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Njeru Duncan
Embu University College

Ibrahim Tirimba Ondabu
Jomo Kenyatta University of Agriculture and Technology

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Effect of Loan Repayment on Financial Performance of Deposit Taking SACCOs in Mount Kenya Region

Njeru Mugambi Duncan[1], Dr. Agnes Njeru[2], Dr. Florence Member[2], and Ondabu Ibrahim Tirimba[3]

[1]PhD Finance Candidate, Jomo Kenyatta University of Agriculture and Technology, Kenya

[2]Lecturer, Jomo Kenyatta University of Agriculture and Technology, Kenya

[3]PhD Finance Candidate, Research Fellow and Lecturer Mount Kenya University, Hargeisa Campus, Kenya

ABSTRACT: This study sought to explore the effect of Loan Repayment on financial performance of deposit taking SACCOs in Mount Kenya Region. The target population was all the thirty licensed deposit taking SACCOs in Mount Kenya Region, the sampling technique employed was simple random sampling and the sample size was 92 respondents. This study adopted a descriptive survey in soliciting information on effects of Loan Repayment on financial performance of deposit taking SACCOs in Mount Kenya region. Primary quantitative data was collected by use of self-administered structured questionnaires. The researcher also used secondary data derived from the audited financial statement of the SACCOs and the regulator (SASRA). The data collected was analyzed, with respect to the study objectives, using both descriptive and inferential statistics. The researcher concluded that there is need for the regulator to introduce credit policy for the sector, this will help in controlling credit risks among the SACCOs in the sector and reduce credit exposure on guarantors. Currently huge percentage of credit risk is on the guarantors but since the sector is on upward trend on growth, there is need to strengthen the sector by adoption of better and efficient credit management system and will ensure the sector is competitive across the Kenyan financial sector.

KEYWORDS: Loan Repayment, Financial Performance, Deposit Taking SACCOs, Mount Kenya Region.

1 INTRODUCTION

1.1 BACKGROUND OF THE STUDY

Cooperative societies are an autonomous association of persons united voluntarily to meet their common economic and social needs through jointly owned and democratically controlled enterprises, which are organized and operated under the principles of cooperatives (ICA, 2005).

They are embodied in the values of self-help, honesty, openness, self-responsibility, social-responsibility, democracy, quality, equity, solidarity, mutual caring, efficiency, transparency and accountability (Okello, 2006; ICA, 2005).

Generally, cooperatives are community institutions voluntarily and autonomously established and managed by the communities, and also give services for the local communities. As Alfred (2011) observed that SACCOs had a high exposure to credit risk (the risk that borrowers are unable to pay or risk of delayed payments) as well as operational risks (Basel Committee report, 2001).

There has been massive fraud of funds by SACCO leaders (Mugisa, 2010) and that delinquency in SACCOs had increased (CGAP report,2006) for instance, AlutKot SACCO in Lira loaned out Ugx 841,000,000 since 2002 but had only recovered 26% of the amount by 2010 (Ojwee, 2010).

Failure to control these risks, especially credit risk, could lead to insolvency (as cited in Wenner, Navajas, Trivelli & Tarazona, 2007). As Alfred (2011) asserts, about 2 out of 3 SACCOs initially formed were not operational (either dormant or collapsed) or for some reasons ceased operations (AMFIU report, 2007). As Alfred (2011) asserts, there have been challenges of managing liquidity (Allen & Maghimbi, 2009). For instance Barr SACCO in Lira had an insufficient loan portfolio of Ushs.12, 690,000 (Kiwalabye, 2008) as well as low profitability (Kyazze, 2010) resulting into some SACCOs failing to repay loans lent to them with recovery rate of loans advanced to SACCOs worse in the Gulu Zone (Acholi and Lango-sub regions) (Ocowun, 2010).

With the population of Kenya at 40 million it is estimated that 63% of Kenyans participate directly or indirectly in cooperative development enterprises. Kenya has the largest SACCO movement in Africa with a total membership of 8 million followed by Senegal at 5 million. To date there are over 11,200 registered SACCOs in the country, with a membership of 8 million Kenyans having mobilized domestic savings estimated at over $ 2.5 Billion. Of which 5,000 are SACCOs and 230 have Front Office Service Activities (FOSAs). The SACCO sector has mobilized over Kshs 200 billion in savings which is about 30% of the national savings. 70% of total Africa continental portfolio is Kenyan, which is also ranked 7th worldwide. Kenya sits in the group ten largest co-operative movements (G10) member's countries, (SACCO Congress, 2010). However even with these developments they still don't meet the demands for the loan applications.

Muthoni (2011) observed that members are not satisfied with the shorter repayment period, and that pegging loan on deposits was denying member's money which they had ability to pay. The Kenya Union of Savings and Credit Cooperative reported that the consequences of the global financial crisis have led to reduced growth savings: 7.6 per cent growth in savings in 2008 compared to 31.2 per cent in 2007, (WOCCU, 2009). It was reported in interviews that SACCOs in Kenya have reported increase in demand for loans, but have exercised caution in responding to requests (WOCCU, 2009).

According to Sambasivam (2013), the deposit and loan portfolio in SACCOs amounts to about 34 percent of national savings and about 24 percent of outstanding domestic credit (as cited in CBK Report, 2008). It is undeniable fact that member's loan demand is very high and incompatible compared with the availability of funds (Sambasivam, 2013). This follows that SACCOs face a risks arising from liquidity shortage and this has been a major cause of failure of many financial cooperatives (Sambasivam, 2013).

SACCOs convert immediately available savings deposits into loans with longer maturities. (Nyabwaga et al., 2011) in their study on the effect of working capital management practices on financial performance contend that working capital management routines were low amongst small scale enterprises as majority had not adopted formal working capital management routines and also the study corroborates that there is a positive relationship between working capital management practices and financial performance.

Clement at al., (2012) in their study on financial practice as a determinant of growth of SACCOs wealth content that growth of SACCO wealth depended on financial stewardship, capital structure and funds allocation strategy. Both studies did not address the issue of Loan Repayment, loan repayment and investment on non-core activities which the current study tries to address. In Kenya, SACCOs do not have access to the lender of last resort, the Central Bank of Kenya. So in times of market difficulties and constrains they have nowhere to get the asset of cash. This makes them prone to the liquidity shortage, and no matter how small, can cause great damage to a savings institution (Monnie, 2009). It is against this background that a study should be carried out on effects of loan repayment on financial performance of deposit taking SACCOs in Mount Kenya Region.

The general objective was to find the effect of Loan Repayment on financial performance of deposit taking SACCOs in Mount Kenya Region. The findings of this study will benefit, policy makers who include the management committees and the managers of the Sacco by providing information on the appropriate Loan Repayment techniques to adopt. Also the decision makers on policy in SACCO regulatory authority will benefit in ensuring SACCOs have sufficient Loan Repayment tools for their liquidity management.

2 THEORETICAL FRAMEWORK

2.1 INTRODUCTION

This chapter reviews the existing literatures theories and models related to the variables used in the study, a review of past studies on the area of study.

2.2 THEORETICAL FRAMEWORK

Kotler & Gary (2005) described theoretical framework as a collection of interrelated concepts such as in a theory to guide a research work as it determines the items for measurement and the statistical relationships being studied. A theory is a reasoned statement or group of statements, which are supported evidence meant to explain some phenomena.

2.2.1 STEWARDSHIP THEORY

Odhiambo (2012) asserts that a steward protects and maximizes shareholders wealth through firm performance, because by so doing, the steward's utility functions are maximized. In this perspective, stewards are managers working to protect and make profits for the shareholders (Davis et al., 1997). Therefore, stewardship theory emphasizes on the role of management being stewards, integrating their goals as part of the organization (Davis et al., 1997).

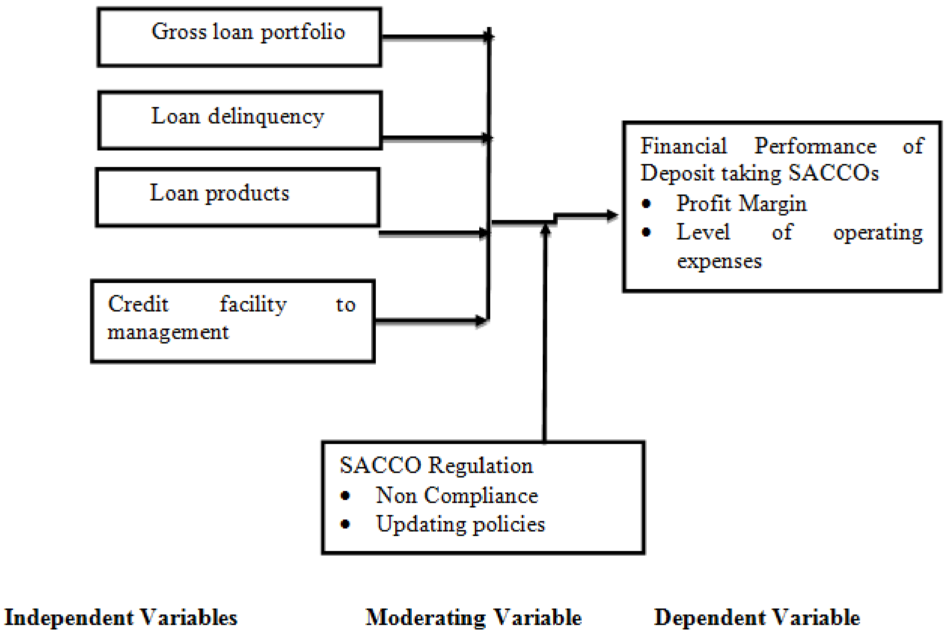
According to Odhiambo (2012) the theory recognizes the importance of governance structures that empower the steward and offers maximum autonomy built on trust (Donaldson & Davis, 1991). It stresses on the position of employee to act more autonomously so that the shareholders' returns are maximized. Indeed, this can minimize the costs aimed at monitoring and controlling employee behaviour (Davis et al., 1997). This theory has a great link to the liquidity management of SACCOs in that managers must be competent since they are employed as stewards of the SACCOs. Also they need to ensure the level of delinquent loans is minimized as stewards of the organization.

2.2.2 FREE CASH FLOW THEORY

As Huseyin (2011) asserts, managers have an incentive to hoard cash to increase the amount of assets under their control and to gain discretionary power over the firm investment decision, (Jensen, 1986). Having cash available to invest, the manager does not need to raise external funds and to provide capital markets detailed information about the firm's investment projects (Huseyin, 2011). Hence, managers could undertake investments that have a negative impact on shareholders wealth. Managers of firms with poor investment opportunities are expected to hold more cash to ensure the availability of funds to invest in growth projects, even if the NPV of these projects is negative(Huseyin,2011). This would lead to destruction of shareholder value and, even if the firm has a large investment programme and a low market-to-book ratio. Thus, using the market-to-book ratio as a proxy, it is likely that the relation between investment opportunity set and cash holdings will be negative. This is critical in management of liquidity in the firm and ensuring there is a balance between meeting the current obligation to mitigate liquidity short fall and investing in the interest of shareholders wealth maximization (Huseyin, 2011).

2.3 CONCEPTUAL FRAMEWORK

As Sammy (2013) asserts, a conceptual framework refers to a group of concepts that are systematically organized in providing a focus, rationale and a tool for interpretation and integration of information (as cited in Balachander & Soy, 2003). This is usually achieved in pictorial illustrations.



2.4 EMPIRICAL REVIEW

As Jared (2013) asserts, the rapid growth of the SACCO movement in Kenya can be pinned on the fact that they have for long periods specialized in offering cheap loans at an 'affordable' repayment history to their clients. This gesture has attracted an exodus of clients from the formal financial institutions such as banks seeking their services (as cited in ACCOSCA, 2012). Some SACCOs in Kenya have adopted Front Office Services Activities (FOSA) to offer the services they render to clients. FOSAs have proved to be one of the key profit centers for SACCOs and members have appreciated the services offered by these FOSAs.

Through the full utilization of the FOSA network, SACCOs provide their members with the full range of basic financial services and consolidate these services to the full satisfaction of members. The introduction of FOSA has contributed positively to the performance of SACCOs through improved profitability which has led to the declaration of a high dividend rates to the members (IFSB, 2005).

Mwaura (2005) insists that lack of credit follow up, credit analysis, and hostile lending of money are some of the factors that have contributed to financial gap and poor performance. In Kenya, following the liberalization of the financial sector in the 1990s (Omino, 2003), the back office model of SACCO operations was found to be inadequate and as a result, many SACCO societies introduced the front office services activities (FOSA) alternatively known as the SACCO Savings Account (SASA). This was motivated by a number of factors including the need to solve the problem of non-remittance through the check-off savings system and was aimed at among other things, improving the SACCO societies' liquidity and the promotion of the owner -user principle. By around 2003, SACCO societies in Kenya were already taking deposits from persons not drawn from the common bond, that is, public deposits, (ICA, 2003).

As Max (2012) asserts, regular share accounts (members' savings) constitute the largest part of a credit union's funding, (as cited in Saunders, 2007). In 2004 for instance, 86.1 percent of American credit unions funding came from the members' savings (Federal Reserve Bulletin, 2004). One way in which members remit their savings to a SACCO is through the regular share accounts. A regular share accounts is the savings accounts of members, (Mishkin et al, 2007).

They are types of payroll savings plans by which employees can automatically set aside a portion of their salary in a savings account, (Rose, 2003). Customers cannot write cheques against these accounts although they can withdraw funds without giving prior notice or incurring any penalties, (Kwame, 2010). However, in Kenya as many other countries, shares are not withdrawable and are used as security for loans to members, (Omino, 2003).

Additionally, customers do not receive any interest on these accounts, (SACCOL, 2011) but instead receive dividends that are not guaranteed in advance but are estimated (Rose, 2003). The share account is analogous to a passbook savings account and its return is referred to as a dividend, although it is treated as interest for individual income tax liability purposes.

A study by Landi & Venturelli (2002) analyzed the determinants and effects of diversification on efficiency and profitability amongst the European banks and found out that diversification positively affected efficiency in terms of profits, costs and revenue growth (Landi et al., 2002). In an earlier study by DeYoung et al., (1999) on the effects of product mix (diversification) on earnings volatility of commercial banks, it was found out that bank's earnings grow more volatile as banks tilt their product mixes towards fee based activities and away from traditional intermediation services, (DeYoung et al., 1999).

According to (Odhiambo, 2013) in his study on the relationship between working capital management and financial performance of deposit taking savings and credit co-operative societies licensed by SACCO societies regulatory authority in Nairobi county. Interest rate on members' deposits as measure of financial performance was used as the dependent variable. The independent variable (working capital management) was measured by cash conversion cycle, current ratio, debt ratio and turnover growth. The findings indicated that efficient working capital management leads to better financial performance of a SACCO, hence a positive relationship existed between efficient working capital management and financial performance variable.

Muriuki (2013) carried a study on the investigation unto the Cash balance management approaches in saving and Credit Cooperative Societies (SACCOs) in Nakuru County, the study's findings indicate that though a majority of SACCOs were conscious about the need to manage their cash balances very few had policies on cash balance management. SACCOs were found to manage cash in a haphazard manner and no one cash management model was found to be used entirely. The study concluded that there was no significant difference in the cash management approaches used by the employee based and association based SACCOs.

Jared (2013) in his study on the challenges facing deposit-taking savings and Credit cooperative societies' regulatory compliance in Kenya found out that the various challenges facing compliance in these institutions included non-separation of shares from deposits, high dependence on short-term external borrowing, lack of liquidity monitoring system, high investment in nonearning assets, inadequate ICT system, inadequate managerial competencies and political interference among others. The study realized that even with the challenges opportunities were available for compliant SACCOs including capital accumulation and agency business largely arising from access to Government funds for on-ward transmission to youth and women groups. The findings of this study are important for the particular organizations under study to address the challenges so as to improve regulatory compliance, the industry to anticipate and endeavor to overcome the challenges and also aid the regulatory Authorities to enhance on their mandate.

3 PRINCIPAL FINDINGS

From the data collected, out of the 92 questionnaires administered, 68 were filled and returned, which represents 74% response rate. This response rate is considered satisfactory to make conclusions for the study.

The researchers established that the level of gross loan portfolio was average as indicated by mean of 3.00 and the point was confirmed by positional average of the median value of 3.00. The level of dispersion was very high as indicated by standard deviation of 0.879 hence it showed that across the period, gross loan was varying at high levels. This also reviews the great need of loan by members which confirms the key mandate of deposit taking SACCOS on the issuance of loan to its members. This reviewed that management has taken precautionally measures on the management of the gross loans and they were abit pessimist on the dangers of having a huge gross loan on their books.

The researchers also established that the rate of loan default was on an increase as indicated by mean of 2.65 and also management provision mean of 3.43. The data reviewed that management had a higher provision that rate of default which is an application of the accounting principle of prudence. Loan default was highly dispersed as shown by standard deviation of 0.787 hence the need to introduce strict measures on the level of loan default for the SACCOS. This is because it has great effect on the cash management since they money is required for undertaking other investment by the institution which directly affect financial performance of the deposit taking SACCOS.

They main way to mitigate loan default by the SACCOS, is through loan guarantees. The researcher established that accessing guarantees was not a big issue as indicated by mean value of 4.68, but dispersion rate was very high as shown by standard deviation of 6.173. Hence the members were fearful in loan guarantees but since they also needed someone to assist them when they needed to access the money, they had no other option.

The level of outstanding loans in the deposit taking SACCOS was very high as indicated by the mean of 3.04; hence the need of the management to established strategies to reduce the level of outstanding loans since it has direct impact on cash management and will definitely affect financial performance of the institution.

To improve their financial performance, SACCOS have moved forward to diversify their loan products, the researcher established that the following were the main loan products offered by the SACCOS: staff members loan; nominal loan; investment loans; agribusiness loan; smart loan; personal loan; premier loan; fanikisha loan; Tosa pride loan; mortgage loan; normal loan; micro credit loan; development loan and business loans. This reviewed that there was high demand of funds by their members hence the need to diversify their loan products portfolio. The researcher also established that in the financial sector there was high competition from other players in the sector hence the need of the institution to diversify their loan products. It also reviewed the role played by the SACCOS in the development of the economy is very critical and the policy makers need to address key policies on the development of the SACCOS so that they can have a level playing field in the financial sector and contribute towards the country's economic development.

There was a Strong positive relationship between Loan Repayment and Financial Performance of Deposit taking SACCOs in Mount Kenya Region as indicated by correlation of 0.786. The p-Value of 0.001 is less than the acceptable significance level (α), hence the null hypothesis that there is no relationship between Loan Repayment and Financial Performance of Deposit taking SACCOS in Mount Kenya Region was rejected. This shows that the sampled data can be applied to the general population across registered deposit taking SACCOs at 95% confidence level.

4 CONCLUSION AND RECOMMENDATION

Loan repayment is the obligation of members to ensure that SACCOs have adequate cash to meet new Members loan obligation. The researchers noted there were huge credit risks encountered among different SACCOs, hence the need of the management to ensure there are improved policy on credit policy and this will reduce liquidity risk and improve financial performance of the SACCOs.

With the SACCO regulator on board, there is need to introduce compliance on international financial reporting standards (IFRS) to ensure that all SACCOs have a standard way of reporting and it will be easier to monitor loan obligation among different SACCOs since huge loan has a ripple effect on the performance of the economy in relation to inflation rate, gross domestic product of the country.

The following are the recommendation from this research study: There is need for the regulator to introduce credit policy for the sector, this will help in controlling credit risks among the SACCOs in the sector and reduce credit exposure on guarantors.

Currently huge percentage of credit risk is on the guarantors but since the sector is on upward trend on growth, there is need to strengthen the sector by adoption of better and efficient credit management system and will ensure the sector is competitive across the Kenyan financial sector.

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