

Loan Security Policies and Financial Performance of Savings and Credit Cooperatives in Kakamega County, Kenya

Author's Details:

⁽¹⁾Musabi Antony Barasa ⁽²⁾Rev. Dr. Willis Otuya (Phd)

⁽¹⁾Part Time Lecturer- Masinde Muliro University Of Science And Technology & Council Lecturer- The Sigalagala National Polytechnic, ⁽²⁾Senior Lecturer & Chaplain-Masinde Muliro University Of Science And Technology

Abstract

Experts have observed that Saccos sector remains fragile. Evidently, SASRA recently gave strict licenses to Saccos that had failed to meet capital requirement of Kshs 10 million. Likewise, unscrupulous Saccos have also colluded among themselves to fleece members of their deposits and investments. Further, parliament recently passed a bill that made mandatory university qualification a requirement for one to hold leadership in Sacco. Though effort by all stakeholders to save troubled Sacco sector is commendable, dynamism of Sacco sector and unending desperate effort to revamp it has now put to question and left most stakeholders in a dilemma on whether loan policies have influence, if any on financial performance of Saccos. This study will therefore investigate the influence of loan collection policies on financial performance SACCOS in Kakamega County, Kenya. This study is supported by Modern portfolio theory. A descriptive survey was adopted and targeted 143 senior management staff from 13 SACCOS located in Kakamega County with a sample size of 105 selected using stratified random sampling technique. A structured questionnaire was used as instrument. A pilot study was conducted among 20 senior management staff of SACCOS in Bungoma County, Kenya, so as to check validity and reliability. The data was coded for completeness and accuracy and stored. Computer software-Statistical Package for Social Sciences (SPSS) version 24 was used in analysis. Descriptive statistics which include percentages, frequencies, mean, and standard deviations will be computed. For variable relationships, correlation analysis, linear and multiple regression analysis was computed. This study will aid SACCO management committees, staff and relevant shareholders in understanding the importance of loan security policy that enables them seek solutions to the loan defaults. The study findings showed a positive correlation between Loan security Policies and financial performance ($R= 0.869$ with ROA). It was evident from results that adherence to Loan Collection Policies positively contributes to financial performance of Sacco's in Kenya and there was variation on financial performance due to changes in loan security policies. The study recommends that Saccos should adhere to loan security policies to ensure increased financial performance and increased volume of business. The study concluded that Loan security policies influence the financial performance of Saccos.

Key Words: Loan Security Policies, Financial Performance, SACCOS

Background of the Study

Loan security policies are guidelines that are used by Saccos in terms of the amount of collateral required before advancing loans to borrowers. Though majority of SACCOS have this guideline well drafted, adherence them to them has not been evident. Studies already done on Loans have not focused on loan security policies and financial performance of the SACCOS. In Kenya SACCO sector is struggling with experts warning that this might escalate a financial crisis in the economy. The saccos sector remains fragile. Efforts made by SASRA including but not limited to strict licenses to Saccos, though commendable, the Sacco Sector continues to perform poorly with some Sacco's openly violating capital requirement regulation of 10 billion. It points out a warning sign that if regulatory measures aren't adhered to, then what about self made policy guidelines such as loan security policies.

Crucially, it is shocking that most researches on SACCO performance have been on credit with little focus on loan security policies. Further, findings by Council of Credit Unions, (2009) which shows that Saccos in rural

areas have become functionless since most of them are already troubled by operational environment and since they have resorted to charging high interest rates on loans to redeem themselves, they have been shun by borrowers. Hence, there is need for urgent solutions by simply coming up with Loan Security Policies to improve on their financial performance. Some empirical evidence has shown that in most developing economies, savings and credit co-operatives have brought millions of citizens into cohesive financial institutions that are succeeding very well in providing financial services to its members for improving their standard of living (Council of Credit Unions, 2009). Likewise previous studies have established that social-economic and demographic factors such as age, income, marital status, gender, family size, occupation, have a bearing on households' credit worthiness and repayment behavior of the borrowers on credit market (Council of Credit Unions, 2009).

SACCO Performance: Kenyan Perspective

Kenya has both financial co-operatives and non-financial co-operatives. There are those involved in financial intermediation such as Savings and Credit Cooperative Societies (SACCOs), the Land or Housing Co-operative Societies, and Investment Cooperative Societies. SACCOs help members afford them an opportunity to accumulate savings and create a source of funds at fair and reasonable rate of interest. They also provide an opportunity for each of its members to improve their respective 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 products as may be required by the members from time to time. SACCOs ensure 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).

Statement of the Problem

SACCOs in Kenya are on the brink of collapse (Ergetew, 2016). This is due to the burden of non performing loans and failure to devise and implement appropriate loan security policies. A recent report by SASRA (2018) indicates that majority of Saccos are under solvency and liquidity crises. This has made government draft legislation that has further complicated the future of SACCOs since non of them are prepared to comply. SASRA has reviewed the licenses of majority of Saccos in Kenya. However this has had little impact on improving the financial performance of SACCO sectors whose impact on economy is evident.

Crucially, it is shocking that most researches on SACCO performance have been on credit with little focus on loan security policies. Further, findings by Council of Credit Unions, (2009) which shows that Saccos in rural areas have become functionless since most of them are already troubled by operational environment and since they have resorted to charging high interest rates on loans to redeem themselves, they have been shun by borrowers. Hence, there is need for urgent solutions by simply coming up with Loan Security Policies to improve on their financial performance. A study by Emmy and Otinga (2019) focused on lending policies and gave little emphasis on loan security policies but gave greater attention to lending policies. While other researches on loan security policies have been based in banks and Micro finance institutions which have even yielded inconclusive study results(Tengey, 2014), with few empirical studies in SACCOs (Maiti, 2015). It is therefore against this backdrop that this study endeavors to investigate the influence of loan security policies on financial performance SACCOs in Kakamega County, Kenya

Specific Objectives

To examine the influence of loan security policies on financial performance SACCOs in Kakamega County

Research Question

Does Loan security policies influence the financial performance of SACCOs in Kakamega County.

Significance of the Study

This study benefits the SACCO board of directors, management committees and staff in understanding loan security policies, reduce loan defaults and consequently solve the problem of non performing loans and improve financial performance of Saccos.

Scope of the Study

The study will only be carried out in SACCOs in Kakamega County, which is one of the forty seven counties located in the Western region of Kenya (Constitution of Kenya, 2010). The study intends to investigate the effect of loan security policy on financial performance of SACCOs in the County. The study was done in August and September 2019.

LITERATURE REVIEW

Balanced Portfolio Theory

The portfolio theory approach is also relevant and plays an important role in financial lending institutions and loan performance (Nzongang & Atemnkeng, 2006). According to the Portfolio balance model of asset diversification, the optimum holding of each asset in a wealth holder's portfolio is a function of policy decisions determined by a number of factors such as the vector of rates of return on all assets held in the portfolio, a vector of risks associated with the ownership of each financial assets and the size of the portfolio. It implies portfolio diversification and the desired portfolio composition of commercial banks are results of decisions taken by the financial institutions management. Further, the ability to obtain maximum profits depends on the feasible set of assets and liabilities determined by the management and the unit costs incurred by the financial lending institutions for producing each component of assets (Nzongang & Atemnkeng, 2006). This theory applies to this study in that, financial performance of SACCOs can be determined by loan security policies.

Loan security policy and financial performance of SACCOs

Nizar and Javed (2007) did a study on the use of loan security in terms of collateral in the Islamic microfinancing sector. The Islamic system of banking and finance, in its essence, is believed to contribute to the emergence of a just and growing healthy economy by giving small enterprises the opportunity to obtain finance on the participatory basis in which collateral would not be necessary. Muslim economists argue that since the Islamic system is a system based on participatory financing then Islamic banking would not depend on tangible collateral as much as Interest based/Western banking. Western/Interest based banking system generally provides credit to those clients who are able to offer sufficient tangible collateral that gives them legal entitlement to tangible assets in the event of default. However, in the long run this banking policy further widens the already large income gap between the upper and lower classes of the society. Furthermore, the existence of collateral requirements makes banks indifferent to the efficiency or success of the business being financed by the loan, as many inefficient micro-businesses may secure credit by virtue of collateral. Conversely, many efficient micro-businesses/ micro-entrepreneurs may not find access to credit because they are not able to provide sufficient collateral (Nizar & Javed, 2007).

Therefore, once collateral requirements are removed, it becomes crucial for MFIs to screen projects on the basis of their feasibility; if a project is unsuccessful then it will not be able to make repayments to the bank hence the bank is bound to screen projects vigilantly. There has been a debate among the Muslim economists on whether collateral is required for Islamic financing activities; Muslim economists have given theoretical justifications that as the profit and loss sharing arrangements, like the equity financing, implies risk sharing, it also by-passes the collateral requirements because in their views, this would improve the efficacy of the credit market (Nizar & Javed, 2007).

In India, Muslim Funds, registered under the Charitable Trust Act of the Government of India, are not entitled by rule to invest depositors' money. Furthermore, these Muslim Funds do not practice any of the Islamic principles of financing such as mudaraba, musharaka or murabaha. The study has shown that as inferred by the

afforested information, Muslim Funds in India are heavily dependent on the collateral for their existence. Since they operate under the rules of the Charitable Trust Act rather than the banking laws of India, they are required to collect collateral or any type of special security (Segrado, 2005).

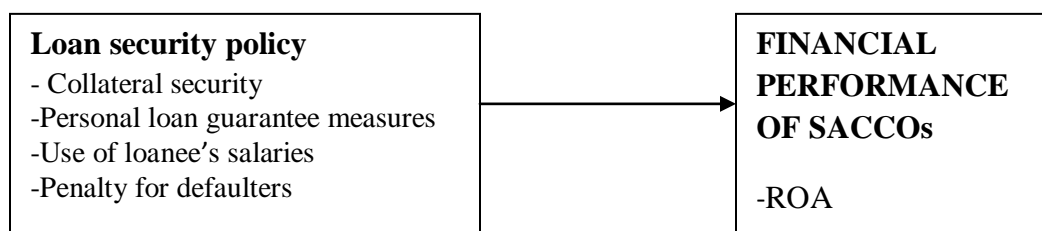
Central Bank of Sudan (2007) asserts that the international and local experience has demonstrated that the best type of guarantee is a viable project, a good client and a close follow-up. Hence any recommendations advocating the adoption of lenient collaterals as a form of extending outreach must be supported by the implementation of best practice in terms of loan analysis, loan product design, risk and delinquency management procedures, actions before and after loan disbursement, and close monitoring. To adopt such practices, banks interested in financing SACCOs should restructure their services in an efficient manner and adopt mechanisms, which make them nearer to the targeted clients. Intensive training to the sales force will be crucial for ensuring proper assessment of projects' viability and client's credibility.

Conceptual Framework

This study was guided by the following conceptual framework (figure 2.1), which will be used to describe the relationship between independent and dependent variables. The framework conceptualizes the components loan security policy as independent variables while the financial performance of SACCOs is the dependent variable.

Independent Variables

Dependent Variable



Loan security policy and financial performance in SACCOs

This will assess if loan security policy in terms of collateral security, personal loan guarantee measures, use of loanee's salaries and the penalty for defaulters influences financial performance of SACCOs in Kakamega County as measured by ROA. This is because secured or no-secured loans can obviously have an impact on financial performance of SACCOs.

Financial performance in SACCOs

This is the dependent variable in the study. Return on Assets (ROA) falls within the domain of financial performance measures and tracks SACCO's ability to generate income based on its assets. The ratio excludes non-operating income and donations. Financial profitability is the ability of a finance lending institution to cover all of its costs through interest and other income paid by its clients (Ayay & Sene, 2010). ROA provides a broader perspective compared to other measures as it transcends the core activity of finance lending institutions namely, providing loans, and tracks income from operating activities including investment, and also assesses profitability regardless of the finance lending institution's funding structure.

Lastly, there is lack of empirical data to support Greenbaum et al. (1991) assertion that when a loan is not repaid it may be due to the loan policies applied in credit assessment procedures, which in turn decides who is granted a loan, consequently influencing financial performance of SACCOs; while Coyle (2000) defines as the potential loss from the refusal or inability of credit customers to pay what is owed in full due to loopholes in loan policies. Therefore, this research endeavours to fill this gap by investigating the influence of loan security policy on the financial performance of SACCOs in Kakamega County, Kenya.

RESEARCH METHODOLOGY

3.2 Research Design

A research design as a road map that provides the glue that holds the research project together (Brown, Venkatesh & Bala, 2013). This study will utilize a descriptive survey design. That is, a descriptive survey design helps the researcher 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 are prevalent in the society. Descriptive surveys further enable the researcher to focus on the links among a smaller number of the target population (Mugenda & Mugenda, 1999).

Target Population

The target population of the study is 143 senior employees of all the 13 SACCOs in Kakamega County as indicated in table 3.1. The list of the 13 SACCOs in Kakamega County is enlisted in the appendix.

Table 3.1 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

3.4 Sample Size and Sampling Techniques

Sampling is a process of selecting a number of individuals or objects from a population such that the selected group contains elements representative of the characteristics found in the entire group (Saunders et al., 2012).

$$n = N / (1 + N(e)^2)$$

Where n=Sample size

N=population under study

e=margin error (0.05)

1= constant

Therefore

$$n = 143 / (1 + 143(0.05)^2)$$

$$n = 143 / (1 + 143(0.0025))$$

$$n = 143 / (1 + 0.3575)$$

$$n = 143 / 1.3575$$

$$n = 105.341 \text{ rounded off to } 105$$

Therefore a sample size of 105 senior management staff will be selected using stratified random sampling technique.

Table 3.2: Sample Size

Category of Staff	No. of Senior Management Staff (N)	n= (N/Target Pop.) X Sample size
CEOs	12	09
Branch managers	01	01
Finance managers	13	10
Internal Auditors	13	10
Credit managers	13	10
Customer Care& Marketing Officers	26	19
Business Operations Officers	26	19
Loan Officers	39	27
Total	143	105

Data Collection Instruments

The study will use a structured (close ended) questionnaire to get uniform responses from respondents. The structured questionnaire is relevant for this study because respondents are provided with questions for each study variable and relevant information can be collected over a short period of time, easy to administer and cost effective (Mugenda & Mugenda, 2003). The structured questionnaire for use in this study will be designed for senior management staff in SACCOs in Kakamega County.

Pilot Testing

The objective of piloting is to detect any ambiguities in the questions, identifying problems in research methodology and data gathering techniques. The result of the pilot test was used to identify areas where the questionnaire requires correction such as clarity of statements and use of flawless words in the questions so as to ensure content validity. In order to test the reliability of the instrument, the Cronbach alpha test which is a measure of internal consistency will be used.

The validity of the Instruments

The validity of an instrument is asking the right questions framed as per study variables to avoid ambiguity. Content validity was used in this study, whereby a pre-test of the questionnaires will be done during pilot testing to ensure the items in the questionnaire are clearly stated, meaningful and have adequate content.

Reliability of Data Collection Instruments

Cronbach's alpha coefficient of internal consistency was used to determine the correlation co-efficient of the reliability of the research questionnaire. That is, in order to test the reliability of the instrument, the Cronbach alpha test which is a measure of internal consistency will be used in which closely relates a set of items are taken as a group and a Cronbach alpha coefficient calculated using SPSS analytical software.

Data Processing and Analysis

The quantitative data collected will be analyzed by the use of descriptive statistics using Statistical Package for Social Sciences (SPSS 24) and presented through percentages, means, standard deviations and frequencies. For variable relationships, correlation analysis and linear regression analysis will be computed

. The multiple regression model equation is;

$$Y = \alpha + \beta_1 X_1 \text{ Where;}$$

Y is the dependent variable (Financial Performance of SACCOs in Kakamega County), α is the constant,

β_1 is beta coefficients,

X_1 are independent variables (lending policy, loan collection policy, loan insurance policy and loan security policy) and

ε is the error term.

Assumptions of Multiple Regression Analysis

(i) Accuracy of data. The study will ensure content validity and cronbach's alpha (which is a measure of reliability) will be applied to ensure this assumption is met.

(ii) Outliers. Since descriptive statistics will be computed during data analysis, values with at least 3 standard deviations below or above the mean will be removed to ensure that this assumption of outliers is met.

(iii) Normality. Data should be normally distributed. The use of histograms with normal bell-shaped curve will be used to check this assumption.

(iv) Linearity test. The independent and dependent variables must have a linear relationship because of regression tests linear relationships. In this study correlation analysis will be computed to determine whether independent variables have significant correlation with the dependent variable.

(v) Multicollinearity-This involves checking to confirm whether two or more predictors in the model are correlated since this leads to problems with understanding which independent variable contributes to the variance explained in the dependent variable, as well as technical issues in calculating a multiple regression model. Correlation analysis will be used to check this assumption.

RESEARCH FINDINGS AND DISCUSSION

Response Rate

According to Mugenda and Mugenda (2003), adds that a response rate of 50% is sufficient for analysis and reporting; a response rate of 60% is good while a response rate of 70% and over is excellent. Table 4.1 shows that the study achieved a response rate of 76%. The response rate for the study was therefore excellent.

Table 1: Response rate.

Questionnaire	Frequency	Percentage (%)
Returned	100	70
Unreturned	43	30
Total	143	100

Descriptive Analysis

In an attempt to determine the influence of the independent variable as represented by loan security policies on financial performance of Saccos in Kakakmega County as represented by return on asset. The results of descriptive analysis are presented as follows:

Loan security policies

The study also sought to determine the influence of loan security policies on the financial performance of Saccos. This variable was operationalised by Collateral security, Personal loan guarantee measures, Use of loanee's salaries, Penalty for defaulters and presented in table 4

Table 2 : Descriptive statistics on Loan Security Policies

	Frequency and Percentage (%)					Mean	Standard Deviation
	SDA	DA	N	A	SA		
Need for collateral Asset	2(2.6)	5 (6.5)	2 (2.6)	56(72.7)	12 (15.6)	4.92	.914
The value of the collateral used	2(2.6)	3(3.9)	2(2.6)	59(76.6)	11(14.3)	4.96	.861
Effectiveness of loan security policies	2(2.6)	2(2.6)	3(3.9)	58(75.3)	12(15.6)	4.99	.824
Use of salary as a security	1(1.3)	2(2.6)	6(7.8)	54(70.1)	14(18.2)	5.01	.787
Implementing Loan Security policies	2(2.6)	2(2.6)	5(6.5)	56(72.7)	12(15.6)	4.96	.841
Personal guarantees for Loanees	2(2.6)	2(2.6)	7(9.1)	56(72.7)	10(13.0)	4.91	.857
Penalty for Defaulters	3(3.9)	2(2.6)	5(6.5)	61(79.2)	6(7.8)	4.84	.852
Valid N (listwise)	100						

Financial performance

The study also analysed financial performance using descriptive statistics. Financial performance was operationalised using return on asset and their results presented in table 4.5.

Table 2: Financial performance

No.	Constructs of FP	Min	Max	mean	Std Deviation
2	Return on Assets	5.90	7.70	7.80	0.8426

Test of Statistical Assumptions

The study carried out tests on statistical assumptions such as normality, linearity, a test of independence, homoscedasticity and multicollinearity using Shapiro-wilk test, ANOVA test, Durbin Watson test, Levine test and variance inflation factor (VIF) respectively.

ANOVA tested the linear regression assumption and non-linearity is exhibited when the p-value < 0.05 hence a p-value > 0.05 means that there is a linear relationship. As shown in table 4.6 the p-values were greater 0.05 which means that the linear regression assumption in the linear regression was met.

The normality test was done using Shapiro-Wilk test. When the results of the test give a significance value < 0.05 the normality assumption has been violated and when the value is > 0.05 the variables had a normal distribution. The results in table 4.6 show that normality was met since values are > 0.05.

This study adopted the Durbin Watson (DW) test to check that the variables in the study were not interdependence. The results as shown in the table show that there was no interdependence among the variables because DW statistics for all the variables were between 1.5 and 2.5 prescribed value for residual independence.

To test for Homoscedasticity Levine test was used. The end results indicate that there was no homoscedasticity because the p values are greater than the 0.05 threshold set for the test.

Table 3 Assumption of Linear Regression

	Threshold Assumption is met if	Loan Collection Policies
Normality test Shapiro-Wilk	p>0.05	0.793
Linearity	p>0.05	0.332
ANOVA Test		
Test of Independence	1.5-2.5	1.909
Durbin-Watson		
Homoscedasticity Test	p>0.05	0.083
Levine Test		
Multi-collinearity Test	VIF 10 Max	0.833 (1.695)

Correlation

The study adopted a pearson correlation to determine the relationship between the independent and dependent and also check multicollinearity between the independent variables. A Pearson value greater than 0.8 shows the existence of multicollinearity.

Table 4 Correlation Matrix

		FP				
Loan Security policies	Pearson Correlation	0.904**	.022	.756*	.846**	1
	Sig. (2-tailed)	.918	.691	.057	.001	
	N	100	100	100	100	100

** . Correlation is significant at the 0.05 level (2-tailed).

Loan security Policies showed a strong association with financial performance.

Regression Analysis

Loan security Policies and Financial Performance

Regression analysis was used to show the relationship between Loan Security policies and financial performance. Therefore how Loan security can be used to predict the financial performance of Saccos in Kakamega, Kenya. The results of the study are indicated in table 5:

Table 5 Loan Security Policies and Financial Performance

Model	R	R Square	Adjusted R Square	Std. The error of the Estimate		
1	.257 ^a	.066	-.286	.96039		
Model	Unstandardized Coefficients	Standardized Coefficients	T	Sig.		
	B	Std. Error	Beta			
1	(Constant)	5.343	3.381		1.580	.212
	Loan Security Policies	-.156	.339	-.257	-.460	.677

Overall Regressions Analysis

Multiple Linear Regression analysis for Loan Security Policies dimensions on financial performance was conducted in order to find out whether the Loan security policies dimension as a whole jointly influences financial performance of Saccos in Kakamega County, Kenya. This facilitated the formulation of the model of the study and its R square. The outcome of the analysis is in table 6

Table 6 : Overall Regression Analysis

R	R ²	Adjusted R ²	Df	F	Sig.
.988 ^a	.976	.701	(1,100)	36.106	.000 ^b

a. Predictors: (Constant), Loan security Policies.

b. Dependent Variable: Financial performance

From table 6, it is evident that there is positive high linear relationship between Financial Performance and all the independent variables which are Loan security Policies with correlation coefficient $r = 0.988$ while coefficient of determination resulting from this analysis was $(r^2) = 0.976$, and this shows that 97.6% of proportion of financial performance can be accounted for by the all independent variables in this study while 19.2% of the amount of financial performance can be accounted for by other factors which have not been included in this model.

It can be noted from results given by ANOVA that F test gave a value of $F(1, 100) = 36.16$, $p < .01$, this attempts to support the goodness of fit of the model in accounting for variation in financial performance. This shows that loan collection policies are an important predictor of financial performance of Saccos in Kakamega County, Kenya.

Table 7: Model Coefficients

	Unstandardized Coefficients		Standardized Coefficients		
	B	Std. Error	Beta	T	Sig.
(Constant)	.140	.528	.493	.426	.671
X ₁	.889	.308	.521	3.683	.000

a. Dependent Variable: Financial Performance

From table 7, Loan security policies carried positive and significant predictive power ($P < 0.05$). When there are no loan collection policies, financial performance was found to be 0.140, $p > 0.05$ indicating that while financial performance is still positive, it is insignificant. Recent research by Emmy (2018) also points out similar trend of finding that there exists a positive relationship between Loan Collection Policies and financial performance. However, this result fails to agree with those made by Angweye (2019) who found that there is no relationship between Loan security policies and financial performance of Saccos.

A regression of all these independent variables with regard to financial performance through what is referred to as multiple linear regression analysis resulted in a model that is:

$$\text{Financial Performance} = 0.140 + 0.889X_1$$

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

Loan Security Policies

It is evident from the findings that there is a high positive statistical significance between Loan security Policies and the financial performance of Saccos in Kakamega County, Kenya. Saccos need to continuously update and draft workable loan security policies and adhere to them in order to witness improved financial performance and curb the existing crises caused by their collapse. This end result agrees with those found by Emmy and Otinga (2019) loan security policies has a positive relationship with return on Asset in Kenya.

Conclusions

Sacco sector has witnessed fragility, financial instability and poor performance due to failure to adopt and implement loan security policies.

Recommendations

SASRA which is a regulatory authority for SACCOs should implement its strict regulations to ensure compliance by SACCOs to minimum capital regulations and other measures.

A competent board of directors should be elected and even employees recruited based on their competence, skills and knowledge.

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