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EFFECTS OF CREDIT RISK MANAGEMENT ON THE FINANCIAL PERFOMANCE OF KARI SACCO LIMITED

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ABSTRACT

SACCO's are in the business of safeguarding money and other valuable assets for the Members besides providing loans and offering investment financial services. Credit creation is the main income generating activity for KARI SACCO LIMITED. The general objective of the project was to determine effects of credit risk management on the financial performance of KARI SACCO LIMITED. Specifically, the study sought to find out the role played by credit monitoring practices on the financial performance of KARI SACCO LIMITED. Descriptive research design was used with a target population of 1,037 and a sample size of 104 Sacco members selected using the stratified sampling technique. The questionnaire was formulated with both open ended and close ended questions based on the objectives of the study. Both the questionnaire and the Data collection sheet was administered to the Sacco members through drop and pick method. The entry and analysis of data was done using SPSS (Statistical Package for Social Sciences) program. Quantitative data was summarized using descriptive statistics which included mean, mode, median, standard deviations, frequencies and percentages. Relationship between variables was determined using the multiple regression models. The data was presented in form of charts, graphs and percentages. The study showed that credit risk management significantly influenced the financial performance of Kari Sacco when the one variable was used. It was evident that if the credit risk management was sound then, the performance level would be satisfactory. Furthermore, if it was poor, the performance would be low. Credit risk management practices employed therefore had a direct impact on the financial performance of the Sacco. The researcher suggests that further study should be undertaken in order to investigate the effects of credit risk management on the financial performance of Sacco's as it did not exhaust everything concerning credit risk. Findings from such study will provide more insight on the relationship between the said determinants, which could be useful in informing risk management strategies and policy in Kenyan SACCO's.

Key Words: *Credit risk management, Financial Performance, Kenya Agricultural Research institute Sacco, Credit Risk.*

INTRODUCTION

The history of cooperative movement according to WOCCU (2008) can be traced way back to 1852 when Herman Frank consolidated two pilot projects in Germany into credit unions. In 1864 another Germany, Raiffeisen found the first rural credit union in rural Germany to cater for the needs of the rural poor. The rural communities were considered unbankable because of very small, seasonal flows of cash and very limited human resources. Since then, there had been a rapid growth in the cooperative movement worldwide based on the organizational methods of Raiffeisen.

Each country globally adopted its own way of inculcating a culture of savings amongst its citizens. This led to the formation of a worldwide co-operative movement called International Co-operative Alliance, ICA of 1995. ICA operates on seven core principles and values, which are; voluntary and open membership, democratic member control, member's eco*nomic* participation, autonomy and independence, education training and information, co-operation among co-operatives and concern for community which are applicable to other countries (ICA, 2002). Today SACCOs are one of the largest financial institutions addressing the needs of all classes of people in the world (ICA 2002).

The first SACCO Society in Africa was introduced in Ghana in 1959. The SACCO was intended to assist villagers improve their economic conditions (Ng'ombe and Mikwamba, 2004). English speaking nations were the first to adopt SACCOs. The first entrants into SACCO community included Ghana, Uganda, Nigeria, Tanzania and Kenya. Most of the non-English speaking nations in Africa started appreciating SACCOs in the 1960s with major influx into SACCO community in 1970s (Mwakajumilo, 2011). SACCO formation in Africa grew tremendously about 28 countries in Africa established SACCOs (Savings Plus, 2010). Due to this growth the African countries formed a continental association of SACCOs, Africa Confederation of Co-operative Society Savings and Credit Association (ACCOSSCA) in 1965. ACCOSSCA was formed with the aim of promoting the SACCO principles, offer SACCO insurance and educate members on SACCO issues (Ng'ombe and Mikwamba, 2004).

In Kenya, the first Co-operative Society was Lumbwa Co-operative Society formed in 1908 by the European Farmers with the main objective of supporting agricultural activities and products to take advantage of economies of scale (Kenya Union of Saving and Credit Co-operatives, 2009). After independence, the Kenyan Government recognized co-operatives as suitable vehicles with appropriate framework to achieve their aspirations and participate in the economic development of the nation. The Kenyan Government encouraged the formation of co-operatives since the white had left behind huge pieces of land that could not be managed by individual farmers and ever since then, the government encouraged this important sector of the economy by having a National Co-operative Day and opening Co-operative Banks in all major towns in the country (ICA, 2002).

Accordingly, steps were taken by the government which saw the rapid growth and expansion of the SACCO Society Movement in the country (Gardeklint, 2009). In fact, the SACCO Movement is considered by the government as one of the economic pillars of the nation. By the year 2010, Kenya had over 5,000 registered SACCOs with a membership of about 7 million. The SACCO Societies had mobilized savings of over 200 billion Kenya shillings (Republic of Kenya, 2008; Ndung'u, 2010).

Statement of the problem

Sacco contribute greatly to the economic development in the world and more so in Kenya. As a result Sacco Societies are fundamental strategies for attainment of Kenya's vision 2030 through savings mobilization and creation of business capital. However studies have shown that in relation to other financial institutions, financial performance of Sacco was rated low (Gathurithu, 2011) compared to other financial institutions. Karagu&Okibo (2014) confirmed high rate of credit default among 37 deposit taking Sacco's in Nairobi which can be attributed to the poor financial performances. Credit risk management strategies are geared to ensure minimum loan default like putting in place strong systems to facilitate capturing of loan defaulters on time and supported by sound credit committee who foresees members are granted loans when they are legible in that shares accumulation must be three times shares and also a third of their basic cannot be below the net pay and accompanied by collaterals as in case of Kari Sacco fill enough guarantors and retirement period is looked into and thus better financial performance of finance institutions (Mbeba, 2007).

The diversification of financial products and services by the SACCOs consumed with some caution and prudence as this involves a great deal of risk. The very nature of the SACCO business is so sensitive because more than 85% of their liability is shares from Members SACCO use these deposits to generate credit for their borrowers, which in fact is a revenue generating activity for most SACCOs. This credit creation process exposes the SACCO's to high default risk which leaded to financial distress including bankruptcy (Saunders & Cornett, 2005). Despite the development and use of highly sophisticated tools and models to measure the exposure of Financial Institutions to Credit Risk, the default rate in the SACCOs in Kenya remain relatively high. For example the amount of defaulted loans for Kenyan SACCOs rose from Ksh. 5 Billion in the year 2007 to over with Ksh 10 Billion in 2012 (MOCD, 2009). This study therefore, analyzed effects of credit risk management on the financial performance of KARI SACCO LIMITED.

Objective of the study

The general objective of the study was to assess the effects of credit risk management on the financial performance of KARI SACCO LIMITED. Specifically the study was to find out how credit monitoring practices influences the financial performance of KARI SACCO LIMITED.

METHODOLOGY

The study adopted descriptive research design which enabled the researcher to focus various variables and described them accordingly besides explaining to how each variable has influenced financial performance.

The target population for the study comprised of members of Kari Sacco Limited.

The study adopted stratified sampling technique. Ngechu (2004,) supports this by stating stratified sampling technique produced estimates of overall population with greater precision and ensured that a more representative sample was derived from a relatively homogeneous population. The researcher stratified the population based on the number of centres of Kari and then, at 10% per strata, randomly picked the samples.

Data Collection Instruments

The study used self-moderate questionnaire which comprised of both closed and open ended questions as well as contingency questions to collect primary data as suggested by Mugenda and Mugenda,(2009).Furthermore, a structured Likert Type of scale questionnaire which is the most commonly used in rating scale questionnaire was adopted for the study. Primary data was collected through interviewing Sacco members within Nairobi and its environs. Use of interviews as a data collection tool helped the researcher in collecting in-depth data of the subject. Published reports like Sacco Star was obtained from the society which will form part of secondary data.

Questionnaires was administered on drop and pick later basis where respondents were given a duration of two weeks to fill before they were collected.

For the interviews, an agreed date and time was discussed between the researcher and the respondents where the researcher carry's out the interview while recording their responses. This approach is described by Kothari, 2004 & Mugenda & Mugenda, 2003, towards effective interviews.

Data collected was compiled, sorted, edited, coded and analyzed using Statistical Package for Social Sciences (SPSS) Version 21 computer program to facilitate addressing the research objectives. Quantitative data was summarized using descriptive statistics which included mean, mode, median, standard deviations, frequencies and percentages. Regression analysis was then being done to determine how credit risk management strategies contribute to performance of Kari Sacco Limited. Relationship between variables was determined using the multiple regression model conceptualized as shown below:

yi = 1xi1 + i where yi is the dependent variable (financial performance), xij is the ith observation on the jth independent variable, and where the first independent variable takes the value 1 for all i (so 1 is the regression intercept), and i is the error in the ith observation.

yi = Financial Performance

xi1 = Credit risk monitoring

i = Error Term.

Quantitative data was presented in various forms such as in tabular form. For better visual impact, data was represented in the form of diagrammatic representation such as pie charts, line charts and bar graphs.

Qualitative data was derived from open ended questions in the questionnaire. The responses was assessed thoroughly and organized in to various categories, distinct from each other and the relationship among the identified categories established. From this information, the study developed narratives and interpretive report in order to explain the situation within the society.

RESULTS AND DISCUSSION

Response rate

The study targeted 104 members of KARI Sacco, and out of 104 questionnaires distributed, only 67 were returned representing 69%. The response rate was considered adequate for reporting as it exceeded the general accepted threshold of 50%(Mugenda&Mugenda, 2003).Also according to Babbie (2010) a response rate of 50% is believed to be adequate for analysis and reporting, whereas 60% is considered good while above 70% is deemed very good.

Demographic profiles of the respondents

The information was collected to determine the gender representation of members of Kari Sacco limited in Nairobi County and its environment. The results showed that majority of members were male (58.6%) and females (41.4%).

As regards the respondent’s occupation,34.3% of Kari Sacco members who responded to this question were accountants, 22.4% were administrators, 7.5% were computer operators, 4.5% each were from finance, information technology, laboratory technicians, researchers and secretary while 1.5 % each from; data clerks, auditors, artisans, auxiliary, clerical officers and statisticians.

Effects of credit monitoring practices

The variable the study considered critical under this factor were whether Credit monitoring is a good strategy for credit risk management, Credit monitoring practice improve financial performance of the society, there are good practices in credit risk identification and scoring in the society as it findings corroborate with the findings of Dornyei, K., (2007). Kari Sacco Ltd has effective risk monitoring management and Loan default follow-up is done according to by laws of the Sacco. Respondents were required to rank these credit monitoring practices. They were to do the ranking using a five point Likert scale where the scale points 5,4,3,2 and 1 represented ‘strongly agree ‘agree ‘neutral’, ‘disagree’ and ‘strongly disagree respectively.

The findings shows majority of the respondents strongly agreed (47.3%) that credit monitoring is a good strategy for credit risk management while 55.4% agreed Credit monitoring practice improved financial performance of the society. Also 55.4% agreed that there are good practices in credit risk identification and scoring in the society. On whether the Sacco was effective credit risk monitoring system, 44.6% agreed, 31.1% neutral and 4.1% disagreed. On the other hand, 38.7% agreed that loan default follow-up being done according to by laws of the Sacco.

Overall, it is clearly seen that the median and mode were 4 for the four factors considered critical in influencing financial performance of Kari Sacco. This means most respondents agreed that Credit monitoring practice improved financial performance of the society; the findings are supported by Chipembere (2009) who attributed success of Sacco's operations on monitoring practices. Therefore there are good practices in credit risk identification and scoring in the society, Kari Sacco Ltd has effective risk monitoring management.

Financial performance of Kari Sacco ltd

The aspects considered essential in financial performance of Kari Sacco were whether credit risk can adversely impact financial performance of the society, financial performance is the key indicator of how society is progressing, lending portfolio affects financial performance of the Sacco, risk and growth are two important factors influencing Sacco financial performance, analysis of the determinants of financial performance is essential for all the members of Sacco. According to the findings, 44.6% agreed and 40.5% strongly agreed that Credit risk can adversely impact financial performance of the society. Further 54.1% agreed financial performance is the key indicator of how society is progressing while 36.5% strongly agreed about the same on the other hand, 56.8% agreed that risk and growth are two important factors influencing Sacco financial performance; however 6.8% were neutral on the same. Regarding Analysis of the determinants of financial performance, majority (63.5%) agreed it is essential for all members of Sacco while 35.1% strongly agreed. Generally on all the five aspects of financial performance, the median and mode were 4. This means most of the respondents agreed these critical aspects were practiced in Kari Sacco, therefore members agreed that credit risk can adversely impact financial performance of the society, financial performance is the key indicator of how society is progressing, lending portfolio affects financial performance of the Sacco, risk and growth are two important factors influencing Sacco financial performance and analysis of the determinants of financial performance is essential for all the members of SACCO these studies are also similar to Njuguna, P. (2008)

Multiple regression analysis was applied in order to determine the relationships between independent variable (credit risk management) and dependent variable (financial performance). The regression equation was estimated as; yi = constant+□1xi1 + □i

The constant and regression coefficients□0, □1, □were (0.575, 0.292) respectively. The regression equation was estimated as; yi = constant+□1xi1 + □i , that is , y = 0.575+0.292x3 where yi = Financial Performance xi1 = Credit risk monitoring,□i = Error Term.

The model illustrates that when the variable is held constant, the value of financial performance would be 0.575. However, holding other factors constant, a unit increase in credit risk monitoring would lead to 0.292 increases in financial performance.

Multiple regression analysis yielded R (0.4050), R-square (0.164), adjusted R20.115), standard error (0.074).

Adjusted R2is called the coefficient of determination and tells how Credit risk monitoring as an aspects of credit risk management at Kari Sacco has influenced financial performance. This means when meeting Credit risk monitoring a change in financial performance would be achieved at 11.5%.

Conclusion

The broad objective of the study was to assess the effects of credit risk management on financial performance of Kari Sacco. The study showed that credit risk management significantly influenced the financial performance of Kari Sacco when the one factor of credit risk management was considered. On the other hand, when these variable was applied, it is evident that credit monitoring significantly influenced financial performance in the society. It was evident that if the credit risk management was sound then, the performance level would be satisfactory. On the other hand, if the credit risk management was poor, the performance would be low.

Therefore this study can be used by the Ministry of Co-operative Development and marketing to draft a policy paper that will guide the Sacco Societies regulatory authorities(SASRA) in the country on adopting credit risk practices that will minimize loan losses and ensure that the profitability of these Sacco is guaranteed.

Recommendation

On the basis of the findings, the following recommendations were made. These recommendations would help improve/ boost the financial performance of Kenya Sacco. Below are the recommendations based on the objectives of the study?

Credit risk monitoring

Sacco ought to implement operational and effective credit monitoring systems in order to improve financial performance. There is need for Sacco's to have good credit monitoring strategies, good credit monitoring practices and loan default follow-up being done according to by laws of the Sacco.

Suggestions for further research

The researcher suggests that further study should be undertaken in order to investigate the effects of credit risk management on the financial performance of Sacco's as it did not exhaust everything concerning credit risk. Findings from such study will provide more insight on the relationship between the said determinants, which could be useful in informing risk management strategies and policy in Kenyan SACCOs. Further research should also consider utilizing both qualitative and quantitative techniques that can be used in assessing the borrowers.

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