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INFLUENCE OF LENDING POLICY ON FINANCIAL PERFORMANCE OF SAVINGS AND CREDIT COOPERATIVES IN KAKAMEGA COUNTY, KENYA

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ABSTRACT

Sacco sector in Kenya had been described as a ticking bomb due to deteriorating liquidity and solvency levels. Moreover, the government had been on record enacting legislation in a bid to save Saccos which were already bleeding with non-performing loans. Government had also introduced new standards of accounting and stringent new regulatory requirement, none of which majority of Saccos were ready to adhere. Experts observed that Sacco's sector was fragile to shocks and kept procrastinating over a decade. Crucially, a court battle between government and Saccos was brewing as the later sought an injunction to block a bill on the floor of parliament that sought to raise taxes on Sacco deposits. Though effort by all stakeholders to save troubled Sacco sector was commendable, the dynamism of SACCO sector and desperate constant effort to revamp it had put to question and left most stakeholders in a dilemma. This study sought to asses on whether lending policy had influence on the financial performance of Saccos in Kakamega County. The study targeted 143 high ranking personnel from the 13 registered SACCOs found Kakamega County. Through stratified sampling technique, 105 respondents were selected. A questionnaire tool was adopted as the main research instrument. A pilot study was conducted among 20 senior management staff of SACCOs in Vihiga County, Kenya, to check data analysis. Descriptive and inferential statistics showed that; from the values of unstandardized regression coefficients with standard errors in parenthesis, the independent variable (loan lending policy) was significant predictors of SACCO performance. It was concluded that lending policy have significant association with the performance of SACOOs in Kakamega County. Accordingly, there was need to craft feasible lending policies to help them attract many customers and improve their total loan ratios which would translate in SACCO's financial growth. The study recommended that SACCOs should craft a credible and substantive loan lending policy. The policy should stipulate loaning guidelines meant to attract more customers while at the same time checking risky borrowers.

Key Words: *Lending policy, SACCOs, Kakamega County*

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INTRODUCTION

SACCOs worldwide have remained the most renowned and instrumental drivers of the economy through credit provision and support, in no small portion of the population to develop loan lending policies, and to guide their operations. These policies will ensure that best business practices are adhered to and guarantee maximum loan recovery (Ergetew, 2015). SACCO members mostly approve loan policies in their annual general meetings which are then registered with the ministry of co-operatives in respective countries. The supervisory or credit committees refer to loan policies when dealing with loan administration (Hannah, 2015).

In Malaysia, for the period 1996 to 2002, a study done by (Ahmad *et al.,* 2004) compared social SACCOs and conventional SACCOs. Their results revealed that variables namely, management efficiency and weighted average of total assets had positive relationships with loan defaults. However, the study did not pinpoint how specific loan policies on loan default costs in the SACCO portfolios affect their financial performance.

Magali (2014) on the influence of gender and location of the borrowers were not significant. The study further observed that rural SACCOS used portfolio diversification, collateral, guarantors, endorsements from ward level government offices, or an affirmation from lawyers as credits risk mitigation techniques. The findings further revealed that fluctuation of the price of agricultural produce threatened the quality of loan portfolio. In view of this, the research recommended that SACCOS should seek the effective insurance services, use the useful software for loan portfolio management and search the market for agriculture produce.

Various types of co-operative enterprises in Kenya can be clustered into two major categories which are determined by their involvement in financial intermediation. They are both monetary and non-monetary cooperatives (SASRA, 2018). These are the co-operatives which are registered with the objectives of financial intermediation on behalf of their members in one way or the other. The membership may be individuals; primary or secondary. SACCOs help members through allowing them to accumulate savings and create a source of funds at a fair and reasonable rate of interest. They also provide an opportunity for each of its members to improve their particular economic and social conditions by providing them credit for purposes of providence or production or both. SACCOs also offer the members complimentary savings and credit services and other financial services based on clients' wishes and aspirations. SACCOs ensure the safety and soundness of the member's funds through a risk management program or appropriate insurance coverage. SACCOs also ensure the progress of its members by educating them continuously on the proper use of credit (Kenya Police Sacco Society Limited, 2017). This instability may cause a drop in investments thus high need for credit.

Statement of the Problem

In developing countries, SACCOs have remained the most popular instrumental drivers in making accessibility to financial resources easier to reach and adopt. The support given to a large portion of the population is a game changer in the sector. The investments are why SACCOs in different sectors and environments must develop loan policies to guide their operations, ensure best business practices are adhered to and guarantee maximum loan recovery (Ergetew, 2015).

However, most researches on SACCO performance little regard to loan policies. Magali (2014) on portfolios furthers that, most researches on loan policies have been based in banks and Microfinance institutions which have even yielded inconclusive study results (Pandey (2004); Agarwal (2009); Ojeka (2012); Byusa and Nkusi (2012); Arishaba (2011); Sindani (2012); Moti, *et al.*(2012); Tengey (2014),with few empirical studies in SACCOs (Maiti, 2015). This study sought to fill the gap by assessing the influence of lending policy on financial performance of SACCOs in Kakamega County

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Objective of the Study

The main objective of this study was to investigate the influence of loan lending policies on financial performance of SACCOs in Kakamega County, Kenya.

LITERATURE REVIEW

Theoretical Framework

Asymmetric Information Theory

Private credit bureaus rely on voluntary information sharing between lenders, which typically involves a trade off. On the contrary, lenders benefit from information sharing since it helps them to select right from bad loan applicants. Besides, information sharing can overcome moral hazard on the part of borrowers, motivating them to exert greater effort in projects and repay loans (Pagano & Jappelli, 1993). Besides, information exchange could open lenders to enhanced competition since lending institutions release secret information about their existing clientele. Banks could thus hold information in competitive credit markets and may be particularly reluctant to share information with close competitors (Kallberg &Udell, 2003).

According to Binks et al. (1992 the banks are moral hazard problem and an adverse selection. Banks will find it challenging to circumvent hence monitor borrowers. When assessing lending applications, bankers face a situation of information asymmetry (Binks & Ennew, 1997). Access to information poses two types of risks for the banks (Deakins, 1999). Firstly, when banks lend to businesses which subsequently fail or when they do not lend to firms which turn successful they risk-averse selection, Altman (1971). Therefore, asymmetric information theory applies to this study in that the SACCOs may fail to lend money to legitimate or potential businesses and instead lend money to suspicious businesses or persons that use fraudulent means to secure loans and eventually fail to repay hence increasing the lending SACCO's non-performing loan ratio. In this regard, SACCOs are therefore required to craft feasible loan policies that will filter useful information from loan applicants to reduce loan delinquency ratio that consequently affects their financial performance.

Empirical Review

According to Agarwal (2009), the lending policy could incorporate credit terms factors such as interest rate, collateral, and loan repayment methods (Laferrara, 2003). Therefore, strong bond is highly unlikely that the borrower fails to honor his/her debt, otherwise due credit reference bureaus information; it would be challenging to find other financial lending institutions willing to grant loans at the credit terms. In this regard, when SACCOs meet their loan obligations, financial performance is improved.

Ojeka (2012) while studying on the influence of lending policy expressed in terms of credit standards and liquidity in financial firms in Nigeria found that setting credit standards and collection period and collection period can lessen the cash flow problem and liquidity of financial lending institutions.

Byusa and Nkusi (2012 assert that rural SACCOs had reliable credit policies that are in line with the set objectives and goal. The results obtained indicated that the rural SACCOs increase their accounts and customer base, thereby maximizing their profits. Further, Maiti (2015) surveyed on how Nairobi based credits and were also applying collection policy, considering non-performing loans and total loans, loan–loss provision coverage an increase in profitability. However, the study did not involve insurance policy or loan security policy which too could have a bearing on SACCO's profitability.

Conceptual Framework

Lending Policy

- Lending terms &standards
- Loan size and limits
- Repayment period
- Use of credit application forms

→

Financial Performance of SACCOs

ROA

Independent variables **Independent Variable**

Figure 1: Conceptual Framework

Source: Author (2019)

Loaning and economic growth of SACCOs

This policy will assess the direct influence of SACCO loaning policy issues such as lending terms and standards, loan size and limits, repayment period, use of authenticated credit capital adequacy and quality. It is because a loaning policy of any financial lending institutions determines its financial performance.

Financial performance in SACCOs

Tracking SACCO's financial ability to cover all of its costs through interest and other income paid by its clients (Ayay & Sene, 2010), which reflects organization's ability to use its assets productively.

$$ROA = \frac{\text{After-tax profits}}{\text{Starting (or period-average) assets}}$$

METHODOLOGY

This is a road in aiding researchers to collect information that describes, explore and help the investigator understand social life. Surveys attempt to quantify social phenomena particularly issues, conditions, and problems that were prevalent in the society. Descriptive surveys further enable the researcher to focus on the links among a smaller respondents (Mugenda & Mugenda, 1999).

Table 1: Target Population

CATEGORY OF EMPLOYEE	NO.OF TARGETED RESPONDENTS
CEOs/Branch Manager	13
Finance Managers	13
Internal Auditors	13
Credit Managers	13
Customer Care & Marketing Officers	26
Business Operations officers	26
Loan officers	39
Total	**143**

Questionnaire tool was adopted to get normal responses from respondents. The structured questionnaire was relevant for this study because respondents are provided with questions for each study variable and relevant information can be collected over a short period, easy to administer and cost-effective (Mugenda & Mugenda, 2003). A pilot study was conducted on 10 senior management staff of SACCOs in Vihiga County. The collected data was analyzed descriptively on SPSS program. For measuring relationships, correlation analysis and linear regression analysis was computed.

FINDINGS

An aggregate of 97 respondents was reached out of the total 105 sampled for the study. This represented an average of 92% response rate. This according to Mugenda and Mugenda (2003) was an excellent turnout to inform an analysis and reporting.

Descriptive Statistics

Descriptive statistics in this study was a summation of responses based on independent variable (loan lending policy) and the dependent variable (SACCO progression fiscally measured by ROA). Descriptive statistics thus showed the outcomes of responses to each of the statements on the study variables using Likert scale. Frequencies of responses as per each statement and its corresponding percentage score in brackets were shown. Respondents were asked to respond to 6 statements and the results were presented in table 2.

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Table 2: Descriptive Statistics;

Statement	5	4	3	2	1	Mean	Std.Dev
	Frequency and Percentage (%)						
1. Formulation of lending terms has been a challenge in loan management.	5(5.2)	49(50.5)	8(8.2)	19(19.6)	16(16.5)	3.08	0.856
2. Exacting loan size limits is a viable strategy in loan management	12(12.4)	56(57.7)	3(3.1)	22(22.7)	4(4.1)	3.52	0.900
3. Flexible repayment periods improve loan repayment.	17(17.5)	61(62.8)	5(5.2)	9(9.3)	5(5.2)	3.78	0.913
4. Penalty for late payment enhances customers commitment to loan repayment	18(18.6)	68(70.1)	3(3.1)	4(4.1)	4(4.1)	3.95	0.870
5. The use of authenticated credit application forms improves monitoring and credit management	10(10.3)	52(53.7)	7(7.2)	24(24.7)	4(4.1)	3.41	0.879
6. Use of credit reference bureau information should inform lending policy	14(14.4)	53(54.7)	7(7.2)	10(10.3)	13(13.4)	3.46	0.751
Valid N (listwise) 97							
Grand mean = 3.533							

From table 2, most respondents agreed (50.5%) and strongly agreed (5.2%) on loan policies being a challenge to some SACCOs because those policies determine the survival of the SACCO and the market value of its products. Secondly, a number of respondents agreed (5.77%) and strongly agreed (12.4%) limits on loan applicants in securing loans according to their repayment ability reduces loan delinquencies. Further, most respondents agreed (62.8%) and strongly agreed (17.5%) that SACCOs have devised various loan repayment periods so that customers secure loans with convenient repayments periods; this is because loan repayments also determine interests charged on varying loan amounts. Thus customers secure a loan with informed consent.

Further, 70.1% and 18.6% of respondents agreed and strongly agreed respectively that most customers feared the risks involved in the penalty for late loan repayments, thus, would instead repay outstanding loans within the stipulated time to avoid the financial stress of penalties for late repayments. More so, 53.7% and 10.3% of respondents agreed and strongly agreed that authenticated loan applications forms have substantive loan terms. Thus, customers make informed decisions on the type of loan and repayment terms.

Lastly, most respondents agreed (54.7%) and strongly agreed (4.4) that use of credit reference bureau information should inform SACCO lending policy. This implies that credit reference bureau information helps SACCOs to detect perennial loan defaulters or customers out to secure a loan from the SACCO using information asymmetry, thus plunging the affected SACCO in financial risks due to high rates of loan defaulters. Therefore, the strong relationship between lenders and borrowers it is highly unlikely that the borrower fails to honor his/her debt, otherwise due credit reference bureaus information; it would be challenging to find other financial lending institutions willing to grant loans at the credit terms. In this regard, when SACCOs meet their loan obligations, financial performance is improved.

Hypothesis testing

On study **Hypothesis**, the study results indicate that there exists a positive and significant influence of loan lending policy on the financial performance of SACCOs in Kakamega County, Kenya (β= 0.462 (0.066), at *p<0.01*. ***Hypothesis was thus rejected***. The results, therefore, implied that a single reinforcement of credible loan lending policies by SACCOs in Kakamega County, Kenya would lead to 0.462 unit growth in the financial performance of SACCOs in Kakamega County, Kenya. These study results were supported by Byusa and Nkusi (2012) who examined the credit policy influence on the performance of rural SACCOs in Tanzania. Using quantitative techniques, the study found that rural SACCOs had reliable credit policies that were in line with the set objectives and goal. The results obtained indicated that the rural SACCOs increase their accounts and customer base, thereby maximizing their profits. Further, Maiti (2015) surveyed on how credit policy affects the performance of SACCOs in Nairobi City. The study used correlation research design.

The study population consisted of all 40 SASRA Regulated SACCOs registered under the Societies Act in Nairobi, Kenya. The study revealed that regulated SACCOs had adopted credit standards as a credit policy and credit term policy loan ratio in the determination of how much a client would borrow. The study also revealed that regulated SACCOs were also applying collection policy, considering non-performing loans and total loans, loan–loss provision coverage ratio and application of credit policy which increased Return on Assets (ROA) for the regulated SACCOs to a great extent. From the regression results, the use of collection policy (Default Rate) led to a significant increase in ROA of regulated SACCOs indicating that lowering non-performing loans to total loans would significantly lead to an increase in profitability. However, the study did not involve insurance policy or loan security policy which too could have a bearing on SACCO's profitability.

CONCLUSIONS

SACCOs crafting feasible loan lending policies can help them attract more customers; improve their total loan ratios which will translate in SACCO's financial growth.

RECOMMENDATIONS

First, SACCOs should craft a credible and substantive loan lending policy that stipulates loaning guidelines meant to attract more customers while at the same time checking risky borrowers.

Areas for further research

First, a comparative study can be done on SACCOs but purely using secondary data for a span of like five years to assess the evolution projections and after implementing particular loan lending policies within SACCOs. Secondly, another study can be done using non-financial measures of SACCO performance to compare results.

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