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EFFECT OF TYPE OF GUARANTOR ON RECOVERY OF NON-PERFORMING LOANS AMONG SACCOS IN NAKURU COUNTY

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ABSTRACT

SACCOS play a crucial role in providing financial services to the marginalized poor, although they face several challenges. One significant challenge is the high rate of loan default. In Nakuru County, SACCOS experiences a higher default rate compared to microfinance and commercial banks. Therefore, this study aimed to analyze the effect of the type of guarantor on recovery of non-performing loans among SACCOS in Nakuru County. The study was guided by information asymmetry theory. The study utilized a descriptive design, focusing on 22 SACCOs within Nakuru County. The unit of analysis was 22 SACCOs in Nakuru County while the unit of observation was 56 credit and recovery officers. Given the manageable size of the target population, the researcher opted for a census approach, including all 56 employees in the study. The study collected data using questionnaires. The study conducted a pilot study in Kericho where 6 questionnaires were issued. Cronbach's alpha coefficient was employed to assess research dependability. Both descriptive and inferential statistics were utilized to analyze quantitative data. Based on the findings, the study concluded that there is a positive and significant correlation between the type of guarantor and the recovery of non-performing loans among SACCOS in Nakuru County (r=0.753, p=0.000). The study recommended that new policies be formulated to classify guarantors more distinctly. SACCOS could benefit from establishing clear criteria for differentiating between Class A and Class B guarantors. It was recommended that this classification ensure higher-risk loans were matched with guarantors better equipped to guarantee repayment. Additionally, practical interventions were recommended to increase loan recovery. These included promoting long-term guarantor memberships and requiring multiple guarantors for higher-risk loans.

Key Words: *Type of Guarantor, Recovery of Non-Performing Loans and SACCOs in Nakuru County*

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INTRODUCTION

A guarantor is a person or entity that agrees to be responsible for someone else's financial obligations, typically in the context of loans, leases, or contracts. In a Sacco set, there are two classes of guarantors; guarantor class A and B. Guarantor class A are the original shareholders of the Sacco while guarantor class B are the business shareholders. For instance, in Cosmopolitan Sacco, guarantor class A is the teachers, in Stima Sacco guarantor class A is the Kenya power employees while guarantor class B is the businesspeople in those respective Saccos, (Batrymenko, 2017). The original shareholders can guarantee up to six borrowers while the business shareholders can guarantee up to 3 borrowers.

In China, the role of personal and corporate guarantors is crucial for SACCOs, especially in rural areas where formal credit is limited (Zhang & Zhou, 2023). Personal guarantors, often community members, help increase access to credit for borrowers who might not meet conventional criteria. This community-based guarantorship fosters a culture of mutual accountability, as guarantors are often closely connected to the borrowers. By providing a guarantee, personal guarantors enable more borrowers to access loans, potentially increasing the number of loans that may later turn into NPLs if the borrower defaults (Liu & Yuan, 2023). The presence of guarantors reduces credit risk for SACCOs, enhancing their confidence in lending. As a result, if a borrower defaults, the likelihood of recovering loans from guarantors helps keep NPLs in check (Sultana, 2019).

In South Africa, the requirement for guarantors in SACCOs especially for larger loans or when creditworthiness is uncertain shapes the credit landscape. Guarantors are often individuals with solid credit histories, which adds a layer of security to the lending process (Ololade & Olagunju, 2019). The need for a guarantor encourages SACCOs to enforce stricter lending criteria, as they rely on the guarantor's creditworthiness. This can lead to lower NPL rates since borrowers who cannot secure a reliable guarantor may be denied loans. As SACCOs are member-owned, the risk associated with defaults is shared among members (Oluyombo, 2019). This can incentivize guarantors to ensure the borrower's success, leading to proactive risk management and potentially lower NPLs.

In Kenya, the requirement for guarantors to be members of the SACCO fosters a strong sense of community and accountability (Wambua, 2018). Guarantors typically have favorable credit histories and are personally invested in both the borrower's and the cooperative's success. The community-oriented approach means that guarantors are more likely to ensure that borrowers meet their repayment obligations (Njeru., Njeru & Ondabu, 2019). This collective responsibility can help lower NPLs. The formalization of guarantorship through legal agreements ensures that guarantors understand their obligations in case of default. This clarity can enhance the recovery process and reduce the incidence of NPLs, as SACCOs can efficiently pursue guarantors for outstanding debts (Pandey & Sharma, 2020).

Recovering loans is a critical component of the lending industry, as unpaid loans can substantially affect the financial stability of lenders (Bol, 2015). The initial phase of loan recovery involves initiating communication with the borrower. Lenders are encouraged to foster positive relationships with their clients, and consistent communication can aid in averting defaults. In cases where borrowers have begun missing payments, prompt contact should be made to ascertain the reasons for the default and propose potential remedies. Communication channels may include telephone calls, electronic mail, or written correspondence (Kimando, 2018).

Ensuring the effective recovery of non-performing loans is paramount for lenders like SACCOs. Maintaining financial stability is one of the key reasons why this is crucial for SACCOs. These institutions depend on the interest accrued from loans to sustain their activities and distribute dividends to their members. The inability to recover non-performing loans can jeopardize financial stability, potentially causing liquidity challenges and even forcing closure. Hence, effective recovery of non-performing loans is vital to guarantee a steady income stream for SACCOs to sustain their operations (Shrimali, Srinivasan., Goel, & Nelson, 2017). Therefore, this study sought to determine the effect of type of guarantor on recovery of non-performing loans among SACCOS in Nakuru County.

Statement of the Problem

An effective loan recovery process is essential for Saccos to maintain financial stability, minimize risks, maintain the confidence of members, and ensure that loans are available to members when they need them. An effective loan recovery process ensures that Saccos remains sustainable and continues to provide much-needed financial services to its members. Despite SACCOs being a critical source of credit for many Kenyans, the rising number of non-performing loans poses a serious threat to their sustainability. A non-performing loan is one where the borrower has not made scheduled payments for a certain period, often 90 days or more. As of 2023, the non-performing loan ratio among SACCOs had reached an alarming rate of 10.3%, a significant rise from the 9.2% reported in 2022 (SASRA, 2023) therefore the study sought to determine effect of type of guarantor on recovery of non-performing loans among SACCOS in Nakuru County.

Research Hypothesis

$H0_1$: The type of guarantor has no statistically significant effect on the recovery of non-performing loans among SACCOS in Nakuru County

LITERATURE REVIEW

Theoretical Review

Information Asymmetry Theory

The study was guided by the Information Asymmetry Theory. This theory was first introduced by George Akerlof in 1970, with a focus on the imbalances in information between two parties during economic transactions (Akerlof, 1970). The theory suggests that when one party (often the seller) has more information than the other, it can lead to inefficiencies in the market. Akerlof illustrated this with his famous "market for lemons" analogy, highlighting how sellers may offer substandard products, exploiting buyers who lack crucial information. Thus, the theory sheds light on the relevance of assessing the type of guarantor on recovery of Non-Performing Loans among SACCOs in Nakuru County.

Empirical Literature Review

Type of Guarantor on Recovery of Non-performing Loans

The type of guarantor plays a significant role in the recovery of non-performing loans among SACCOs. Guarantors can be categorized into different types based on their relationship with the borrower, such as family members, friends, or professional associates, (Lucian, 2017). Each type of guarantor carries distinct implications for loan recovery. For instance, family members or close friends may be more invested in ensuring the borrower repays the loan to avoid straining personal relationships, potentially leading to higher recovery rates (Okoth, 2019). In contrast, professional associates might prioritize the financial implications of the guarantee but may lack the same emotional connection.

Moreover, the financial stability of the guarantor is a critical factor in recovery. A guarantor with a solid financial background and a good credit history is likely to enhance the loan's credibility, thus improving recovery prospects for SACCOs (Mugo, 2020). Conversely, if a guarantor is financially unstable or has a history of defaults, their involvement may pose additional risks to the lending institution. Therefore, SACCOs often assess the financial health and reliability of potential guarantors before approving loans, ensuring that the types of guarantors associated with loans are conducive to effective recovery strategies.

Lastly, the social dynamics surrounding the type of guarantor can impact borrowers' behavior. Borrowers with professional guarantors may feel a higher level of accountability, knowing that their default could harm the guarantor's reputation and financial standing (Mwaniki & Mburu, 2018). This understanding may incentivize timely repayments, thereby enhancing the overall recovery rates for SACCOs. Consequently, recognizing the type of guarantor in loan agreements can significantly influence repayment behaviors and, ultimately, the recovery of non-performing loans.

Oluoch, (2018) researched on the effect of guarantor type on loan recovery in SACCOs in Kisumu County, Kenya. The study adopted a descriptive survey design. The study found that the use of SACCO members as guarantors significantly improved loan recovery rates compared to non-members. The study also found that the use of non-member guarantors led to a higher rate of default.

Oladejo, (2020) researched the effect of guarantor type on loan recovery in microfinance banks in Nigeria. Cross-sectional survey Findings: The study found out that the use of group guarantors led to a higher loan recovery rate compared to using individual guarantors. The study also found that the use of multiple guarantors did not significantly improve loan recovery rates.

Nyawade, (2022) conducted a study on the effect of guarantor type on loan recovery in rural and urban microfinance institutions in Kenya. The study found out that the use of community-based guarantors led to a higher loan recovery rate in rural microfinance institutions, while the use of institutional-based guarantors led to a higher loan recovery rate in urban microfinance institutions. The study also found out that using multiple guarantors improved loan recovery rates in both rural and urban microfinance institutions.

Conceptual Framework

Type of Guarantor
- Class A
- Class B

→

Recovery of Non-Performing Loan
- Case of Defaulted Loan Recovered

Independent Variable **Dependent Variable**

Figure 1: Conceptual Framework

METHODOLOGY

The research adopted a descriptive design, employing a survey approach to gather data from the entire study population. The study was conducted among Saccos in Nakuru County. Nakuru County boasts a vibrant SACCO sector, with numerous cooperatives catering to various economic sectors and community groups. The unit of analysis was 22 SACCOs in Nakuru County while the unit of observation was 56 credit and recovery officers. Given the manageable size of the target population, the researcher opted for a census technique, encompassing all the 56 target employees in the study.

In this study, questionnaires served as the primary data collection instruments, comprising close-ended questions. The pilot study was conducted in neighboring Kericho County, where six questionnaires were distributed among four savings and credit cooperative societies: Kimbilio Daima Sacco, Kenya Highlands Sacco, Partners Sacco, and Simba Chai Sacco. Content validity was achieved by issuing the questionnaire to the supervisor who acted as the expert to review and validate the items. Internal consistency was achieved by determining the Cronbach's alpha coefficient.

The collected data predominantly comprised quantitative data. Quantitative data analysis was conducted using the Statistical Package for Social Sciences (SPSS) version 24. The analysis entailed both descriptive and inferential statistics. Descriptive statistics included percentages, frequencies, measures of central tendency (mean), and measures of dispersion (standard deviation). Inferential statistics involved correlation and regression analyses. The study undertook preliminary diagnostic tests (normality tests, multicollinearity tests, and Autocorrelation Test) to ensure the suitability of correlation and multiple linear regressions.

RESULTS

Response Rate

Out of 56 distributed questionnaires, 50 were completed and returned, resulting in an 89% response rate.

Type of Guarantor on Recovery of Non-Performing Loans

The second objective examined the effect of the type of guarantor on the recovery of non-performing loans among SACCOS in Nakuru County. The results were as shown in Table 1.

Table 1: Type of Guarantor on Recovery of Non-Performing Loans

Type of Guarantor	SA (%)	A (%)	N (%)	D (%)	SD (%)	N (%)	Mean	Std
Class B guarantors usually guarantee a smaller number of borrowers compared to Class A guarantors	47	43	2	8	0	50	4.22	0.45
Saccos prefer Class A guarantors compared to Class B guarantors	56	34	3	7	0	50	4.46	0.32
Class A guarantors are considered less risky and hence they have a positive effect on loan recovery	47	33	13	7	0	50	4.20	0.43
Class A guarantors can guarantee a high number of borrowers which result to high loss to the Sacco in case several borrowers default	59	31	3	7	0	50	4.02	0.52
The type/classification of guarantor affect the recovery of non-performing loans among SACCOS	48	48	2	2	0	50	4.26	0.23

From the findings, the respondents (mean=4.22; standard deviation=0.453) agreed that majority of Class B guarantors usually guarantee a smaller number of borrowers compared to Class A guarantors. Further, the respondents agreed (mean 4.46; standard deviation= 0.321) that Saccos prefers Class A guarantors compared to Class B guarantors. The respondents also agreed (mean= 4.20; standard deviation= 0.432) that Class A guarantors are considered less risky and hence they have a positive effect on loan recovery. The findings agree with Copisarow, (2013) who noted that Class A guarantors are often chosen based on their strong financial position, stable income, solid credit history, and overall credibility. From the study, the respondents (mean= 4.02; standard deviation= 0.521) agreed that most Class A guarantors can guarantee a high number of borrowers which result in a high loss to the Sacco in case several borrowers' default. SACCOs prefer Class A guarantors over Class B guarantors due to their higher financial stability, better credit histories, and stronger repayment capacity. Class A guarantors are perceived as having lower credit risk, making them more desirable as guarantors for loans. Their involvement provides greater assurance to the SACCO regarding the repayment of loans.

Finally, majority of the respondents (mean = 4.26; standard deviation = 0.231) agreed that the type/classification of guarantor affects the recovery of non-performing loans among SACCOS. This matches Mohamed, (2016) who noted that the classification of guarantors significantly influences the recovery of non-performing loans within SACCOs. Loans guaranteed by Class A guarantors are generally associated with higher recovery rates due to the lower credit risk associated with these guarantors. In contrast, loans guaranteed by Class B guarantors may face greater challenges in recovery due to the higher credit risk associated with these guarantors.

Recovery of Non-Performing Loans among SACCOS

The dependent factor established the recovery of non-performing loans among SACCOS in Nakuru County. The respondents were asked to indicate the aspect of recovery of non-performing loans among SACCOS in Nakuru County. Table 2 has the findings.

Table 2: Recovery of Non-Performing Loans among SACCOS

Statement on Recovery of Non-Performing Loans	SA %	A %	N %	D %	SD %	N	Mean	Std
There is a decrease in non-performing loans	68	23	2	4	3	50	4.258	0.886
Their use of a guarantor is very effective in recovering non-performing loans	69	21	0	5	5	50	4.403	0.557
The loan portfolio of the Sacco has grown over the years	40	55	0	2	3	50	4.145	0.807

The findings revealed that there is a decrease in non-performing (mean=4.258, standard deviation =0.886). On whether the use of a guarantor is very effective in recovering non-performing loans, majority of the respondents agreed (mean=4.403, standard deviation =0.557). The respondents further agreed that the loan portfolio of Sacco has grown over the years (mean=4.145, standard deviation=0.807). The findings of the study are in line with Tangem, (2014) findings which revealed that a growing loan portfolio indicates that more members are actively engaging with Sacco's services. Members are accessing credit for various purposes, which reflects a healthy demand for financial assistance. A larger loan portfolio means that Sacco is fulfilling its primary purpose of providing financial services to its members. This growth reflects Sacco's ability to meet its members' diverse financial needs.

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Correlation Analysis

Type of Guarantor on Recovery of Non-Performing Loans

Table 3: Correlation between Type of Guarantor and Recovery of Non-Performing Loans

		Type of Guarantor
Recovery of Non-Performing Loans	Pearson Correlation	.753*
	Sig. (2-tailed)	.000
	N	50

The findings indicated r=0.753 and p=0.000 revealing a positive and significant connection of type of guarantor and recovery of non-performing loans among SACCOS in Nakuru County. The findings implied that the type of guarantor enhances recovery of non-performing loans among

SACCOS in Nakuru County. According to Oluoch, (2018) who founds that found that the use of SACCO members as guarantors significantly improved loan recovery rates compared to non-members. The author also instituted that the use of non-member guarantors led to a higher rate of default.

DISCUSSION

From the analysis, the study revealed that Class B guarantors usually guarantee a smaller number of borrowers compared to Class A guarantors. Moreover, Saccos prefers Class A guarantors compared to Class B guarantors. The study also revealed that Class A guarantors are considered less risky and hence they have a positive effect on loan recovery. The Class A guarantors can guarantee a high number of borrowers which result to high loss to the Sacco in case several borrowers' default. The study also revealed that the type/classification of guarantor affects the recovery of non-performing loans among SACCOS. The findings indicated that there was a positive and significant connection of type of guarantor and recovery of non-performing loans among SACCOS in Nakuru County, (r=0.753 and p=0.000).

CONCLUSIONS AND RECOMMENDATIONS

From the findings the study concluded that Class A guarantors can guarantee a high number of borrowers which results in a high loss to Sacco in case several borrowers' default. The study also concluded that the type/classification of guarantor affects the recovery of non-performing loans among SACCOS. From the findings on hypothesis testing, the study concluded that p-value 0.000<0.05 and hence based on the rule of significance, the study rejected the null hypothesis ($H0_2$) and concludes that the type of guarantor affects SACCOS in Nakuru County's not performing loan recovery.

From the findings the study recommended that new policies be formulated to classify guarantors more distinctly. SACCOS could benefit from establishing clear criteria for differentiating between Class A and Class B guarantors this classification should ensure higher-risk loans is matched with guarantors better equipped to guarantee repayment. Class A guarantors, for instance, should be allowed to guarantee a limited number of borrowers to prevent excessive loss in the event of defaults by multiple borrowers.

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