Credit Risk Management and Financial Performance of Micro - Finance Institutions in Kenya

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Abstract

Purpose: The purpose of this study was to find out the effect of credit risk management factoring institutional size as a moderator on Financial Performance of Micro Finance Institutions in Kenya. Specifically, the study sought to find out: effect of Credit Appraisals, Credit Risk Control, Credit Terms, Credit Approvals and Institution's Size on the financial performance of Micro Finance Institutions in Kenya.

Methodology: The study adopted a descriptive survey research design and used census technique. Data was collected using questionnaire for primary and record survey sheet for secondary. Data was analyzed using descriptive and inferential statistics.

Findings: The study findings established that Credit Appraisal, Credit Risk Control, Credit Terms, Credit Approvals and institution size have significant effect on performance of Micro Finance Institutions in Kenya. Effective credit risk management reduce bad debt, improve cash flow and profitability.

Unique Contribution to Theory Practice and Policy: The study recommends Micro Finance Institutions in Kenya to adopt risk management practices to improve on financial performance. The study recommends for further study including unregistered micro finance institutions across the country by employing comparable variables and different technique.

Keywords: *Credit Risk Management, Microfinance Institutions, Risk Assessment, Financial Performance*

INTRODUCTION

Globally, credit risk management (CRM) has evolved into a complex challenge for financial institutions due to dynamic business environments and increasing customer diversity. Studies from the U.S., Europe, and Asia highlight the widespread adoption of CRM practices, emphasizing their role in enhancing profitability and reducing unexpected losses. Scholars such as Levy et al. (2017) and Catherine (2020) underscore the importance of systematic credit appraisal, risk control mechanisms, and structured credit terms. However, despite these advancements, microfinance institutions (MFIs) remain vulnerable to credit-related shocks, especially when CRM systems are poorly implemented or misaligned with borrower realities. The literature also reveals conceptual tensions. Some studies affirm CRM's positive impact on financial performance, while others question its efficacy, pointing to methodological and contextual inconsistencies.

In Sub-Saharan Africa, CRM practices are increasingly recognized as pivotal to financial sustainability, yet implementation remains uneven. Nigerian and Ghanaian studies (Addae, 2014) show that poor credit control and limited institutional capacity often undermine performance. MFIs in the region face structural constraints, including limited access to credit scoring infrastructure and weak regulatory oversight. These regional insights expose a critical research gap: while CRM is acknowledged as essential, few studies integrate its multiple dimensions (credit appraisal, risk control, terms, and approvals) into a unified framework. Moreover, existing research tends to focus on commercial banks or rural setups, leaving MFIs underexplored. This gap is both methodological (fragmented variable analysis) and contextual (limited sectoral focus), warranting a more integrated and localized investigation.

Kenya's microfinance sector is relatively advanced, with over 50 registered MFIs operating under a regulatory framework established by the Microfinance Act of 2006. Despite this progress, MFIs continue to grapple with poor financial performance, driven by non-performing loans, liquidity constraints, and weak credit approval systems. Local studies (Wanja & Jagongo, 2017) affirm the relevance of CRM but often isolate variables or rely on outdated data. The thesis identifies a clear research gap: the need to empirically assess the combined effect of credit appraisal, risk control, terms, and approvals on financial performance within Kenyan MFIs. By synthesizing global best practices and regional challenges into Kenya's evolving financial landscape, the study aims to offer a nuanced, evidence-based framework for improving CRM and enhancing institutional sustainability.

Problem Statement

The effectiveness of credit risk Management of Micro- Finance Institutions largely dictates their success as these institutions generate their earnings from interest earned on loans advanced. Crisis in the Micro-finance Institutions call for compact credit risk management control measures. The current study would like to evaluate the effect of Credit Appraisal, Credit Risk Control, Credit Terms, and Credit Approvals on financial performancebe of Microfinance Institutions in Kenya. A few previous studies have synchronized the effect of these four variables, though in general perspective. Therefore, it is correct to state there exists a methodological, theoretical, contextual and conceptual knowledge gap in that regard. In addition, while some studies done by Charles, Okaro, and Kenneth (2013) found no correlation between Credit Risk Management and the financial health of microfinance institutions, other researchers (Wanja and Jagongo, 2017) concluded that Credit Risk Management strategies have effect on financial performance. Few studies (Muturi, 2016) examined the credit management strategies that MFIs are known to utilize. Therefore, it was important that a study be conducted to establish effect of these four variables on financial performancebe of Microfinance Institutions. The results of this research showed where other researchers had fallen short of and experimentally contributes to the existing literature. This research used more recent data and a more recent time frame.

LITERATURE REVIEW

Theoretical Framework

The study's theoretical foundation integrates Agency Theory, Asymmetric Information Theory, and Financial Intermediation Theory to explain the relationship between credit risk management (CRM) and financial performance in microfinance institutions (MFIs). Agency Theory, proposed by Jensen and Meckling (1976), highlights the conflict between shareholders and managers, suggesting that governance mechanisms like structured credit appraisal and approval systems can align managerial decisions with institutional goals. Asymmetric Information Theory, introduced by Akerlof in the 1970s, emphasizes the imbalance of knowledge between lenders and borrowers, advocating for rigorous credit evaluation to mitigate adverse selection and moral hazard. These theories collectively justify the inclusion of CRM components such as credit appraisal, risk control, and approval processes as essential tools for reducing default risk and enhancing institutional profitability.

Financial Intermediation Theory, developed by Gurley and Shaw (1960) and expanded by Diamond and Dybvig (1983), positions MFIs as intermediaries that manage liquidity and reduce

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transaction costs in imperfect markets. It underscores the role of credit terms and approval systems in maintaining solvency and operational efficiency. By synthesizing these theories, the study constructs a conceptual framework that captures governance, informational, and institutional dimensions of CRM. This theoretical triangulation not only supports the empirical investigation but also contextualizes global insights within Kenya's microfinance landscape, offering a robust foundation for assessing how integrated CRM practices influence financial outcomes.

Conceptual Framework

A conceptual framework serves as a visual and narrative roadmap that outlines the relationship between the study's variables. The conceptual framework was as illustrated below.

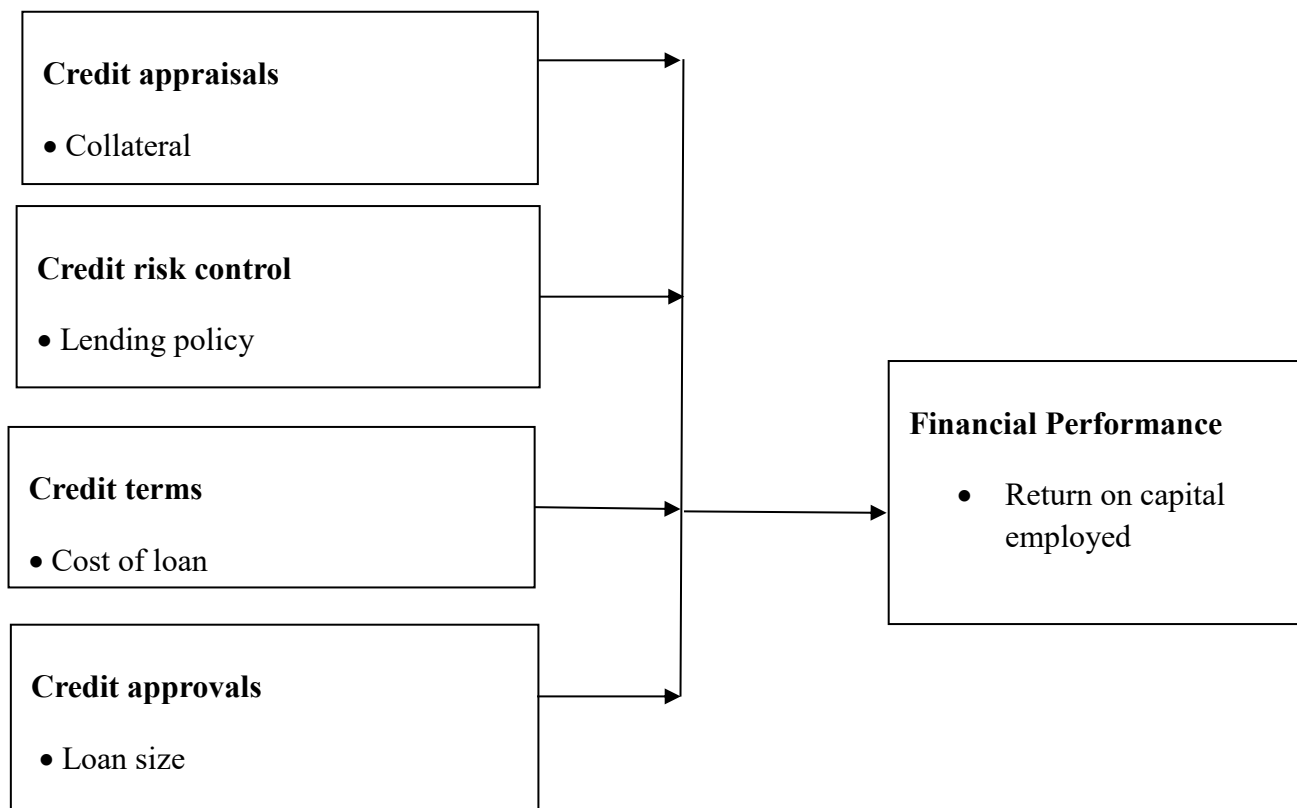**Independent Variables**   **Dependent Variable**

Figure 1: Conceptual Framework

Empirical Review

Murthy and Mariadas (2017) investigated loan default determinants among MFI borrowers in Shah Alam, Malaysia, using a sample of 120 respondents. Their findings revealed that borrower age and business type significantly influenced loan failure, with Cronbach's Alpha values exceeding 0.8, indicating strong internal reliability. However, the study's scope was narrow, focusing solely on borrower demographics while excluding institutional perspectives and broader credit appraisal dimensions. The research did not incorporate credit managers' insights or institutional credit evaluation frameworks. This gap underscores the need for a more comprehensive appraisal model—such as the 5Cs (character, capacity, capital, conditions, collateral)—to assess creditworthiness more holistically. The current study addresses this limitation by integrating institutional-level variables and expanding the appraisal criteria to include credit scores, agency reports, and loan purpose.

Kisala (2014) examined the impact of credit risk control on loan performance among Kenyan MFIs, analyzing data from five institutions over a five-year period. Using ROE, CAR, and NPL ratios as indicators, the study found a strong negative relationship between credit risk indicators and profitability, particularly between NPL and ROE. While the study confirmed the relevance of CRM to financial health, it focused narrowly on risk control and omitted other CRM dimensions such as credit appraisal, terms, and approvals. Moreover, the limited sample size and reliance on historical data restrict generalizability. The current study builds on Kisala's findings by incorporating a broader set of CRM variables and using more recent data to capture evolving institutional practices and regulatory dynamics.

Sindani (2012) explored the effectiveness of credit management systems in Kenyan MFIs, emphasizing the role of credit terms and stakeholder involvement in shaping loan performance. The study found that steep interest rates negatively affected loan effectiveness, while participatory credit term formulation improved creditworthiness. Complementing this, Wangechi (2012) highlighted that service quality and customer retention enhanced sustainability and profitability in MFIs. However, both studies lacked empirical integration of CRM components and did not quantify the financial impact of specific credit terms. The current study addresses this gap by empirically testing the effect of credit terms—alongside appraisal, control, and approvals—on financial performance, thereby offering a more structured and measurable framework.

Kolapo et al. (2012) applied a panel model to assess the long-term impact of credit risk on the financial performance of Nigerian commercial banks. Using ROA and credit risk indicators such

as NPL/LA and loan loss provisions, the study found a consistent negative effect of credit risk on profitability across all banks. Similarly, Poudel (2012) examined CRM in Nepalese banks and established a statistically significant negative relationship between ROA and both default rate and capital adequacy ratio. While these studies offer robust macro-level insights, they focus on commercial banks and overlook the unique operational dynamics of MFIs. Their findings, though valuable, are not directly transferable to the microfinance context. The current study fills this contextual gap by tailoring the CRM-performance relationship to Kenyan MFIs, whose clientele, regulatory environment, and risk exposure differ markedly from those of commercial banks.

METHODOLOGY

This study adopted a descriptive survey research design. The study limited itself to effects of credit risk management on Financial Performance of selected micro finance institutions in Kenya. This study aimed at all of the microfinance institutions in Kenya that are in the Association of Microfinance Institutions (AMFI) database in Nairobi City County. Since the population was relatively small and the institutions being studied were easily accessible, a census methodology was deemed appropriate for this study. Data was acquired from selected microfinance organizations, published journals, and publications from the Kenya Association of Microfinance Institutions. The primary data was collected by use of a questionnaire, while secondary data by record survey sheet. A sample size of five micro finance institutions respondents were chosen to form the pilot study. Cronbach's Alpha coefficient and the test-retest method were used to calculate the reliability of the study's instruments. The content validity of the instrument was determined through piloting information, where the response of the subjects was checked against the research objectives. The Collected data was encoded and entered into SPSS (SPSS version 20). Inferential statistics were used to draw conclusions about the data, while descriptive statistics (frequency, percentage) were used to help make sense of the numbers. This study used the mean, median, and standard deviation as its primary statistical methods. The outcomes of the data analyses were displayed in tables and charts, and the interpretation of the results was based on the aims of the study. The research results were analyzed, conclusions and suggestions were made. Hierarchical regression was used to establish the influence between independent and dependent variables. The t - test was used to test statistic. The probability value (p value) for each t - value tested the significance of regression coefficients at 5% significance level. The Analytical model for the study took the form below:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon$$

RESULTS

Return Rate

The study had a target population of 52 micro finance institutions but only 50 qualified for requirements of the study, hence were supplied with questionnaires that resulted into a return rate of 96.15% of the response, which is regarded appropriate.

Descriptive Analysis

Effect of Credit Appraisals on Financial Performance of Micro finance Institutions in Kenya.

These are simplified comments to the question of whether Credit Evaluations affect the Financial Performance of MFIs in Kenya. The descriptive outcomes are shown in table below.

Table 1: Credit Appraisals

Statement	5	4	3	2	1	Mean	Std. Dev
The MFI adheres to reasonable, well-defined credit evaluation criteria.	(16%)	(24%)	(30%)	(18%)	(12%)	3.63	0.989
Individual and counterparty credit limits have been imposed by the financial institution.	(24%)	(16%)	(18%)	(30%)	(12%)	3.49	0.928
3. The MFI has a well-defined procedure for approving both new and current credit.	(18%)	(36%)	(18%)	(10%)	(18%)	3.74	1.053
All credit extensions are made on an arm's-length basis.	(18%)	(34%)	(18%)	(16%)	(14%)	3.14	1.104
A competent credit evaluation procedure influences loan performance.	(22%)	(24%)	(16%)	(16%)	(22%)	3.32	1.132
The Credit Risk Management system follows a sound credit evaluation procedure.	(16%)	(22%)	(28%)	(18%)	(16%)	3.50	0.883
Valid list wise=50 Grand mean =3.47							

With a grand mean of 3.47 across all items, the overall perception of credit evaluation practices is moderately positive but reveals gaps in consistency and institutional rigor. As Juliana (2017) emphasized, effective credit risk management requires well-trained managers to monitor and mitigate exposure, while Catherine (2020) noted that institutional performance hinges on proactive credit control measures.

Effect of Credit risk control on Financial Performance of Micro finance Institutions in Kenya

These are summarized responses on whether Credit Risk Control influences Financial Performance of MFIs in Kenya. The descriptive results are presented in table 2 below.

Table 2 Credit Risk Control

Statement	5	4	3	2	1	Mean	Std Dev
The MFIs' credit risk strategy and important credit risk rules are approved by the board of directors.	(20%)	(24%)	(18%)	(22%)	(16%)	3.40	0.962
The senior management implements the credit risk plan established by the board of directors in a rigorous manner.	(18%)	(28%)	(24%)	(8%)	(22%)	3.50	0.884
Management formulates policies and procedures for recognizing, assessing, monitoring, and controlling credit risk.	(24%)	(24%)	(20%)	(12%)	(20%)	3.49	0.928
The policies and procedures designed for credit risk handle credit risk at both the individual and portfolio levels.	(16%)	(28%)	(22%)	(16%)	(18%)	3.40	0.962
The bank recognizes and manages credit risk across all products and activities.	(20%)	(30%)	(12%)	(20%)	(18%)	3.14	1.104
The board of directors must approve the MFIs' credit risk strategy and policies.	(20%)	(32%)	(20%)	(12%)	(16%)	3.4	0.962
Valid list wise=50							
Grand mean =3.46							

With a grand mean of 3.46, the overall perception of credit risk control practices is moderately positive but marked by significant variability. This aligns with Kisala's (2014) findings, which demonstrated a strong negative relationship between credit risk indicators particularly non-performing loans (NPL) and capital adequacy ratio (CAR) and financial performance (ROE) among Kenyan MFIs.

Effect of Credit terms on Financial Performance of Micro finance Institutions in Kenya

These are simplified responses to the question of whether Credit Terms impact the Financial Performance of Microfinance Institutions in Kenya. Table 3 displays the descriptive data.

Table 3 Credit Terms

Statement	5	4	3	2	1	Mean	Std.dev
The MFIs have a mechanism in place to manage the many credit risk portfolios they hold.	(24%)	(32%)	(26%)	(12%)	(12%)	3.55	0.917
There is harmony between the rating system and the bank's operations.	(16%)	(36%)	(12%)	(20%)	(16%)	3.52	0.921
MFIs have procedures and analytical methods to evaluate both on- and off-balance-sheet credit risk.	(18%)	(28%)	(20%)	(24%)	(14%)	3.45	0.923
The credit portfolio data available through the management information system is sufficient.	(22%)	(24%)	(18%)	(20%)	(16%)	3.48	0.927
When evaluating credit applications and portfolios, MFIs take into account the possibility of economic shifts in the future.	(24%)	(32%)	(16%)	(20%)	(8%)	3.38	0.929
Credit quality is tracked by the MFIs so that adequate provisions and reserve can be made.	(22%)	(30%)	(18%)	(14%)	(16%)	3.49	0.918
Valid list wise=50 Grand mean =3.48							

With a grand mean of 3.48, the overall perception of credit terms practices is moderately positive but reveals notable gaps in consistency, analytical depth, and responsiveness to economic dynamics. These findings align with Sindani's (2012) study, which emphasized that credit conditions particularly interest rate structures and stakeholder involvement, significantly influence loan performance.

Effect of Credit Approvals on Financial Performance of Micro finance Institutions in Kenya

These are summarized responses on whether Credit Approvals influences financial performance of MFIs in Kenya as presented in table 4.

Table 4 Credit Approvals

Statement	5	4	3	2	1	Mean	Std.dev
The results of approval reviews are reported to the board and senior management.	(16%)	(28%)	(24%)	(16%)	(16%)	3.58	0.919
The Internal control system ensures reports are timely for any approval.	(18%)	(30%)	(22%)	(16%)	(14%)	3.57	0.921
Approvals follows the laid down procedures.	(16%)	(28%)	(16%)	(24%)	(16%)	3.52	0.928
Approval is per ISO standards.	(20%)	(24%)	(18%)	(20%)	(18%)	3.46	0.931
Only senior officer's approve.	(20%)	(26%)	(22%)	(18%)	(14%)	3.43	0.927
System acknowledges integration of all departments processes executed.	(18%)	(28%)	(20%)	(18%)	(16%)	3.49	0.914
Valid list wise=50							
Grand mean =3.51							

Source: Author (2025)

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With a grand mean of 3.51, the overall perception of credit approval practices is moderately positive, yet marked by procedural and regulatory inconsistencies. These findings resonate with Kargi's (2011) study on Nigerian banks, which emphasized that poor credit risk management particularly in approvals, NPL levels, and capital adequacy, can significantly impair institutional profitability.

Correlation Analysis

The study used correlation technique to analyze the degree of relationship between two variables which was based on Pearson correlation coefficient (r), hence the coefficient (r) yields a statistic that ranges from -1 to 1. If the correlation coefficient is positive (+) it means that there is a positive relationship between the two variables, however, a negative relationship (-) means that as one variable decreases, then the other variable increases and this is termed as an inverse relationship, otherwise a zero value of r signifies that there is no association between the two variables.

Table 5: Correlations

		Credit Appraisal	Credit Control	Risk Credit Terms	Credit approval	Financial Performance (ROCE)
Credit Appraisal	Pearson Correlation	1				
	Sig. (2-tailed)					
	N	50				
Credit Risk Control	Pearson Correlation	.561**	1			
	Sig. (2-tailed)	.000				
	N	50	50			
Credit Terms	Pearson Correlation	.554**	.557**	1		
	Sig. (2-tailed)	.000	.000			
	N	50	50	50		
Credit approvals	Pearson Correlation	.545**	.556**	.521**	1	
	Sig. (2-tailed)	.000	.000	.000		
	N	50	50	50	50	
Financial Performance(ROCE)	Pearson Correlation	.825**	.753**	.676**	.718**	
	Sig.(2-tailed)	.000	.000	.000	.000	
	N	50	50	50	50	1

Pearson correlation model: $Y = \beta_O + 0.825X1 + 0.753X2 + 0.676X3 + 0.718X4 + €$ where:- Y = Financial Performance, X1 = Credit Appraisal, X2 = Credit Risk Control,

X3 = Credit Terms, X4 = Credit approvals, βo = Intercept, β = Coefficient of independent variables, and €= error term ($\pm$ 2.819)

Results of the studies revealed a good connection between the financial performance and predictors in micro finance institutions (credit appraisal, credit risk control, credit terms and credit approvals) and financial performance. Unstandardized regression coefficients illustrate how the dependent variable varies by x units in each unit of the independent variable. This suggests that a unit increase in appraisal would lead to a financial performance boost of 0.825 in net profit. An increase in credit risk control by one unit will have an effect of 0.753 on financial performance. An increase in credit terms by a unit will boost financial performance by a factor of 0.676. A rise by unit of credit approval would improve financial performance by 0.718 and vice versa. The standardized coefficients of regression are based on changes in standard deviation devices. The model for correlation shows that credit appraisal, credit risk control, credit terms and credit approvals are closely related to financial performance.

Linear Regressions

Linear Regression of Credit Appraisals on Financial Performance

Table 6: Direct influence of Credit Appraisals on Financial Performance Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					
					R Square Change	F Change	df1	df2	Sig. F Change	
1	.825	.680	.676	.69397	.680	159.562	1	49	.000	

ANOVAb

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	76.844	1	76.844	159.562	.000a
	Residual	36.120	49	.482		
	Total	112.964	50			

Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	.682	.232		2.939	.004
	Credit Appraisals	.919	.073	.825	12.589	.000

a. Dependent Variable: Financial performance"

This tested the direct influence of Credit Appraisals on Financial Performance of Micro Finance Institutions in Kenya. Credit Appraisals also has a favorable and statistically significant effect on the financial performance of Kenya's microfinance institutions, according to a coefficient analysis (β= 0.919 (0.073); at p<.01). This means that the financial performance of MFIs in Kenya might improve by 0.919 percentage points with just one increase in MFI efficiency. The linear regression equation is;

Financial performance of MFIs in Kenya = 0.682 + 0.919 Credit Appraisals

Linear Regression of Credit Risk Control on Financial Performance

This tested the direct influence of Credit Risk Control on Financial Performance of MFIs.

Table 7: Direct influence of Credit Risk Control on Financial Performance

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics R Square Change	F Change	df1	df2	Sig. F Change
1	.753	.567	.562	.80708	.567	64.303	1	49	.000

ANOVA[b]

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	64.110	1	64.110	64.303	.000[a]
	Residual	48.854	49	.997		
	Total	112.964	50			

Coefficients

Model		Unstandardized Coefficients B	Std. Error	Standardized Coefficients Beta	T	Sig.
1	(Constant)	.921	.269		3.424	.001
	Credit Risk Control	.801	.081	.753	9.889	.000

a. Dependent Variable: Financial Performance

Credit Risk Control accounts for 56.7% of the variance, whereas other factors account for 43.3% of the variance. Coefficient analysis reveals a favorable and statistically significant effect of Credit Risk Control ($\beta = 0.801$, std error=0.081); $p<.01$). This results in a rise of 0.801 standard deviations. Kisala (2014) looked into how credit risk controls affected the lending outcomes of MFIs in Kenya. The study's methodology was descriptive, and it analyzed how microfinance firms manage credit risk and the profitability of their loans. Primary data was gathered from nine MFIs and secondary data was from five MFIs via questionnaires and yearly reports (2007-2011). In this analysis, we

used the ROE to gauge financial performance, and CAR and NPV to gauge credit risk management. The linear regression equation is;

Financial Performance of Micro Finance Institutions in Kenya = **0.921 + 0.801** Credit Risk Control

Linear influence of Credit Terms on Financial Performance

This tested the direct influence of Credit Terms on Financial Performance of MFIs in Kenya.

Table 8: Direct influence of Credit Terms on Financial Performance

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	R Square Change	F Change	df1	df2	Sig. F Change
					Change Statistics				
1	.676ᵃ	.457	.449	.90463	.457	41.171	1	49	.000

ANOVAᵇ

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	51.587	1	51.587	41.171	.000ᵃ
	Residual	61.377	49	1.253		
	Total	112.964	50			

Coefficients'

Model		Unstandardized Coefficients B	Std. Error	Standardized Coefficients Beta	T	Sig.
1	(Constant)	1.162	.304		3.822	.000
	Credit Terms	.756	.095	.747	7.958	.000

a. Dependent Variable: Financial Performance

Table 8 presents a summary of the model, showing that R^2 = 0.457, which indicates that 45.7% of the variance in the Financial Performance of MFIs in Kenya can be attributed to differences in Credit Terms, while the remaining 54.3% of variance can be attributed to factors outside the scope of the study model. Furthermore, coefficient analysis demonstrates that Credit Terms has a

positive, statistically significant effect on financial performance at Kenya's MFIs ($\beta = 0.756$ (0.095); at $p<.01$). This means that the financial performance of MFIs in Kenya might improve by 0.756 percentage points with just one change in effective Credit Terms. According to a study by Sindani (2012) titled Effectiveness of Credit Management System on Loan Performance: Empirical Evidence from Micro Finance Sector in Kenya, the credit terms established by the microfinance organizations do affect loan performance. Therefore, the linear regression equation is;

Financial Performance of Micro Finance Institutions in Kenya = **1.162 + 0.756** Credit Terms

Linear Regression of Credit Approvals on financial performance

This tested the direct influence of Credit Approval on Financial Performance of MFIs in Kenya.

Table 9: Direct influence of Credit Approval on Financial Performance

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	R Square Change	F Change	df1	df2	Sig. F Change
					Change Statistics				
1	.701	.491	.489	.75295	.491	52.215	1	49	.000

ANOVA[b]

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	58.272	1	58.272	52.215	.000[a]
	Residual	54.692	49	1.116		
	Total	112.964	50			

Coefficients

Model		Unstandardized Coefficients B	Std. Error	Standardized Coefficients Beta	t	Sig.
1	(Constant)	.996	.179		5.564	.000
	Credit Approval	.672	.087	.669	7.724	.000

a. Dependent Variable: Financial performance

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According to the model summary in table 9, Credit Approval explains 49.1% of the variance in the Financial Performance of MFIs in Kenya, while other factors not included in the study model account for the remaining 50.9%. Coefficient analysis further reveals that Credit Approval significantly affects the financial performance of Kenya's microfinance institutions (β= 0.672 (0.087); at p<.01). A 0.672 point gain in financial performance can be expected from Kenya's microfinance institutions if credit approval times are reduced by just one percentage point. Nonperforming loan and CAR and profitability were examined by Hosna et al., (2009) for four Swedish banks from 2000 to 2008. Nonperforming loan and CAR were found to have a negative impact on return on equity, albeit the strength of this relationship varied by bank. Other research has similarly identified negative correlations between firm profitability, performance, and credit risk indicators (Musyoki and Kadubo, 2015).

Therefore, the linear regression equation is;

Financial Performance of Micro Finance Institutions in Kenya =**0 .996 + 0.672** Credit Approvals

Multiple Regression Analysis

The adjusted R square indicates a value of.642. The R-squared coefficient estimates how much of the total variance in the dependent variable can be attributed to the independent variables in the regression model. Having a high value, near to one, implies that the model is effective since it can explain more of the observed variation in the dependent variable. The model's R square value of 0.642 indicates that 35.8% of the variation in Financial Performance can be attributed to the four management techniques included in the model. Exogenous variables account for the remaining 35.8% of the variance. The value of R (the correlation coefficient) provides insight into the quality of the connection between the research variables. Regression results can also be evaluated by comparing the adjusted and unadjusted R square values; the closer these two values are, the better the model fits the data. When we look at the values in the table and compare them to the predicted values, we see that they are very similar. Listed below are the outcomes of the multivariate analyses:

Table 10: Multi regression results

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics R Square Change	F Change	df1	df2	Sig. F Change
1	.801[a]	.642	.639	.36136	.642	14.898	4	46	.000

ANOVA[b]

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	63.764	4	15.941	14.898	.000[a]
	Residual	49.200	46	1.070		
	Total	112.964	50			

a. Dependent Variable: Financial Performance

b. Predictors: Credit Appraisals, Credit Risk Control, Credit Terms, Credit Approvals

The regression slope is not substantially different from zero, which is tested by the ANOVA results. According to the F-statistics, the model's regression slope is substantially different from zero (df (4, 46), F=14.898, p<0.001).

Table 11: Coefficients

Model	Unstandardized Coefficients B	Std. Error	Standardized Coefficients Beta	T	Sig.
1 (Constant)	.610	.103		5.922	.000
Credit Appraisals	.311	.061	.398	5.098	.000
Credit Risk Control	.210	.065	.180	3.231	.000
Credit Terms	.205	.053	.289	3.868	.040
Credit Approvals	.154	.041	.196	3.756	.003

a. Dependent Variable: Financial Performance

Source: Author (2025)

Finally, the values of un-standardized regression coefficients with standard errors in table 4.15 indicate that all the study's independent variables (Credit Appraisals; $\beta = 0.311$ (0.061) at $p<0.05$, Credit Risk Control; $\beta = 0.210$ (0.065) at $p<0.05$; Credit Terms; $\beta = 0.205$ (0.053) at $p<0.05$, Credit Approvals; $\beta = 0.154$ (0.041) at $p<0.05$, significantly influenced Financial Performance of Micro-Financial Institutions in Kenya.

The model of the study derived from the multiple regression results is

$$Y = 0.610 + .311X_1 + .210X_2 + .205X_3 + .154X_4$$

Summary of Hypotheses Tests

Table12: Hypotheses results

Hypothesis	Method of statistic	T-test and Prob	Decision
H_{01}: Credit Appraisals has no significant effect on Financial Performance of Micro Financial Institutions in Kenya	Linear Regression	β= .311 t =5.098, p=.000	Reject H_{01}
H_{02}: Credit Risk Control has no significant effect on Financial Performance of Micro Financial Institutions Kenya	Linear Regression	β= .210 t=3.231, , p=.000	Reject H_{02}
H_{03}: Credit Terms has no significant effect on Financial Performance of Micro Financial Institutions in Kenya	Linear Regression	β=.205 t=3.868, , p=.040	Reject H_{03}
H_{04}: Credit Approval has no significant effect on Financial Performance of Micro Financial Institutions in Kenya	Linear Regression	β= .154 t=3.756, , p=.003	Reject H_{04}

CONCLUSIONS AND RECOMMENDATIONS

Summary

The study investigated the impact of Credit Risk Management (CRM) practices—specifically credit appraisal, credit risk control, credit terms, and credit approvals—on the financial

performance of microfinance institutions (MFIs) in Kenya. Findings revealed that credit appraisal significantly enhances financial outcomes by evaluating client character and collateral, supported by prior studies such as Njeru et al. (2016) and Moti et al. (2012). Credit risk control also showed a strong positive correlation with profitability, with practices like credit committee oversight, regular checks, and penalty enforcement proving effective, echoing Poudel's (2012) conclusions. Credit terms were found to influence performance both positively and negatively, depending on how loans were structured and deployed, with Muturi (2016) affirming their strategic importance. Lastly, credit approvals were shown to directly affect profitability, where timely and standardized approval processes contributed to institutional success, reinforcing Muturi's findings on the necessity of robust credit vetting procedures.

Conclusions

Financial results of Kenya's microfinance institutions are highly dependent on effective credit risk management. Based on the data, it appears that Credit Appraisal, Credit Risk Control, Credit Terms, and Credit Approval all have a role in the MFIs' bottom lines. Credit Appraisal, Credit Risk Control, Credit Terms, and Credit Approvals, in addition to Institution Size, were found to have a significant impact on MFIs' financial success. Indicators of a positive link and relationship between financial performances of MFIs showed that an increase in Credit Risk Control, Credit Terms, and Credit Approvals, in combination with the size of the institution, would lead to an increase in Financial Performance.

Recommendations

Based on a comparison of the study's final findings and conclusions, I advise MFIs to strengthen client appraisal processes, credit risk control, and credit approvals in order to boost their financial performance, attract more high-quality customers, and lower the percentage of their loans that go into default. Microfinance institutions' returns are very sensitive to their own size; the bigger the institution, the higher its net profit and, by extension, its financial performance.
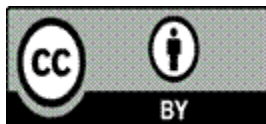
Areas for further research

First, a similar study can be done on all commercial banks in Kenya using time series analysis so as to compare study findings. Secondly, do a similar study retaining similar variables but use other methods for analysis. And thirdly include non-registered MFIs not captured by the Association of micro finance institution MFI.

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