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Exploration of Relationship on Loan Conditions and Client Exit from Microfinance Institutions: A Case of Kenya Women Finance Trust North Rift Region of Kenya.

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Abstract
The study took place in North Rift Region of Kenya where escalation of client exits from MFIs was identified as a problem. The purpose of this study was to explore the relationship between Loan conditions and Client exit in Kenya Women Finance Trust. Microfinance is a new concept in finance sector that has evolved rapidly in the last decade. This concept has gained popularity by the use of innovative ways of lending financial products to the low financial earners who don't qualify for credit from formal financial institutions. In recent times many people have been attracted in the first borrowing but are declining to take a repeat financial product. Non exit clients' loan repayment practices or repeat borrowing is critical for the long-term financial viability of microfinance institutions (MFIs). High client exit may hamper organizational and financial sustainability, Simanowitz, (2012). This study sought to explore the relationship between Loan conditions and Client exit in microfinance institutions. Objectives of the study were to; determine the factors related to loan conditions that cause client exit and to determine the relationship between loan conditions and client exit. The study adopted the Diffusion of Financial Mechanisms Theory by Di Maggio and Powell, (1983), The Iron Cage Revisited: A case of Institutional Isomorphism and Collective Rationality in Organizational Fields, at Yale University in New Haven, Connecticut, America The study also adopted a conceptual framework which will guide the process of client exit and the influence of loan conditions on client exist. The beneficiaries of Kenya Women Finance Trust in North Rift Region of Kenya include a total of 37,520 non exit and exit clients. To obtain the sample, the researcher used proportionate random sampling for non exit clients and snowball sampling for exit clients to select a total of 300 non exit and exit clients from the eight towns, according to where they received their loans in the North Rift Region of Kenya. Questionnaires and likert scale were used to collect data from the sample. Data was analyzed by a combination of factor analysis, spearman's correlation analysis. Results from the analysis revealed that there was a high response rate from the questionnaire administered (92%) 276 out of 300 respondents owing to the application of innovative sampling techniques such as the snowball sampling. 147, (53.3%) of the respondents had exited the program and 129, (46.7%) were current clients of the KWFT loan program. Findings reveal that loan conditions correlate negatively well with client exit and low loan amount, high loan processing fees, high interest rates and loan approval procedures as variables also significantly correlate with loan conditions. The research contributes to the debate on the relationships of microfinance institutions' loan practices' and client exits in Kenya.
Key words: Loan Conditions, Loan Practices, Client Exit

1.0 Background to the Study

Microfinance is small scale financial services - primarily credit and savings provided to people who operate small enterprises, (Tilahum and Mekonnen, 2012). Microfinance is an effective tool to fight poverty by providing financial services to those who do not have access to commercial banks and other financial institutions. The low income earners cannot offer any loan security which banks require, have no credit history and loans are generally far too small compared to transaction costs, (Dokulilova et al, 2009). Governance of microfinance institutions is generally characterized by effective management of financial resources which are critical for the long-term financial viability of microfinance institutions (MFIs). The advent of microfinance has experienced a considerable shift in access to financial services by rural people in many developing countries sometimes called "local revolutions", (Claessens et al. 2010). Almost all microfinance institutions aim ultimately at expanding the number of clients being served. One measure of microfinance market scope is the number of active clients served. The number of active clients includes borrowers, depositors and other clients who are currently accessing any financial service, (Rosenberg, 2009). The 2006 award of Nobel Prize to Mohammad Yunus, founder of Grameen Bank in Bangladesh and a pioneer of microfinance attests to the place microfinance has reached in poverty alleviation. In awarding the Nobel Prize to Mohammad Yunus, the Nobel Foundation stated that the prize was being awarded for the recipients "efforts to create economic and social development" (Nobel Foundation 2006). Despite this international consecration, there are still dropouts from MFI. The East African

MFIs case illustrates a high rate of dropouts (25%-60%) of clients some MFI can face and may undermine the success of the programs. A new phenomenon emerging (Simanowitz,2012) points to client exit in microfinance institutions instead of repeat borrowing. Repeat borrowing is critical for the long-term financial viability of microfinance institutions (MFIs). Repeat borrowers reduce microfinance institutions administrative costs, lower risks, and increase organizational productivity. A rising exit rate of clients may indicate major problems for an MFI and even threaten its survival, (Micro Banking Bulletin, April 2004) It is for this reason that exit clients' repayment practice draws attention of financial researchers and practitioners alike. The factors for dropping out identified by previous studies are many and illustrate a wide range of reasons. The majority of studies found that most clients exit due to organizational failures, (Meyer et al, 2001; Wright and Al, 2001; Hulme et al, 1999; Stark and Nyirumuringa, 2002; Musona and Coetzee, 2001). However, (Pagura 2004) has taken the debate a step further in making an in-depth analysis of the factors leading to clients' dropouts, using duration models such as the Time of stay model in order to examine the clients' decision to remain or exit the borrowing relationship in a group loan program. In line with the above insights, this study will explore the relationship between loan practices and client exit in microfinance institutions. The study will focus on loan conditions with an aim of establishing the causes of client exit and also the form of relationship that exist between loan conditions and client exits.

1.1 Statement of the problem

The financial sector in Kenya experiences stark reality of persistent high levels of client exit. About 50 % of micro-finance programmes is coupled with the seemingly inability of the Kenya government to deal with the problem, (World Bank, 2011). High client exit may increase operational costs for microfinance institutions, which usually portrays client exit as a negative impact mostly perceived as a threat to the organization's financial health. Client exit may reduce repeat borrowing which is the mainstay of microfinance institutions, which benefit more from repeat loans due to the lending curve effect. Client exits are likely to discourage other clients from joining, reduce prospects for sustainability and being among the factors constraining outreach (Simanowitz, 2012). In a microfinance institutions environment that exhibit's escalation of client exits, donors, policy makers and ultimately taxpayers withdraw from supporting an industry that shows little signs of sustainability, (Mustafa *et al*., 1996). It is on the basis of this background experience that warranted the study for the researcher to explore and disclose the impeding relationship between KWFT loan conditions and client exit in microfinance institutions using a case of Kenya Women Finance Trust in the North Rift Region of Kenya.

2.0 Literature Review

2.1 Introduction

Microcredit is the provision of small amounts of money to clients by a bank or other institutions. Microcredit can be offered, often without collateral, to an individual or through group lending, (UN Department of Public Information, 2004). Low income clients often need more than credit, (Helms, 2006). Microfinance therefore moves beyond only credit services and includes a range of activities such as loans and credit, savings and deposit services, insurance, transfer services, and other financial products targeted at low income clients, (UN Department of Public Information, 2004). Credit services are mainly entrepreneurial loans, but can also include educational loans. Insurance products include for example health schemes. Deposit services aim at encouraging saving as a tool to increase welfare. An additional benefit of savings is that it can be used as a relatively inexpensive source of capital for relending by MFIs thereby decreasing the costs of loans, (Morduch 1999). Microfinance contributes in three ways. Firstly, it reaches the poor thereby combating poverty and contributing to empowerment of especially women. Given the higher rate of client exit in KWFT compared to the industries average it is likely that its potential contribution towards uplifting the livelihoods of vulnerable groups may not be realized if factors associated with client exit are not immediately identified and addressed. Secondly, microfinance initiates the building of institutions, contributing to a country's infrastructure and distribution channels of services. Finally, microfinance contributes to deepening countries' financial system's reach.

2.2 Lending Conditions in Finance

Clients exit, in finance and banking, has not been modeled explicitly per se; however, an extensive literature exists on the benefits of lending relationships. Theoretically, bilateral benefits of long-term relationships are formally modeled in, (Rajan 1992), (Berglof and von Thadden, 1994) and (Boot and Thakor 1994). Microfinance practitioners, especially those of older, more established microfinance organizations (MFOs) for which growth has slowed, are starting to take a serious look at clients' exits and its drain on profitability. Once growth begins to wane, the impact of client exit on profitability and overall sustainability becomes much more visible and dramatic. The state of the sound loan conditions is still considered inadequate by many observers but adoption is increasing and research is keeping pace evaluating adoption and impact on client retention and exit. The factors influencing adoption of sound loan condition practices and the barriers to adoption are a major research focus as proponents look for ways to increase adoption. Research includes case studies of specific sound loan condition practices systems within micro-finance institutions as well as broad overviews of the state of loan condition practices in the globally and locally. Two studies by (Fonkych and Taylor, 2005; Bower, 2005) estimate adoption and implementation levels and examine the impact on retention of clients. They find that as of 2005 the rate of adoption was increasing but the overall level was still very low; micro-finance institution adoption of best practice sound loan condition systems was between 20 and 30 percent. There was also large variation in adoption rates related to size of MFI, and industry tenure. Small MFIs were slower adopters and hence experienced greater client turnover. Younger MFIs were correlated with an increased probability of adoption with a consequent less turnover (Fonkych and Taylor, 2005). A more recent survey of MFIs in Kenya from 2007-2008 found larger MFIs are still more likely to adopt sound loan condition practice and therefore more likely to retain clients. Only 4% reported having adopted full best practice loan condition systems with a score of 90 % and above but 13% reported having a basic system with an index of less than 50 % (Des Roches, 2008). (Wang et al., 2005) performed an analysis of factors influencing client exit and came to similar conclusions as (Fonkych and Taylor, 2005). Micro-finance institution market, financial, and organizational factors are all related to the adoption of microfinance sound condition practices and therefore rate of client exit. Larger micro-finance institutions are more likely to adopt information management systems. Although, Cutler et al., (2005) found larger micro-finance institutions were much less likely to adopt best practices of loan management. (Parente and Van Horn 2006) addressed older verses younger micro-finance institution adoption of loan condition practices behavior in more detail. They concluded these organizations behave in ways consistent with the organization's motives. Older micro-finance institutions adopt sound loan condition practices to reduce a client's length of stay while younger micro-finance institutions adopt microfinance sound loan condition practices to increase the number of clients served. However, not all studies identify the same adoption influences. (McCullough 2007) did not find an effect of older status on the probability of adoption. (McCullough 2007) also identifies a decreasing effect of micro-finance institution scale on the probability of adoption throughout the 1990's unlike (Wang et al. 2005) and (Fonkych and Taylor 2005). Though the adoption process is better understood today than it was even a few years ago research in this area will continue as microfinance sound loan management adoption continues. Even if sound loan condition practices are shown to improve the retention of clients globally and locally the improvements will eventually be evaluated in relation to the costs. Cost savings need to be realized through higher quality clients to offset the costly new sound loan condition practices systems. Some researchers have begun to address the issue using the limited available data. A study of the impact of microfinance sound loan management practices on micro-finance institution costs using data from 2007 - 2011 found sound loan condition practices do reduce micro-finance institution operating costs 3-5% but there is a substantial lag time before those costs are realized, 5 years, and those savings are only achieved if there is a large enough asset base within the micro-finance institution (Borzekowski 2009). A cost-benefit analysis of a Women's Micro-finance institution in South Africa found recommended loan management practices saved the micro-finance institution $28.5 million dollars over 11 years. The cost to develop, implement and operate the practices however, was $11.8 million (Kaushal et al. 2006). An improved feature related to the practice at the same micro-finance institution resulted in a $3.49 million net benefit after 5 years through greater client retention (Mavigilia et al. 2007). These studies prove that it is possible to achieve a positive return on investment through policies aimed at client retention (Chaudhry et al. 2006). A study by (Hillestad et al. 2005) predicted over $1 billion in savings annually due to retention of clients if standardized loan condition practices were incorporated in all micro-finance institutions throughout the country (Hillestad et al. 2005). Realistically, the 100% adoption rate of such loan condition management systems assumed in Hillstad et al is not likely to occur soon.

3.0 Research Methodology

3.1 Research Design

This study employed a co-relational research design. This type of research is done to determine relationship among two or more variables and to explore their implications, (Fraenkel and Wallen, 2000). Co-relational design avoids manipulation or intervention on the part of the researcher other than that required to administer the research instruments for data collection. Specifically, this type of research is undertaken when a researcher wants to look for and describe relationship that may exist among naturally occurring phenomena without trying in any way to alter these phenomena. The study targeted a population of 37,520 clients' of Kenya Women Finance Trust loanees in the North Rift Region, this included non exit and exit clients. A sample of 300 respondents was considered adequate for this study and was selected because it arose from good evidence based on the study Koul (1986) as representative of the population .The choice of this region for the study was ideal because it was an identifiable segment of the microfinance organization sector with similar business attributes.

3.2 Data Collection Procedures

Data was collected using structured questionnaires administered by the researcher from the selected non exit and exit respondents in KWFT. The questionnaire had items that captured the general information deemed relevant for the study using objectives. A 5 point Likert rating-scale ranging from strongly agree to strongly disagree was adopted to collect data. The items elicited responses with regard to KWFT loan conditions on non exit and exit clients' loan repayment practices. Open ended items were included in the questionnaire to allow participants to bring out unnoticeable responses.

3.3 Data Analysis and Presentation

Data was analyzed by a combination of factor analysis, spearman's correlation analysis with the assistance of SPSS for extraction of results.

4.0 Findings and Discussions

4.1 Findings

In most microfinance institutions most of the members either give up because of the process followed during loan repayment or because of the loan conditions that they should meet before their loan is processed. This study sought to determine the relationship between loan conditions and exit of KWFT clients. The study initially sought to establish the percentage contribution of each priority variable in the loan conditions factor. This was necessary to find out the highest priority areas to prevent client exit.

Table1. Showing correlation of selected variables to the Loan condition Factor

			Loan Conditions Factor
Spearman's rho	KWFT high interest charge rates part of loan condition factor that influence Client Exit	Correlation Coefficient	.600**
		Sig. (1-tailed)	.000
		N	275
	KWFT high loan processing fee part of loan condition factor that influence Client Exit	Correlation Coefficient	.606**
		Sig. (1-tailed)	.000
		N	275
	Low KWFT loan amount part of loan condition factor that influence Client Exit	Correlation Coefficient	.618**
		Sig. (1-tailed)	.000
		N	275
	Long time taken by KWFT to approve loan part of loan condition factor that influence Client Exit.	Correlation Coefficient	.306**
		Sig. (1-tailed)	.000
		N	275
	Loan Condition as factor	Correlation Coefficient	1.000
		Sig. (1-tailed)	.
		N	275

Source: Survey Data (2013)

From the Table 1, loan conditions as a factor had four priority variables that accounted for its influence on client exit. The correlations' of loan conditions to the respective variables are depicted in the table; Loan conditions was significantly correlated with high interest rate $r = .600^{*}$, high loan processing fees $r = .606^{**}$, Low loan amount $r = .618^{**}$ and long loan approval duration $r = 306^{**}$ Coefficient of determination, R^2 was used to show the variability accounted for by each of the variables; thus high interest rate, 36%, high loan processing fees 36.7%, Low loan amount 38.2% and long loan approval duration 9.3%. The variables are significant ($p< .001$)

Table2. Showing the relationship between Loan conditions and Client Exit

			Client Exit
Spearman's rho	Loan condition as a factor	Correlation Coefficient	-.142**
		Sig. (1-tailed)	.009
		N	275

**. Correlation is significant at the 0.01 level (1-tailed).

Source: Survey Data (2013)

The results show that the significance is not by chance but by the influence of the variables as shown by two asterisks (**). From the results shown in Table 2, it is seen that, loan conditions as a factor correlates negatively well with client exit $r = -0.142$. $p < 0.001$. The negative correlation implies that as you tighten the loaning conditions, there will be a negative retention of loan clients. By taking the coefficient of determinant, loan conditions as a factor contribute 28.4 % variability in client exit.

4.2 Discussion of Results

In light of the divergent views and accompanying supportive empirical findings on the relationship between loan conditions and client exit, the study's results provide further empirical evidence that loan conditions correlates negatively well with client exit. This implies that as loan conditions are tightened then there will be a negative retention of loan clients. Low loan amount, high loan processing fees, high interest rates and loan approval procedures as variables also significantly correlate with loan conditions as a factor. Using studies done in Africa primary East Africa, Kanshangaki, (1999), Maxmambali (1999) examined client exist issues of 17 Micro Finance Organizations, most of which offering group loan and revealed that annual exit rates are high in this part of the world, ranging from 14 to 60 percent. Clients' in this region are more frequently pushed out of the microfinance market due to loan conditions than they are pulled out in form of competition and client maturity factors, thus the study found evidence in support of the significant correlation between loan conditions and client exit.

5.0 Summary, Conclusions and Recommendations

5.1 Summary

Respondents in this study got between Ksh. 40,000- 60,000, 91 (33%) thereafter very few clients were able to access a higher amount. The number of times the respondents borrowed revealed that most 113 (40.9%) only borrowed twice, indicating lack of desire for continuous repeat borrowing, study also revealed that, 226 (81.9%) of the respondents state that the grace period given by KWFT is not adequate. On the relationship between loan conditions and client exit, the study's results show that loan conditions correlates negatively well with client exit. Low loan amount, high loan processing fees, high interest rates and loan approval procedures as variables also significantly correlate with loan conditions as a factor. Loan conditions as a factor alone contributed 28.4% variability in client exit.

5.2 Conclusion

The study was set out to explore the relationship between loan conditions and client exit in Microfinance Institutions; A case of Kenya Women Finance Trust (KWFT) North Rift Region. The study was designed to identify key causes of client exit from the KWFT loan program. The study was also to establish the relationships that exist between various loan conditions and client exit. Lastly the study sought to know the contribution of the variability of loan condition factor to client exit. Empirical findings were synthesized to answer the study's purpose and research questions. Loan conditions correlates negatively well with client exit. Low loan amount, high loan processing fees, high interest rates and loan approval procedures as variables also significantly correlate with loan conditions as a factor. Loan conditions as a factor alone contributed 28.4% variability in client exit. Loan conditions as a factor with a standardized beta coefficient of -.086 indicates that as loan conditions increases by 1 std deviation, the client retention decreases by -.086 std deviations if the effects of other predictors are held constant.

5.3 Recommendations

From the findings it is apparent that a lot need to be done to reduce client exit. KWFT should increase the loan amount offered, check the interest rate charged, reduce loan processing fees and shorten the loan approval duration.

5.4 Suggestions for Further Research

The findings of the study were limited to the area of study and thus there is need for further research on the same field of study. The following are some areas that need further research; the sustainability of microfinance clients paying commercial interest rates and the loan products to be offered to microfinance clients.

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