rates and lower transaction costs when lending to the poor by providing incentives for peers to screen, monitor and enforce each one's loans, the problem of poor loan repayment performance persists. Chama financing was introduced in Faulu Bank in 2006 with 60 Chama in Bungoma Branch being able to finance approximately 30 million. The recovery rate of the loan was 99% with only two groups defaulting partially. However, in the subsequent years, the performance of the Chama loans has been very wanting. Currently Faulu Bank Bungoma branch has financed 120 Chama a sum of Ksh. 64 million with 80 groups being partially or fully in default representing approximately 67% of the total Chama financed. The performing Chama were financed a total of Ksh 19 million while those who have a rate of default were financed a total of approximately 45 million part of which has been repaid. This is far below the performance of Chama in the preceding studies. This calls for an analysis of factors that may be contributing to this wanting performance of Chama loans in Faulu Bank.

Oladebo and Oladebo (2008) examined the determinants of loan repayment among smallholder farmers in Ogbomoso Agricultural Zone, Nigeria. Results from multiple regression analysis showed that amount of loan obtained by businessmen, years of business experience with credit, level of education, were major factors that positively and significantly influenced loan

repayment. Many researchers have validated the success of peer monitoring in relation to better repayment performance (Hossain, 1988; Siamwalla et al., 1990; Goetz and Sen Gupta, 1996; Manimekalai, 2004). But, the high frequency of meetings does not necessarily always lead to high level of mutual control (Von, 2004).

Based on past literature, the factors affecting loan repayment performance of MFIs can be divided into four factors namely individual/borrowers factors, firm factors, loan factors and institutional/lender factors. Several studies (Greenbaum et al., 1991; Hoque, 2000; Colye, 2000; Ozdemir & Boran, 2004) show that when a loan is not repaid, it may be a result of the borrowers' unwillingness and/or inability to repay. Stiglitz and Weiss (1981) recommend that the banks should screen the borrowers and select the "good" borrowers from the "bad" borrowers and monitor the borrowers to make sure that they use the loans for the intended purpose. This is important to make sure the borrowers can pay back their loans.

Greenbaum and Thakor (1995), suggest to look at a borrower's past record and economic prospects to determine whether the borrower is likely to repay or not. Besides, characters of the borrowers, collateral requirements, capacity or ability to repay and condition of the market should be considered before giving loans to the borrowers. Some authors link the repayment performance with firm characteristics. Such authors like Nannyonga (2000), Arene (1992) and Oke et al. (2007) maintain that firm's profit significantly influenced loan repayment. Besides that, Khandker et al., (1995) raise the question of whether default is random, influenced by wanting behavior, or systematically influenced by area characteristics that determine local productions conditions or branch-level efficiency. Their study on Grameen overdue loans supports the idea of partial influence of area characteristics. Rural electrification, road width, primary educational

infrastructure and commercial bank density are positively correlated with a low default rate as well as predicted manager's pay. Micro-financial institution that offers savings and credit services is facing realities of market competition due to the liberalization of the economy, excess liquidity in big commercial banks, inadequate financial resources resulting to low liquidity in lending institutions among other factors (Dinos et al, 2010).

Godquin (2004) suggests that the provision of non-financial services such as training, basic literacy and health services has a positive impact on repayment performance. Roslan & Mohd Zaini (2009) found that borrowers that did not have any training in relation to their business have a higher probability to default. Screening methods are used to screen out bad borrowers while, Awoke (2004), reports that most of the default arose from poor management procedures, loan diversion and unwillingness to repay loans. Therefore, the lenders must devise various institutional mechanisms that aimed to reduce the risk of loan default.

A few researchers also found out that loan characteristics play an important role in determining repayment performance (Roslan & Mohd Zaini, 2009; Njoku, 1997; Ugbomeh et al., 2008). Copisarow (2000) found out that defaults generally arise from poor program design or implementation, not from any essential problems with the borrowers. Roslan Abdul Hakim et al. (2007) in their study conclude that close and informal relationship between MFIs and borrowers may help in monitoring and early detection of problems that may arise in non-repayment of loans. In addition, cooperation and coordination among various agencies that provide additional support to borrowers may help them succeed in their business. The study compared the good practices and performance of selected MFIs in Malaysia namely; Amanah Ikhtiar Malaysia,

TEKUN, Koperasi Kredit Rakyat and Bank Pertanian Malaysia.

Koopahi and Bakhshi (2002) used a discriminated analysis to identifying defaulter businessmen from non-defaulters of micro finance bank recipients in Iran. Results showed that use of machinery, length of repayment period, bank supervision on the use of loan had significant and positive effect on the agricultural credit repayment performance. On the other hand incidence of natural disasters, higher level of education of the loan recipient and length of waiting time for loan reception had a significant and negative effect on dependent variable.

A research on Factors Affecting loan Repayment Performance of Businessmen in Khorasan-Razavi Province of Iran by Kohansal and Mansoori (2009) showed that businessman's experience, income, received loan size and collateral value have positive effect while loan interest rate, total application costs and number of installments imply a negative effect on repayment performance of recipients. Comparing the elasticities of significant variables indicated that loan interest rate is the most important factor in their model. Business experience and total application costs are the next factors respectively.

The Grameen Bank (2000a) has identified fourteen different microfinance Models four of which have been discussed below and which Faulu Bank has borrowed from in designing its model.

As the name suggests, a bank guarantee is used to obtain a loan from a commercial bank. This

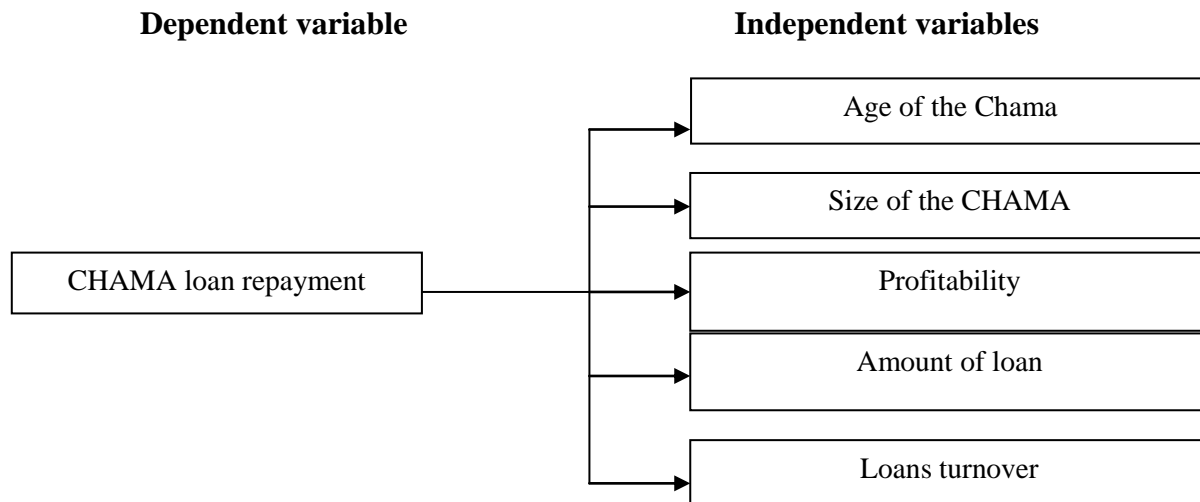
guarantee may be arranged externally (through a donor/donation, government agency etc.) or internally (using member savings). Loans obtained may be given directly to an individual, or they may be given to a self-formed group. Bank Guarantee is a form of capital guarantee scheme. Guaranteed funds may be used for various purposes, including loan recovery and insurance claims. Several international and UN organizations have been creating international guarantee funds that banks and NGOs can subscribe to, to lend or start microcredit programs.

## 6.0. THEORETICAL FRAMEWORK

The theoretical framework is based on The Grameen model. This model is based on group peer pressure whereby loans are made to individuals in groups of four to seven (Berenbach and Guzman, 1994). Group members collectively guarantee loan repayment, and access to subsequent loans is dependent on successful repayment by all group members. Payments are usually made weekly (Ledgerwood, 1999). According to Berenbach and Guzman (1994), solidarity groups have proved effective in deterring defaults as evidenced by loan repayment rates attained by organizations such as the Grameen Bank, who use this type of microfinance model. They also highlight the fact that this model has contributed to broader social benefits because of the mutual trust arrangement at the heart of the group guarantee system. The group itself often becomes the building block to a broader social network.



## 7.0. CONCEPTUAL FRAMEWORK



### 7.1. Independent variables.

Age of the CHAMA is the number of years from the date it was registered with social services department. Size of the group is the number of members in a group. Profit is the difference between selling price and cost price. Amount of loan represents the amount of money granted to the group. Loans turnover represents the number of times loans are taken from Faulu Bank of Kenya by each CHAMA.

### 7.2. Dependent variables.

Dependent variable is loan default. This is the Loan status measured as a percentage of loans in default with those not in default recording zero percent and those whose loan is fully in arrears and have not made partial payment recording 100%.

## 8.0 RESEARCH METHODOLOGY

### 8.1. Research design

The research adopted census method to collect data from the sample group members. The census method incorporated all the groups under financing by the privately owned Faulu Bank of Kenya- Bungoma County.

### 8.2. Target population

The target population was Chama members of 120 Chama loans in Faulu Bank- Bungoma County.

### 8.3. Sample size and Sampling techniques

Out of the 120 Chama loans in Faulu Bank, 80 were partially or fully in default while 40 were not in default. Stratified sampling was used to identify the groups in default and those not in default to be represented in the sample after which simple random sampling was used to select one representative from each group to be represented in the survey 50% from the default group and 50% from non-default group.

### 8.4 Data collection methods

Primary data was collected by use of structured questionnaire while secondary data was obtained from the Chama's Faulu branch administrative files.

### 8.5 Data analysis and model specification

The data collected was classified, coded and tabulated in a spread sheet. The data collected was analyzed using descriptive statistical methods which constituted regression analysis. Descriptive methods were used to describe the sample group in terms of averages while multiple linear regressions was used to measure the extent to which the various factors affect the repayment performance of group loans. We estimated a multiple regression equation of the form:

$$D = \beta_1 + \beta_2A + \beta_3LA + \beta_4GS + \beta_5EX + \beta_6EP + \varepsilon$$

Where: **D** is the percentage of loan in default

**A** is the age of the group

**LA** is the loan amount

**GS** is the group size

**EX** is the loan turnover

**EP** is the profit margin

$\varepsilon$  is the stochastic term

## 9.0 RESEARCH FINDINGS

**Table 4.1** back ground characteristics of the respondents

Independent variable	Minimum	maximum	Average
Age of group	2	12	4.1
Size of group	5	15	17
Amount of loan	250,000	2,500,000	833,333
Profit	50,000	750,000	250,000
Loan turnover	1	10	7.5
Default status %	0	100	31.4

Table 4.1 above shows in summary, that the minimum group size is 5 members which is Faulu Bank's policy on Chama lending. The largest group consists of 15 members. The Chama with the highest loan turnover is 10 which is the number of times the Chama has borrowed since Faulu Bank began its Chama lending program.

The table also shows that the maximum amount of loan financed to a single Chama in Bungoma branch when the data was collected was Ksh 2.5 million and the lowest was Ksh 0.25 million. However, loans are given based on the Chama's ability to implement the project, service the loan and profitability margin.

**Table 4.2** Multiple linear regression results

<b>Multiple R</b>	0.532723478			
<b>R Squared</b>	0.283794304			
<b>Adjusted R<sup>2</sup></b>	0.134584784			
<b>S.E</b>	35.42334356			
<b>Observations</b>	30			
	Coefficient	S.E	t- stat	P – value
Intercept	2.492613952	53.9226111	0.046225765	0.963512804
Age of group	-1.43574642	2.198202668	-0.65314561	0.519870983
Size of group	3.74008474	1.915813332	1.952217723	0.062673102
Amount of loan	1.00401E-05	1.7107E-05	0.586904606	0.562748565
Profitability	-3.1920959	2.039305381	-1.56528587	0.130607327
Loan turnover	-2.72473966	3.473166247	-0.78451173	0.440415169

From the analysis of the data in Table 4.2, it can be seen that the size of the loan has no effect on loan default. The probability of getting such a result is 56%. Thus, with a t-value of 0.6 less than 2, confirms that the amount of the loan has no

significant effect on default rate. Further, the group size has a positive effect on default. From the table above it can be observed that a 1% increase in group size results in 3.740% increase in default. This is statistically significant having a

t- value of approximately 2. The probability of obtaining such a result is however, about 6%. The age of the group, loan turnover and profit have negative effect on default. For every 1% change in age of the group there is a reduction of default by 1.436%, with a probability of 52%. Since age can only increase, it means that the rate of default reduces as the group age increases. Similarly, for every 1% change in profitability there is a reduction of default by 2.725% with a probability of 44%. Loan turnover refers to the number of times loans are taken. The more the number of loans taken, the lesser the risk of default experienced. It can further be observed that for every 1% increase in profitability there is a reduction of default by approximately 3.192% which is slightly significant having a t- value of approximately 2. An  $R^2$  value of 28.4% indicates that age of group; amount of loan, size of Chama; profitability and loan turnover contribute 28.4% variation in loan default while 71.6% is caused by factors not in the study.

This low figure of  $R^2$  could mean that very important variables could have been omitted from the research model specification. It suggests that, based on these results there is a weak positive relationship between the dependent and the independent variables specified in the model. It is therefore worthy noting that age of the Chama, Chama size, Loan turnover and profitability are significant in determining default rate for Chama loans. Other variables that could be of importance are location of the enterprise, experience of CHAMA members and training in finance, and Chama supervision by the lending institutions.

## 10.0 CONCLUSIONS AND RECOMMENDATIONS

The findings of this study are mixed. Large Chama have a high chance of defaulting in loan repayment. This may be attributed to the fact that large Chama face serious management challenges and depict high levels of inefficiencies. They may

often be characterized by slow decision making and infighting among the members of the Chama. In this connection, institutions' financing Chama or following Chama lending models should consider reducing the membership of the said Chama.

It can further be observed that amount of the loan does not affect default rate. Providing that the loan amount is pegged on the Chama' ability to pay, irrespective of the amount is of no consequence to default rate. Lending institutions should therefore not deny borrowers funds on the basis that the amount involved is too large.

The age of the Chama is providing an interesting result. As the age of the Chama increases, the default rate declines. This could be attributed to the fact that the lending organization could have developed a soft spot for this loyal Chama or that the Chama has learnt more relating to the policies on financing such that they are able to take advantage to avoid damaging their image or even that the Chama could have been trained severally on how to manage and utilize the funds lent. Therefore, while it is important to concentrate on the more mature groups to avoid high rates of default, more focus and attention should be on how to attract more groups to increase the loan portfolio.

The turnover of loans per Chama is very crucial. Provided the Chama is able to repay its loan within the stipulated contractual guidelines, it should borrow as many times as possible. These borrowers exhibit reduced default rate as opposed to lending to a totally new Chama. More emphasis should therefore be placed on second or third time borrowers as the default risk is mitigated. This is because they have accumulated wealth of experience in financial management matters. The profitability level of the members comprising the Chama is also critical. This is corroborated by the fact that the higher the profitability level, the lower the default rate. This means that for policy

purposes, Chama should comprise some members whose profitability levels are higher to provide guidance to the other members of the Chama and decision making.

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