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EFFECT OF LOAN REPAYMENT DETERMINANTS ON CUSTOMERS PERFORMANCE AMONG COMMERCIAL BANKS BRANCHES IN BUNGOMA COUNTY, KENYA

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ABSTRACT

Commercial Banks as financial intermediaries play a cardinal role in an economy by mobilizing savings, reducing costs of financial transactions and managing risks. Careful management of banks' credit portfolios is therefore essential for their stability as a significant amount of bank revenue is from interest income generated from lending. But over the years decline of loan performance by borrowers is growing and is becoming more complex task. The main objective of this study was to investigate determinants of loan repayment among customer performance of commercial banks in Bungoma County, Kenya. Specifically, the study sought to find out the effect of loan security, on customer performance among customers of commercial banks in Bungoma County. Both descriptive and inferential analysis revealed that all conceptualized predictor variables significantly influenced loan repayment among customers of commercial banks in Bungoma County (the outcome variable). That is; loan security (β=0.551 (0.112) on customer performance. The study concluded that first, commercial banks engaging in viable loan security measures reduce loan delinquency ratios which can consequently positively influence customer performance. The study recommended that first, commercial banks should engage in viable loan security measures meant to reduce loan delinquency ratios which can consequently influence positive customer performance; and secondly, commercial banks should craft feasible book keeping, debt and financial management programs to equip both lenders and borrowers with sound book keeping, budgetary, debt or financial management skills required to boost loan repayment performance.

Keywords: *loan repayment determinants, loan security, customer performance, commercial bank*

1. Background of the study

Commercial banks are financial institutions that play a very important role in an economy. Specifically, they channel financial resources from savers to lenders (deficit units). In developing economies, they help borrowers who have no access to capital markets (Akkizidiz, 2012).

According to Fallon (1996), commercial banks face three types of risks, financial risk-with credit risk being a component, operational and strategic risk. These risks have different impact on performance of commercial banks.

The magnitude and the level of loss caused by credit risks compared to others are severe in causing banks failures (Njeru et al., 2014). The concept of credit can be tracked back in history and it was not appreciated until and after the Second World War when it was largely appreciated in Europe and later in Africa (Haron, 2012). Banks in USA advanced credit to customers with high interest rate which sometimes discouraged borrowers and hence the concept of credit didn't become popular until the economic boom in USA in 1885 when the banks had excess liquidity and wanted to lend the excess cash (IFSB, 2003).

In Africa the concept of credit was largely appreciated in the 50's when most banks started opening the sections and department to give loans to white settlers. But as commercial banks give credit to borrowers, loan repayment issues emerged. The first part is influenced by factors relating to commercial banks or lenders. Items of this category are interest rate, repayment period allowed, loan processing procedure/preliminary credit analysis, repayment monitoring and how long it takes for the bank to disburse loan (Oni *et al*., 2005; Appiah, 2011; Awunyo, 2012).

According to (Williamson, 2012) loan repayment can be expressed in form of the non-performing loans (represents credits which the banks perceive as possible loss of funds due to loan defaults) and also known as the non-performing loan ration. A non-performing loan is either in default or close to being in default in terms of repayment (Appiah, 2011). This requires bank to create a provision for such a doubtful debt. Subsequently, if the loan is not repaid ultimately, it becomes a bad debt Samuel, (2011). Most researches on determinants of loan repayments in banks have yielded mixed results with in exhaustive conclusions and recommendations for further research on the matter.

2. Loan Repayments: Global Perspective

Globally, studies on determinants of loan repayments have been done in several countries. For example, Stern and Feldman (2014) while studying on influence of loan amount on loan defaulting in commercial banks in selected banks in USA found that larger loans have greater risk exposure, so the variable cost per currency is higher, that is, if lenders do not take extra care, there could be more loan defaults. According to Njanike (2010) further pointed out that average balance; a proxy for depth of outreach is directly proportional to revenue and default risk and amount of loans could be directly related to risk (Awunyo 2012).

In studies done in selected commercial banks in Australia, Arsyad, (2006) found that loan recovery rate for larger loans were lower than small loans (Nkusu, 2011). That is, the small size of loans reduces credit risk for new borrowers, thus a sound credit record should be built before bigger loans are granted to customers. Khaled (2016) asserts that it may be an important incentive for the customers to receive more loans in the future if they have good payment records and lenders will tend to award higher loans to those with good credit.

3. Statement of the problem

Most commercial banking institutions are currently facing the problem of repayment of loans determinants (Njeru et al., 2014). Repayment of loans is not only harmful to the financial performance of commercial banks, but they also have other serious negative impacts in economic recovery and development of a country (Oni et al., 2015). Thus, potential loan borrowers may be denied the opportunity to access loans from commercial banks, since a big chunk of bank funds that could be made available to them as loans are still tied to non repaid loans.

Commercial banks in Kenya are not an exception on the problem of non repayment of loans because in the recent past, the Central Bank of Kenya put two banks on receivership as of April 2016 that is Chase Bank and Imperial Bank of Kenya due to poor financial performance majorly caused by non repayment of loans. Further, Karekaho,(2009) reported that profits for commercial banks in 2015 shrunk by 5 per cent from Sh139.7 billion to Sh134 billion and specifically, the National Bank of Kenya went through a rough patch with its profit after tax having dropping to Sh138.1 million in September 2017 compared to Sh521 million reported over a similar period in 2016 (CBK,2017).In this regard, existing empirical data on determinants of loan repayment in commercial banks in Kenya does not give exhaustive explanations for non repayment of loans by borrowers, hence the need for this study that endeavors to investigate the influence of loan security, portfolio characteristics, portfolio diversification plus financial literacy on loan repayment among customers of commercial banks branches in Bungoma County, Kenya.

4. Objectives of the Study

The objective of this study was to investigate the loan repayment determinants on customers performance among of commercial banks branches in Bungoma County, Kenya.

5. Theoretical Review

A theory is a reasonable statement or group of statements which are supported by evidence meant to explain some phenomena. Finance theories are very critical as they complement empirical investigations and they must be included at every level due to their explanatory and predictive capabilities (Ngumi, 2013). This section presents a theoretical review of the study. The theories reviewed here are liquidity preference theory and default theory.

6. The Default Theory

This theory was proposed by Vigenina in 2004 to explain investors defaulting payment in terms of money given for investment. The density of non-payment arises when money borrowers are capable to pay but reluctant to convene their money obligations. With combined legal responsibility, if a borrower discards to reimburse his or her share of the loan credit, the entire rate in the group is taken carefully as being default behind subsequent loans (Boeve, 2010).

This encourages the grouping of interest rates in the banks whichever to pay back for offending associate or to make use of social demands on him. As a result of this encouragement, the bank lenders are competent to attain repayment of each and every loan by means of high prospect. As soon as it comes in the direction of mortgage contracts (if a borrower discards mortgage repayment), the loan official once more plays the central role by means of warning as well as if necessary authorize non-payment clients. Apart from the danger of advertising the security within a small number of days, they can slash off borrowers commencing extra way in to loans. According to Berge, (2013) the assets of non-payment fear are the main official of highs interest rates within defaulting theory.

Credit risk is basically the risk faced by investor to lose money from borrower who fails to make payments. This may result in default or default risk. Investors may lose interest and principal that can result in increased cost of collection and decreased cash flows. Previous studies have noted that high credit risk controls (CRC) result in low chances of defaults (Acharya, 2006).

Therefore, credit risk could be alleviated by utilizing danger based evaluating, contracts, credit protection, tightening and broadening. The intelligent and effective lawful collection takes place for better performance of the loan. If financial institutions do not follow well administered collection procedures, this would result in loan defaults (Horcher, 2015).

Previous studies, Szczesmy, A. & Schenk, G. (2010) Eze and Ibekwe, (2007) indicate that microfinance institutions need to have strong and effective credit risk management policies for ensuring consistent recoveries from clients. For microfinance institutions, the main source of income is the credit, which is why they need to have strong policies for credit risk management. The advance reimbursements may be questionable and the accomplishment of giving out credit relies on the philosophy connected to assess and to grant the credit.

Subsequently Finscope, (2012) observed that the determinants of Bank affect lending performance in Germany. the credit choice ought to be focused around a careful assessment of the danger states of the loaning and the qualities of the borrower. Various approaches have been created in customer evaluation preparation by budgetary establishments which run from generally straightforward techniques, for example, the utilization of subjective or casual methodologies, to reasonably mind boggling ones, for example, the utilization of mechanized reproduction models (Horcher, 2005; Horne, 2007). It is broadly recognized that lack in credit risk administration and management policies by monetary establishments have helped altogether to the financial downturn around the world.

7. Empirical Literature Review

Loan Security

In this study loan security is conceptualized in terms of types of security, type of collaterals used, value of collateral and loan recovery policies among others. For instance, Nkusu (2011) analyzed factors affecting loan security, loan repayment and bank performance. The study findings indicated that a lot has been reviewed in terms of lending activities of various commercial banks. Some opinions deliberated on the factor responsible for banks willingness to extend much credit to some sector of the economy without security.

Finscope (2010) observed that no Closing Cost loans are subject to terms and conditions of Fremont Bank's Application Fee Agreement, which lists the specific costs and fees the borrower will not pay. An application fee may be required after a loan application is submitted, which will be refunded as a credit on Closing Disclosure statement. Application fee is non-refundable if the loan is denied, withdrawn or does not close for any reason. Borrower is responsible for paying all fees and charges imposed by brokers or an existing third party lender (for example, payoff demand statement fee and/or a reconveyance fee) as well as any prepayment penalty imposed by any third party lender.

In the USA, Graeber (2011) noted that refinancing to lower monthly payment may extend the number of monthly payments and/or the total amount paid when compared to current loan situation. Other loan programs are also available. If securities are a service member on active duty, prior to seeking a refinance of the existing mortgage loan, please consult with the legal advisor regarding the loss of any benefits they are entitled to under the Service members Civil Relief Act or applicable state law and Program available for properties located. Ezirim (2015) indicated that Loans with points and/or fees (Closing Costs) may have a lower nominal interest rate than "No Closing Cost loans and discount points are a form of prepaid interest paid up front in exchange for a lower interest rate.

The reduced interest rate will only save money over a long term; the longer a borrower plans to live in the home, the better the chance of reaching the "break-even" point. The success of every lending activity to a great extent therefore, hinges on the part of the credit analysts to carry out good credit analysis, secured loans, presentation, structuring and reporting.

Mohammad (2010) did a study on risk management in Bangladesh banking sector with a main objective to investigate the contribution of credit risk on non-performing loans. He found that, the crux of the problem lies in the accumulation of high percentage of non-performing loans (NPL over a long period of time. Not all loan programs are available in all areas for all loan amounts. Actual rates may vary. Loans security is subject to credit qualifications and underwriting requirements (Moti, 2011).

Wondimagegnehu (2012) also studied on determinants of non-performing loans in Ethiopian banks. The study showed that in relation to collateralizing loans and occurrence of non-performing loans, only 33.8 and 24 percent of respondents agree with statement that collateralizing loan protect loan default and non-collateralized loans would be defaulted respectively (Nkusu, 2011). However, respondents were of the view that borrowers would service their debt if they have pledged collateral. (Berge, 2012) with regard to the relation between collateralizing loans and occurrence of nonperforming loans, only 33.8 and 24 percent of respondents agree with statement that collateralizing loan protect loan default and non-collateralized loans would be defaulted respectively. However, respondents are of the view that borrowers would service their debt if they have pledged collateral. Therefore loan security is a key determinant of loan payment and consequently affect financial lending institutions profitability.

8. Research Gap

The review of the literature for this study reveals the existence of many knowledge gaps with respect to the determinants of performance among customers of commercial banks, especially in the Kenyan context. This is because most of the reviews of the literature are empirical and non-empirical researches done on influence of general credit management practices on loan performance in developed and few developing countries. In addition, empirical literature review shows the existence of non-conclusive studies with varying results on the influence of varied factors on loan repayment. This has left a significant knowledge gap of influence of such specific factors such as loan security, portfolio characteristics and diversification plus financial literacy on loan repayment. Further, existing research in this area does not also exhaust conclusive explanations of the effects of the named factors loan security and on customer performance in commercial banks, since most of them focused on just generally, any financial institution.

9. Research Methodology

This study employed a survey research design. The questionnaire or survey can be a written document that is completed by the person being surveyed, an online questionnaire, a face to face interview, or a telephone interview (Moyo and Rohan, 2016).

The study targeted 94 management employees from 13 commercial banks branches operating in Bungoma County, Kenya. This comprised of branch managers, operation managers, business banking supervisors, personal banking supervisor, and credit managers of commercial banks in Bungoma County as annexed in the list of appendices.

Table 1: Distribution of the Target Population.

Category of employee	No. of respondents
Branch Managers	13
Operations Manager	13
Business Banking Supervisors	18
Personal Banking supervisors	24
Credit Managers	26
Total	**94**

According to Kothari, (2014) any statement made about the sample should also be true for the population. Census method was preferred since data collection through a total of 94 management employees. Data was analyzed by descriptive statistics where the regression analysis was further computed to investigate the relationship between independent and dependent variables.

RESEARCH FINDINGS AND DISCUSSION

This presents research findings of the study and discussion. It includes reliability tests, response rate, demographic profile of respondents, descriptive statistics, assumptions of regression model and inferential analysis as well as their interpretations.

10. Validity and Reliability Tests

To test validity and reliability of research instruments, ten (10) respondents were used in a pilot study done in Kenya commercial Bank, Kakamega branch in Kakamega County, which neighbors Bungoma County-the study area. Items on the questionnaires were checked for clarity of words and statements in line with study variables and necessary corrections on the questionnaires were done to ensure content validity. Reliability test was done using Cronbach alpha test, where the responses yielded an acceptable measure of more than 0.7.

11. Descriptive Statistics

Descriptive statistics in this study are summation of responses based on independent variable (loan security) and the dependent variable (customer performance). Descriptive statistics thus shows the outcomes of responses to each of the statements on the study variables using Likert scale with values ranging from 5 to 1; that is; 5=Strongly Agree, 4=Agree, 3= Uncertain, 2=Disagree and 1= Strongly Disagree. The results are presented in the table form showing frequencies of responses as per each statement and its corresponding percentage score in brackets.

12. Loan Security

This assessed the influence of loan security on customers performance in commercial banks in Bungoma County. Respondents were asked to respond to 7 statements; (i) Collateralizing loans protect loan default; (ii)The bank sometimes give credit to¸ some borrowers without security (iii) Type of loan security granted affects customer performance; (iv)Type of collateral security given influence customer performance (v) The value of collateral security given influence customer performance; (vi)The use of loanee’s salaries enhances customer performance and (vii)Imposing personal loan guarantee measures is viable strategy in customer performance. The results are presented in table 2.

Table 3: Loan Security

Frequency and Percentage (%)							
Statement	**5**	**4**	**3**	**2**	**1**	**Mean**	**Std. Dev**
1.Collateralizing loans protect loan default	8(9.4)	57(67.1)	2(2.4)	11(12.9)	7(8.2)	3.56	.896
2.The Bank sometimes give credit to some borrowers without security	3(3.5)	13(15.3)	6(7.1)	51(60.0)	12(14.1)	2.34	.818
3.Type of loan security granted affects customer performance	15(17.6)	49(57.7)	3(3.5)	10(11.8	8(9.4)	3.62	.785
4.Type of collateral security given influence customer performance	13(15.3)	51(60.0)	4(4.7)	12(14.1)	5(5.9)	3.65	.887

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5.The value of collateral security given influence customer performance	14(16.5)	55(64.6)	2(2.4)	8(9.4)	6(7.1)	3.74	.971
6.The use of loanee's salaries enhances customer performance	17(20.0)	58(68.2)	3(3.5)	5(5.9)	2(2.4)	3.98	.831
7.Imposing personal loan guarantee measures is viable strategy in customer performances	10(11.8)	48(56.5)	7(8.2)	15(17.6)	5(5.9)	3.51	.798
Grand mean = 3.48							

From table 3, the majority of the respondents (67.1%) agreed that collateralizing loans protect loan default which was reinforced by 60% of respondents who disagreed that the bank sometimes gives credit to some borrowers without security. This implied that loan security is a viable measure for reducing loan delinquency which consequently help improve customer performance. Use of collateral security is supported by Nkusu (2011) who posited that type of collaterals used plus value of collateral has a bearing on customer performance. This is further supported by 57.7% of respondents, who agreed that the type of loan security granted affects customer performance implying that non-secured loan could attract higher delinquency than collateralized ones.

Further, 60.0% of respondents agreed that type of collateral security given influence customer performance and 64.6% also agreed that the value of collateral security given influence customer performance. This implies that loan securities that are really valued by customers taking loan will push them to be committed in repayment loans for fear of repossession than undervalued loan securities which loanees do not mind if repossessed.

More so, 68.2% of respondents agreed that the use of loanee's salaries enhances customer performance. This is because customer performance by check off system is a sure and consistent way of loan recovery. Use of loanee's salaries also makes the loanee be committed to customer performance for fear of being black listed by credit reference bureaus which can affect the blacklisted loanee's future prospects of applying for loan facilities.

Lastly, most respondents (56.5%) agreed that imposing personal loan guarantee measures is viable strategy in customer performance. This indicated that loanee defaults affect customer performance, the risk will be passed to guarantors like most SACCOs do. This normally scares potential guarantors from guaranteeing perennial loan defaulters thus; assist the bank in reducing loan delinquency ratios.

13. Inferential Analysis

The inferential analysis was based on linear and multiple regressions, assumptions of multiple regression analysis were taken into consideration. The study showed that loan security; *$r = .682$ at $p = 0.000$*). Linear regression analysis was employed to test four study hypotheses; that is, to test the influence of loan security on customer performance in commercial banks in Bungoma County, Kenya.

Table 4: Model Summary

					Change Statistics				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	R Square Change	F Change	df1	df2	Sig. F Change
1	.682[a]	.466	.459	.76452	.466	72.315	1	83	.000

ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	42.267	1	42.267	72.315	.000[a]
	Residual	48.512	83	.584		
	Total	90.779	84			

Coefficients[a]

		Unstandardized Coefficients		Standardized Coefficients		
Model		B	Std. Error	Beta	T	Sig.
1	(Constant)	.436	.114		3.840	.000
	LS	.765	.125	.682	8.504	.000

a. Dependent Variable: customer performance

The above model summary shows that R squared is 0.466 which implies that 46.6% of variation in customer performance is explained by loan security while other factors not in the model accounts for 53.4% variation in customer performance. Further coefficient analysis reveal that there exists a positive and significant effect of loan security on customer performance (β= 0**.**765 (0.125); *at P<.001*). The results therefore imply that a single increase in loan security measures will lead to 0.765 unit increase in customer performance. Therefore, the linear regression equation model is; $\boldsymbol{Y = 0.436 + 0.765X_1}$ Where: Y = customer performance, X = Loan Security, ε = error terms

Linear regression analyses showed both the F values and the corresponding Significant values that the predictor variable (loan security), is indeed different and that it affect the dependent variable (customer performance) in a different manner, hence, the possibility of running multiple regression. Requisite model assumptions for running multiple regression analysis were also checked earlier and met.

The results shows that the F-statistics produced is significant (F=32.255, *significant* at *p<.001*), thus confirming the fitness of the model. For an R square of 0.617, we can say that the study model explains 61.7% of the variations in the commercial bank's customer performance.

CONCLUSIONS AND RECOMMENDATIONS

14. Conclusion

This completes the research with a summary of study findings, concluding comments drawn from the summarized study findings, recommendations plus suggestions for further research. The study investigated the loan repayment determinant affecting customer performance among commercial banks in Bungoma County, Kenya. The study tested a total of four hypotheses, that is; (i)Ho_1; There is no significant relationship between loan security and customer performance among commercial banks in Bungoma County. Hypothesis stated that there is no significant relationship between loan security and loan repayment among customers of commercial banks in Bungoma County. The study results indicate that there exists a positive and significant effect of loan security on customer performance among commercial banks in Bungoma County (β=-0.551 (0.112), at *p<.01*. The study results therefore imply that a single increase in loan security measures will lead to 0.551 unit increase in customer performance among customers of commercial banks in Bungoma County.

The study results indicate that there exists a positive and significant effect of loan security on customer performance among commercial banks in Bungoma County. In this regard the study concludes that commercial banks engaging in viable loan security measures reduce loan delinquency ratios which can consequently positively influence customer performance.

15. Recommendations

From the results, it is recommended that commercial banks should engage more viable loan security measures meant to reduce loan delinquency ratios which can consequently influence positive customer performance, if commercial banks are to achieve the desired customer performance, they should consider all key customer characteristics that can significantly influence customer performance.

16. Areas for Further Research

Based on the findings and the gaps in the study, a similar study can be carried out for Commercial banks in other counties in order to test whether the conclusions of this study will be valid. The focus of this study was on determinants of customer performance among Commercial banks, it is, therefore, recommended that a similar study can be replicated in all commercial banks in Kenya. A similar study can also be done but targeting borrowers of bank loans so as to get their perception about determining factors of non-repayment of bank loans by borrowers.

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