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THE INFLUENCE OF STAFF COMPETENCE ON CREDIT RECOVERY IN DEPOSIT-TAKING MICROFINANCE INSTITUTIONS IN NAKURU COUNTY, KENYA

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Abstract:
The study looked into how staff competencies affect loan recovery at deposit-taking microfinance firms in Nakuru County, Kenya. Microfinance institutions have evolved into self-sustaining financial organizations that provide credit for a fee and profit. Despite efforts to prevent loan defaults, MFIs are experiencing an increase in loan defaults. The study employed two theories: knowledge asymmetry and delegated borrower monitoring. The findings revealed that staff competencies had a substantial impact on credit recovery among MFIs. MFI management should guarantee that the crediting team has enough capacity to detect and prevent bad debt and that adverse debt reports are addressed promptly. Management and staff should inform clients about the repercussions of loan default, as bad debts lead to institutional failure.

JEL: G21, O16, D82, G32, M12

Keywords: staff competencies, loan defaults, deposit-taking microfinance, loan recovery

1. Introduction

Proper loan management is crucial for the financial success of microfinance institutions (MFIs) and the overall economic performance of a country. Non-performing loans (NPLs) have consistently increased in Kenya's banking sector, emphasizing the importance of routine loan evaluation and an early warning system to avoid systemic disasters. Poor

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loan collection has caused significant liquidity problems and financial losses for institutions, prompting many to seek government assistance. Microfinance institutions provide financial services to low-income individuals who do not have access to traditional financial services due to a lack of bank loans and savings. These organizations have a great impact on the country's economy and development because they provide free, guaranteed small loans to low-income and unemployed people. Although financial products are not profitable, microfinance institutions assist businesses by providing financial services such as payments and insurance, as well as financial services that help customers save money and obtain loans.

Microfinance institutions (MFIs) need to effectively manage credit since microcredit is their main source of income. However, a 2010 report from Kenya's Central Bank showed high credit risk in MFIs, resulting in rising non-performing loans and limiting credit availability in rural areas. MFIs can improve service quality by leveraging traditional savings practices among the poor (Kariuki, 2014). It is important for financial services to be adaptable and innovative to meet clients' needs and have a long-term impact on poverty alleviation. MFIs face repayment challenges (Mwaka, 2017).

Microfinance is important for reducing poverty and increasing access to social services such as housing, health, education and food. It enables low-income families to escape loan sharks, open small businesses, create jobs and increase their income (Gudza, 2014; Abaidoo & Apong, 2015).

Africa's microfinance industry has expanded dramatically over the years, with loans totaling $8.5 billion and serving 8 million users (Zouair, 2018). The sector has progressed through several stages, with assistance from non-governmental organizations, credit unions, and banks. However, due to insufficient infrastructure, many rural communities continue to lack access to microfinance institutions (MFIs), which are primarily concentrated in cities. Informal providers, such as Tontines in Cameroon, Sensus in Ghana, and *Banquiers Ambulants* in Benin, have attempted to fill the void, but they face obstacles such as restricted credit, weak investment abilities, and high interest rates. In Kenya, the rise of mobile phones, as illustrated by M-pesa, has helped close the gap, but the danger of default remains considerable. Various internal and external factors contribute to loan defaults in Kenyan financial institutions, including inadequate management, poor communication channels, untrustworthy audit frameworks, poor credit rating, and poor credit management skills. Despite efforts to reduce defaults, non-performing loans have increased over the years, leading to credit risk and negatively impacting financial performance. A 2011 report by Musyoki and Kadubo found that defaults account for 54% of total credit risk.

2. Statement of the Problem

Microfinance institutions have evolved from relying on donor subsidies to being self-sustaining entities that provide credit at a fee. Loan defaults have been documented, although it is unclear whether they are the result of staff incompetence in credit recovery,

which has an impact on the organization's profitability and lending capacity. This trend jeopardizes the viability and sustainability of MFIs and undermines their objective of providing loans to the rural unbanked population. Microfinance institution (MFI) staff in Africa often lack the necessary skills to assess clients' creditworthiness, resulting in increased loan defaults. Additionally, some MFI institutions cannot train their staff on loan management, leading to poor credit assessment, misappropriation of funds, and poor investment decisions. In some cases, staff is not timely enough to detect the chances of loan default, making them ineffective in default mitigation.

Microfinance institutions' performance is strongly reliant on an efficient credit management system because their income is derived from loan interest. However, research on the impact of loan default on MFIs is scarce, and there are few findings based on existing literature. This study intends to supplement past research by looking at how staff competencies affect credit recovery in microfinance banks in Nakuru County, Kenya. The purpose of this study was to assess the influence of staff competence on credit recovery in deposit-taking microfinance institutions in Nakuru County, Kenya.

3. Literature Review

3.1 Information Asymmetry Theory and Borrower Delegated Monitoring Theory

In the 1970s and 1980s, George Akerlof, Michael Spence, and Joseph Stiglitz developed information asymmetry theory to provide a convincing explanation for widespread events that traditional equilibrium-based economists could not handle. The Information asymmetry theory underlies a premise that a disparity of knowledge between consumers and suppliers in a given market environment can lead to inconsistent results (Ross, 2018). According to (Kouam & Tchegho's, 2021), World Bank global economy research, access to credit information remains a serious concern. According to the authors, adequate market information asymmetry is defined as knowing the possible risks and rewards of investment projects for which funds had been set aside. Arguably, perceived knowledge asymmetry results in two distinct challenges for MFIs: the moral hazard challenge that is present in the form of monitoring entrepreneurial conduct) and adverse selection challenges that present in terms of making errors during and after making the decision to lending (Mboto, Atseye, Doris, & Nkamare, 2022). Since information on a customer's suitability is not freely available, factors that influence the suitability of a client must, therefore, be adequately addressed before the credit is issued.

This theory was the basis of a study by (Tsujii, 2011) that revealed that some microfinance institutions are not adequately transparent and honest to their borrowers. The author established that microfinance institutions, particularly those charging high interest rates, are often hesitant to discuss their loan terms openly. Microfinance institutions use flat interest rates, which generally appear lower than they actually are for borrowers. Such inefficiencies result in information symmetry. In establishing the influence of staff competencies on credit recovery among microfinance institutions, one of the measures of such competency is occurrences of information symmetry. MFIs have

a role in elevating poverty, which can only be achieved through proper communication with creditors to avoid cases of loan defaults and the occurrence of auctioneering. Mboto, Atseye, Doris and Nkamare (2022) investigated credit administration and how it influenced the performance of selected microfinance institutions in Cross River State, Ghana. To improve performance, the study recommended proper loan appraisal, follow-up, and an elaborate screening procedure for loans by credit officers. It was also used by (Inuwa, 2021) in a study that looked into how borrower's attributes and that of their business influenced MFIs in deciding to approve credit applications. The information symmetry theory was relevant to this study because it dealt with communication between creditors and MFIs. Customers' lack of knowledge about their loan status causes such inefficiencies, which can lead to information asymmetry.

Another theory that explains this study is the borrower delegated monitoring theory. It is also known as Diamond's 1984 theory of delegated tracking of borrowers, which can also be referred to as a financial institution's tracking of a borrower; it refers to knowledge collected before and after a loan is provided, such as testing requests for loans, investigating the borrower's ongoing reliability, and guaranteeing that the borrower follows the contract's terms. Borrower delegated monitoring theory incorporates financial intermediary costs by giving incentives for delegated monitoring, which adds to lower operational costs even in a risk-free market. The hypothesis serves as the foundation for (John, Abu, & Luisa's, 2021) investigation of the role of delegated monitoring in crowd-funded microfinance, with a focus on the Kiva platform. Kiva is a crowd-funding website that collects money to lend to borrowers through microfinance institutions (MFIs), which serve as middlemen and manage loan agreements on the crowd's behalf. According to the study, customers who receive regular supervision from MFIs are more likely to repay crowd-funded loans on time.

Moya-Dávila and Rajagopal (2020) used the theory in a study on the role of modern financial intermediation and the role of relationships in lender-borrower interaction. According to the findings of the Mexican study, social connections and a closer relationship developed between the MFI and women influenced higher payback performance. In the setting of this research, the theory informed us that the MFIs' responsibility is to screen and assess the borrower's creditworthiness as well as acquire important information to aid in the lending process. Following that, these activities engage the MFIs during the management of the debt collectors' officers and, as a result, test the staff's competence in loan recovery. According to the theory argument, credit officers require a continuous assessment of the contract after advancing the loan in order to increase performance.

Diamond (1984) criticizes the delegated monitoring theory, saying that it gives rise to a new private information problem: the person doing the monitoring as an agent now has private information. Further, it cannot be verifiable whether the monitoring has been undertaken. Delegated monitoring can lead to delegation costs. On the other hand, delegating monitoring to one agent avoids duplication but can cause incentive problems

for the agent who was delegated the monitoring task. Consequently, small lenders will not observe the effort put into monitoring or the information monitored by the agent.

3.2 Past Studies

Borrowers' creditworthiness can be assessed by their willingness and aptitude, as well as the institutions' lending characteristics. Borrowers' repayment behaviour is determined by their views regarding the loan, willingness to repay, and ability to repay, resulting in a choice between repaying and defaulting (Garomsa, 2017). Some internal and external factors that influence borrowers' repayment attitudes can significantly affect lending institutions' payback recovery rates.

Agola (2014) conducted research on Kenyan microfinance institutions' credit policies and financial performance. The study was survey-based and used regression analysis to assess the link between the variables. The study sample included 59 MFIs registered by member-based institutions. It discovered that staff loan assessment techniques are critical to reducing loan defaults and advised MFIs to improve their client appraisal techniques in order to avoid having un-creditworthy clients, which could lead to loan delinquency. In terms of recovery, this would improve financial performance by having credits paid and a positive loan portfolio.

To avoid the consequences of loan defaults, it is critical that the borrower understand the details of loan collection procedures. Mwangi (2016) conducted a survey study titled "Effect of Loan Collection Procedures and Loan Default in Microfinance Institutions in Kirinyaga County." A survey containing descriptive data was conducted with 300 MFIs, employees being the subjects. MFIs can hire a consultant to help them develop strategies and thus become more competitive in loan collection, according to the findings (Mwangi, 2016).

The conclusion was that if management and workers are made aware of extra external variables that they were previously unaware of, such as market adoption of new technology, their perspective will shift. Chamshama (2015) conducted a study in Tanzania titled "The impact of staff training and financial management on the performance of financial institutions in Tanzania." The study found a positive relationship between workforce training and economic stability in Morogoro City. The study found negative impacts on the financial management and financial stability of MFIs in Tanzania.

Sangwan (2023) explored whether microfinance could be developed flexibly to improve economic outcomes in northern India. Low-interest loans used by most financial institutions (MFIs) had weekly repayment schedules, no variances, some benefits for lending to the poor, and the money arrived seasonally. Previous studies have shown that these bonds could hurt the health of poor borrowers, leading to capital losses, property sales, borrowing too much from the wrong sources, reduced consumption and income, and, in some countries, deteriorating borrowers' health. impressed by stress and anxiety. Research shows that customers who pay monthly invest more in their business and make

more money than those who pay weekly and regularly. This finding was compared to data from this study examining employee abilities and credit recovery.

Obeng and Krah (2016) published a paper titled "Default risk and debt recovery strategies of microfinance institutions in a comparative study of MFIS in Ghana." This was a descriptive analysis study that collected data from two MFIs in Ghana, namely Skilimit Microfinance Limited and Principal Capital Microfinance Limited, via a survey method. This study on default risk and debt recovery strategies of microfinance institutions suggested that MFIs strive to reduce default risk by implementing early loan default detection strategies and effective application screening before granting loans to their clients to reduce the occurrence of bad loans.

Afonso (2017) studied the Dominican Republic's microfinance sector, which was seen as a solid market, with best practices for avoiding over-indebtedness being widely and efficiently implemented. Best practices have been described as self-regulation products based on data collection and analysis and have proven not to achieve the goals of Dominican Business Copy. While financial constraints support the idea of a large microfinance business, researchers argue that the importance of development and high competition prevent microfinance from delivering positive results in society, and this will become a reality due to the changing worldview in the sector. change the situation. Assuncao and Agier (2011) provided evidence of this by examining documents. It shows that the written resolution request is submitted to the credit committee for approval after reviewing the post-case conditions and that the credit agreements are complied with in cases where late payments may occur. all help improve credit performance.

Moranga and Omagwa (2017) examined the debt management and financial performance of selected financial institutions in Nairobi city and town, Kenya. Data for this study were provided by 36 employees, including branch managers, loan officers, debt collection officers and finance officers, from nine financial institutions in Nairobi and the city. According to the findings, management is responsible for the recruitment of debt management professionals and the relevant regulatory requirements regarding the financing of MFIs. Debt collection strategies, according to the study, are critical for an effective debt management system, and as a result, the organization should implement rigorous and precise debt follow-up methods for late payments.

Lucia *et al.* (2021) examined the impact of frequent group discussions on the repayment of microcredit borrowers using a quasi-natural experiment conducted by the South African Small Business Foundation, a South African microfinance institution that provides cooperative credit groups. In the pilot program, the meeting frequency has been reduced from two nights to one month, and group members are not obliged to attend every meeting, but they can send representatives. To assess the impact of the policy change, a difference-in-differences regression was conducted using an appropriate control group using a standardized score comparison procedure. Although it was predicted that the pilot project would increase loan repayment delays and reduce deposit groups, it had a negative impact on loan groups. Data mining techniques applied to the case studies revealed that a lack of trust in groups where members did not meet regularly

outside of the payback meeting was one of the reasons for the experiment's negative results. The study concluded that group meetings are an effective tool to promote pooling of resources among microfinance borrowers.

4. Methodology

This study adopted a descriptive research design where primary data was collected using a standardized questionnaire with closed-ended questions. The structured questionnaires enabled the researcher to ask precise questions based on the desired outcome. It was designed to collect data about a particular phenomenon by using surveys. The study used data from 94 public relationship officers in four DTMs, and sought to investigate the impact of staff competency on loan payback in MFIs in Nakuru County, Kenya. In this study, each individual in the population was assigned to a particular cluster. The DTMS population, in this case, was divided into three geographical clusters: Naivasha, Nakuru, and Molo. The sample size was 50 respondents. Cluster sampling allowed for cost-effective research with a low level of variability. A pilot study was carried out in a neighboring county, Nyandarua County, to assess the reliability of the research instrument, and the reliability coefficient was obtained using Cronbach's alpha.

5. Findings

5.1 Descriptive Analysis

There were four variables used as proxies for staff competence: creditworthiness assessment skills, staff's credit training skills, staff early detection of credit default and credit staff professionalism. The dependent variable was credit recovery and the moderating variable was legal framework. Opinions were sorted on a Likert scale of 1-5 for the proxies. An average mean of 3.37 was recorded, which indicated an agreement that employee creditworthiness assessment skills have an influence on credit recovery in deposit-taking microfinance institutions in Kenya. The average response for this staff's credit training skills was 2.91, indicating that participants disagreed with the statement about the staff's credit training skills. The average response staff early detection of credit default was 2.97, indicating that respondents were unsure whether they agreed or disagreed with the statement about workers discovering credit difficulties early. For staff professionalism, an average mean of 3.18 was achieved, indicating that respondents agreed with the statement about staff professionalism. For the moderating variable, legal framework, an average score of 3.61 was achieved, indicating that participants an agreement agreed with the statement about the legal framework.

5.2 Inferential Analysis

From the results shown in Table 1, H_5 is rejected implying that the relationship between staff competence as represented by creditworthiness assessment skills and credit

recovery is moderated by legal framework. Therefore, MFI managers in Kenya may need to be concerned with the legal framework when making credit recovery decisions.

Table 1: Moderating Effect of Legal Framework on Influence of Staff Competence on Credit Recovery

Variable	Model1	Model2	Model3	Model4	Model5
Credit Worthiness Assessment Skills	-.01294368***	-.01348925***	-.01332166***	-.01458113***	-.0140008***
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Credit Training Skills	2.4644988***	2.4942337***	2.536071***	2.811709***	2.8406829***
	(0.38)	(0.38)	(0.41)	0.45	0.46
Early Loan Default Detection Skills	-.82439766***	-.8072154***	-.81486641***	-1.0139421***	-.9483577***
	0.17	0.17	0.18	0.23	0.24
Credit Staff Professionalism	.00926216	.0024183	.00132412	.02066694	.0046876
	0.03	0.03	0.03	0.04	0.04
Legal Framework	.08416965***	.07002539***	.07952357*	.03967438	.0395156
	0.01	0.02	0.04	0.05	0.05
Cwas*Lfw		.00035991	.00045223	.00032164	-.00001978
		(0.00)	(0.00)	(0.00)	(0.00)
Cts*Lfw			-.01081992	-.06059251	-.07655188
			0.04	0.05	0.06
Eldds*Lfw				.03658934	-.07655188
				0.03	0.03
Csp*Lfw					.00346833
					(0.00)
_cons	1.6603619***	1.7208943***	1.6983084***	1.8701593***	1.8075775***
r2	.5332	.5344	.5345	.5366	.5374
r2_a	.5275	.5276	.5265	.5275	.5271
rmse	1.26	1.26	1.261	1.26	1.26

Legend: * p<0.05; ** p<0.01; *** p<0.001
Source: Author, 2024.

The results of model 2 indicate that the variance of credit recovery accounted for by creditworthiness assessment skills and legal framework is 53.32% before the inclusion of interaction term (creditworthiness assessment skills * legal framework). The multiple regression model 2 produced R^2 = .5344, and p < .05. The model reveals a statistically significant relationship between credit recovery (dependent variable), legal framework (moderating variable) and creditworthiness assessment skills (independent variable).

The results of model 3 indicate that the variance of credit recovery accounted for by early credit training skills and legal framework increased to 53.45% from 53.32% on further inclusion of interaction term (credit training skills * legal framework). The multiple regression model (model 3) produced R^2 = .5345, and p < .05. The model reveals a statistically significant relationship between credit recovery (dependent variable), legal framework (moderating variable) and credit training skills (independent variable).

The results of model 4 indicate that the variance of credit recovery accounted for early loan default detection skills and legal framework increased to 53.66 from 53.45% on

further inclusion of interaction term (early loan default detection skills * legal framework). The multiple regression model (model 3) produced R^2 = .5366 and p < .05. The model reveals a statistically significant relationship between credit recovery (dependent variable), legal framework (moderating variable) and early loan default detection skills (independent variable).

The results of model 5 indicate that the variance of credit recovery accounted for credit staff professionalism and legal framework increased to from 53.66 % to 53.74% on further inclusion of interaction term (credit staff professionalism * legal framework). The multiple regression model (model 3) produced R^2 = .5374 and p < .05. The model reveals a statistically significant relationship between credit recovery (dependent variable), legal framework (moderating variable) and credit staff professionalism (independent variable).

As a consequence, the null hypothesis that staff competency had no effect on credit recovery in Nakuru County, Kenya, was rejected. All interaction variables are significant ($p < 0.05$), rejecting Hypothesis 2 that legal frame work has a beneficial impact on the link between capacity development and loan recovery in MFIs in Nakuru County, Kenya. Therefore, the predictive equation for multiple regressions is shown below;

$$Y = 1.81 - .014X_1 + 2.84X_2 - .948X_3 + .005X_4 + .0395X_5 - .000X_6 - .076X_7 + - .077X_8 + .003X_9 + \varepsilon;$$

According to the predictive framework, staff credit worthiness assessment abilities, credit training skills, early detection of credit default, and the influence of credit staff professionalism all had a moderating effect on the legal framework. The results were congruent with those of Agbana, Bukoye, and Arinze-Emefo (2023), who assessed the influence of credit risk management on financial institution performance in Nigeria. Buluma, Kung'u, and Mungai (2017) stressed robust management systems based on severe credit terms and standards, while Wambua *et al.* (2021) viewed credit evaluation in SACCOS as an internal policy necessity.

6. Conclusion

This study concluded that before granting a loan, most financial institutions consider the borrower's history, past payments, the customer's willingness to pay, and security and housing adequacy. Employees of financial institutions usually evaluate the capital of the enterprise, the willingness of the borrower to do business, the ability of capital to do business, the actual income, and the brand target of the payday loan.

Half of the MFIs had regular training for their clients, but the other half did not. On the other hand, slightly more MFIs participated in lending than those that did not. While most staff are trained in financial literacy, most MFIs are not trained in sales planning and management. Most employees have access to computer applications, and most MFI employees are equipped with the latest tools and software. Nevertheless,

despite the good performance of most MFIs, many MFI staff are unable to interpret loan terms and prepare payment plans.

The study concludes that staff do it early enough to detect default, and those complaints are raised in time. In a significant number of MFIs', the crediting team has limited capacity to prevent bad debt from arising, even though bad debts were low in most cases. Most of the MFI's complaints about bad debts are not attended to promptly. In addition, customers are not aware of the consequences of loan default, and bad debts result in institutional failure in their roles. Late detection of bad loans leads to a negative image of the MFIs. The study concluded that most MFI employees comply with time regulations and work overtime. They are able to complete tasks on time, and half, if not all, of MFI staff have good communication skills. At most MFIs, employees communicate in a friendly and personal way, are flexible, and generally comply with the dress code. However, most MFI staff are not consistent in reporting their responsibilities.

The following findings determine the rejection of the null hypothesis (H01): Employee credit scores are not linked to loan repayments at banking deposit institutions in Nakuru County, Kenya. Since the prior hypothesis was shown to be false, the hypothesis "Employee Ratings have a positive impact on deposit returns of financial institutions in Kenya Nakuru County" was adopted. As a result, this study demonstrates that employees' ability to analyze loans has a beneficial effect on loan repayment at a 5% significant level.

7. Recommendations

Based on the foregoing, this study recommends that MFI in Kenya and other financial institutions' management and leadership should ensure that their employees work by managing the solutions, obligations, liabilities, conditions, and resources that must be met before loan disbursement.

Management in the financial sector should focus on training in lending, financial skills, sales planning and management, and negotiating loan terms and payment plans. The management of financial institutions should ensure that the credit team has sufficient capacity to detect and prevent the occurrence of bad debts and pay timely attention to non-performing loans. Management and employees should always inform customers of the consequences of bad debts when bad debts render the company inoperable. MFI employees must ensure that they complete their work on time, communicate well, and follow through on their work.

Conflict of Interest Statement

The authors declare no conflicts of interest.

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