INFLUENCE OF LENDING POLICY ON THE QUALITY OF LOAN PORTFOLIO AMONG DEPOSIT TAKING SAVINGS AND CREDIT CO-OPERATIVES IN STAREHE SUB-COUNTY, NAIROBI, KENYA

BY

JOASH KIPROTICH NGENO

A Research Project Report Submitted in Partial Fulfillment of the Requirements for the Award of the Degree of Master of Arts in Project Planning and Management of the University of Nairobi

2017

DECLARATION

This is my original research project report work and has not been presented for examination in any other university.

Signature……………………………….. **Date…………………………..**

JOASH K. NGENO

L50/71359/2014

This research project report has been submitted for examination with my approval as the University Supervisor.

Signature……………………………. Date…………………………….

DR. ANNE ASEEY
SENIOR LECTURER, UNIVERSITY OF NAIROBI

DEDICATION

This research project is dedicated to my loving wife Daisy and my beloved daughter Elizabeth for their unending support and encouragement.

ACKNOWLEDGEMENT

In undertaking this study, I received invaluable guidance and support from many individuals and I wish to most sincerely express my gratitude to them all. I thank my supervisor Dr. Anne Aseey for the technical advice, encouragement and guidance she provided during the development of this research report.

My sincere appreciation also goes the lecturers in the department of extra mural studies, University of Nairobi led by the chairman of the department Prof. Charles Rambo for their guidance and professional support while undertaking this course.

Finally, I thank my colleagues for their constructive criticisms, suggestions and encouragement which greatly contributed to my completion of this research project.

TABLE OF CONTENT

LIST OF TABLES

LIST OF FIGURES

ABBREVIATIONS AND ACRONYMNS

BOSA:	Back Office Service Activity
CBK:	Central Bank of Kenya
CEO:	Chief Executive Officer
CRB:	Credit Reference Bureau
DTS:	Deposit Taking SACCO
FOSA:	Front Office Service Activity
FSD:	Financial Sector Deepening
KBA:	Kenya Bankers Association
KCB:	Kenya Commercial Bank
KIPPRA:	Kenya Institute of Public Policy and Research Analysis
MFI:	Micro Finance Institution
SACCO:	Savings and Credit Co-operative Organization
SASRA:	SACCO Societies Regulatory Authority

ABSTRACT

The need for project financing remains high throughout the world as more countries require increasing supplies of utilities and infrastructure. At the center of the project financing structure are the lending institutions and the growing importance of credit and lending thereof. Sound loan portfolio of lending institutions in Kenya is a prerequisite for their stability, continuity and growth. Accordingly, a vast majority of previous studies have largely focused on commercial banks and Microfinance Institution in Kenya (MFIs) and financial performance thereof, leaving SACCOs and particularly deposit taking SACCOs with respect to the quality of loan portfolio largely unexplored. Against this backdrop, the present study sets out to investigate the influence of the lending policy on the quality of loan portfolio with reference to deposit taking SACCOs in Starehe Sub County, Nairobi County. More specifically, this study sought to establish the influence of the following variables on the quality of loan portfolio among deposit taking SACCOs in Starehe Constituency: character appraisal; collateral appraisal; capital appraisal and capacity to pay appraisal. Both theoretical and empirical literature pertaining to the study problem were reviewed. Whereas the theoretical literature focused on the theories and models underpinning the study, the empirical literature reviewed previous scholarly work in relation to the present study's research objectives. This study used the descriptive research design. The target population consisted of all the twelve licensed deposit-taking SACCOs in Starehe Sub County, Nairobi County. The sample size of the study consisted of a census of the SACCOs in the target population. The study used both primary and secondary data. A structured questionnaire was used to collect data. Data was analyzed using descriptive statistics and represented using figures and tables. Mean and standard deviations was also used as measures of central tendencies and dispersion respectively. The study found that client character plays a significant role on how a client repays credit granted 60 (80%), most respondents indicated that client collateral appraisal reduces delinquency rate, loan provisions and bad debts, M=3.946 (SD=0.8523), almost all respondents indicated that lending institution performs client capital appraisal when advancing credit 60 (80%) and almost all respondents indicated that client has to demonstrate capacity to pay before credit is advanced 74 (99%).The study recommends that SACCOs should ensure full compliance with the lending policies in advancing loans to clients and also balance between collateral requirements and the individual capacity to pay when making their lending decisions. The study also recommends that SACCOs should continuously review their lending policies to enhance the evaluation of loan applications and to ensure applications are ranked according to merit. The study suggests that further research should be done on the influence of the lending policy on the quality of loan portfolio among deposit taking SACCOs in other Counties to establish if the findings will be the same.

CHAPTER ONE

INTRODUCTION

1.1 Background of the study

The need for project financing remains high throughout the world as more countries require increasing supplies of utilities and infrastructure. At the center of the project financing structure are the lending institutions and the growing importance of credit and lending thereof. In the financial sector, giving out loans is the dominant assets of most lending institutions and is said to generate the largest share of operating income (Gyemibi, 2011). However, poor loan portfolio quality among lending institutions as indicated by low percentage of loan recovery has been reported the world over attributable to factors such as adverse selection and failure to match borrower characteristics with the loan amount or any other external shock that may interfere with the borrower ability to pay back the loan (Kimutai and Akuku, 2013).

The performance of lending institutions the world over has been of great interest to academic researchers since the great depression of the 1930 (Ongore et al., 2013). Globally, lending institutions performance crises have been reported in countries like Mexico and Venezuela and in Japan (Njanike, 2009). Elliot (2008) asserts that in the USA Citi Group alone wrote-off more than thirty-nine billion US dollars in losses in the year 2008. Waweru and Kalani (2009) assert that lending institutions in the US and in many countries both developing and developed have at time experienced serious performance difficulties in the last century. This happens when lending institutions profitability decline significantly, while clients' defaulted payment of the credit advanced.

Client appraisal is one of the loaning policy undertakings executed to reduce losses arising from default and improve loan quality portfolio among lending institutions (Ongore et al., 2013). Lending institutions face multiple risks in their line of business. Due to the nature of business (lending), lending institutions are exposed to the risk of default from borrowers. The default risk arises as a result of a number of factors both external and economic related or weakness and failure of internal processes within the lending institutions (Kumbirai and Webb, 2010).

According to Waweru and Kalani (2009) controlling default is very important for the performance of individual bank financial performance. The loan portfolio is the primary income generating asset for a lending institution and it is most commonly subject to material misstatements. Most lending institution failures stem from the deterioration in the quality of the loan portfolio. An assessment of the risks and inadequacies inherent in a lending institution's portfolio therefore assumes tremendous importance and this is the most important objective of a loan portfolio assessment. The quality of loans deteriorated in 2007-2008 globally (Kumbirai and Webb, 2010). A report by Central bank of India (2009) points a rise in non-performing assets (loans) in the year 2009 as reflected in the increased amount of provisions to cater for the defaulted loans. Within three years, 2007-2010 the provisions grew by 22.4 per cent. This was aimed at cushioning lending institutions towards the expected losses arising from default to pay loans (Kroszner, 2010). In Norway from 1987-93 the central bank provided special loans to six banks suffering from post-recession of 1985-86 and from problems in real estate. The state took control of three largest banks whose loan losses were capable of wiping out their entire capital. In Mexico in the 1980 the government took control of trouble lending institution, while in Japan in the 1990 unofficial estimate of non-performing loans was around 40 trillion yens (Mikiko, 2013).

The performance of lending institution in Africa has not been any better. The continent was not spared from global lending crisis and poor performance of lending institutions. According to Njanike (2009) between 2003 and 2004 several banks were forced to close in Zimbabwe, with the number of lending institutions declining from 40 to 29 over this period. This was mainly attributed to insider loans, speculative lending and high concentration of credit to certain sectors, contrary to prudent client appraisal required (Njanike, 2009). The closure was also due to the fact that lending institutions in Zimbabwe were incurring losses which reduced capitalization making continued operation impossible.

Kenya's financial sector has had turbulent past characterized by lending institutions failure. According to Kariuki and Wanjiri (1994) Kenya experienced banking crisis from 1986 culminating in the closure of several banks in the 1990s. The major reason to the massive failure of lending institutions in Kenya was attributed to borrowers defaulting loan repayment. These loans were granted to politically connected individuals prior to the 1992 election in total disregard of appraisal criterion. Further, Waweru and Kalani (2009) opined that, large local banks which collapsed in the past such as Trade Bank and Pan African Bank were due to involvement in a widespread insider lending, often to politicians. This was done with appraising borrowers' character, collateral, ability to pay or even asset and liabilities owned by the borrowers. The funds extended were invested in speculative projects which could not generate immediate returns to pay the loans, resulting to losses which affected lending institutions performance leading to eventual collapse.

In Kenya, according to the KIPPRA report (2012), the growth of the financial sector in Kenya slowed in 2012 to 6.5 per cent from 7.8 per cent in 2011.The existence of non-performing loans in the accounting books of lending institutions are closely associated with the drop of profitability levels and banking crisis (Kroszner, 2010). Consequently, according to CBK report (2013) default has been on the increase with the ratio of non-performing loan to gross loans being 4.8 per cent in 2012 compared to a country like South Africa which had 1.1 per cent over the same period. This puts in to question the thoroughness of clients' appraisal process in Kenyan lending institutions.

Over the past four decades, SACCOs in Kenya have been especially vibrant in rural areas, as the banks left a gap when they withdrew from service provision to the rural poor. The membership of rural SACCOs grew from 500,000 in 1975 to 1.2 million in 2005. During these four decades SACCOs were primary closed cooperatives dealing only with active members of specific organizations dealing with a particular line of services or products (Cheruiyot et al., 2012). Many SACCOs still continue to offer limited services to members only, but a few others, which are larger, have opened up to non-member clients by establishing front office services which offer a broader range of financial services to both members and non-members. Larger SACCOs in terms of capital base began offering front office services during the economic liberation period of 1990's when commercial banks withdrew their services from less profitable areas. Thus the FOSAs attract former bank customers who were left un-banked (Turtiainen, 2008).

The SACCO sub-sector comprises both deposit taking (FOSA) and non-deposit taking SACCOs. Whereas non deposit taking SACCOs are regulated and supervised by Commissioner for Co-operatives, the deposit taking SACCOs are licensed, regulated and supervised by SASRA. However, SASRA only licenses SACCOs that have been fully registered under the Cooperative Societies Act CAP 490 (CBK, 2012). All SACCOs operate BOSA, but few have established FOSAs which offer basic banking services such as withdraw-able savings, issuance of debit cards, loan advances, deposits, money transfers, automated teller machines, salary processing and so on. Members of SACCOs operating FOSAs enjoy semi-banking services unlike BOSA where their savings are only accessible upon exit from the SACCO. Thus members can enhance their access to loans and earn returns on savings (Gweyi and Karanja, 2014).

1.2 Statement of the Problem

Sound loan portfolio of lending institutions is a prerequisite for their stability, continuity and growth. In Kenya, performance of lending institutions has been skewed and dominated by tier one commercial banks like Kenya Commercial Bank, Equity Bank, among others. According to Kamau and Were (2008), who examined 32 commercial banks, tier one banks had balance sheet of over 100 billion, tier two banks had balance sheet between 30 and 100 billion and tier three banks had balance sheet of less than 10 billion. However even the tier one lending institution has had their share of performance issues. During the year 2013, Equity bank Ltd wrote-off bad debts amounting to 1.4 billion (Equity Bank Ltd Financial statement, 2013) while Kenya commercial Bank wrote-off debt valued 2.8 billion in the year 2011(KCB Financial Statement, 2011).

Generally, the performances of lending institutions in Kenya vary and some indicators point to some underlying failures. According to Central Bank of Kenya report (2013) lending institution provision for bad loans increased by 17 percent from 4.7 billion in 2012 to 5.5 billion in 2013. Over the same period Non-performing loans grew from 57.7 billion to 77 billion. This has been attributed to lending boom, whereby lending institution gave huge loans to customers without critically appraising clients' ability to pay. Loan write-offs, provisions and increasing non-performing loan have adverse impact on profitability and overall financial performance of lending institutions. This trend not only threatens the viability and sustainability of lending institution in Kenya but also hinders intended growth.

Previous studies have largely focused on commercial banks and Microfinance Institution in Kenya (MFIs) and financial performance thereof, leaving SACCOs and particularly deposit taking SACCOs with respect to the quality of loan portfolio largely unexplored. Gatuhu (2013) articulates that Microfinance Institutions (MFIs) in Kenya (MFIs) uses client appraisal to a great extent. Pafula's (2009) pointed out that there is a strong negative relationship between loan appraisal and lending institution outreach (growth). Further, according to CBK (2013), income leakage through increase in provisions, increase in non-performing loans, evidence of loan write-offs and dominance by of tier one commercial banks, points clearly that lending institution performance in Kenya is experiencing some challenges.

However, the case of deposit taking SACCOs in the country remain largely inconclusive due to scanty published literature. The SACCO Supervision Report (2014) indicates that non-performing loans among deposit taking SACCOs increased by 5.75% from Kshs. 9.3 billion in 2012 to 13 billion in 2013. During the same period, there was an increase in the provision for loan losses by 30.1% from Kshs. 1.1 billion to 1.5 billion. This presents a worrying trend and raises questions on the thoroughness of the loan appraisal processes among the SACCOs in Kenya. Against this backdrop, this study sets out to investigate the influence of the lending policy on the quality of loan portfolio with reference to deposit taking SACCOs in Starehe Sub County, Nairobi County.

1.3 Purpose of the study

The purpose of this study was to investigate the influence of the lending policy on the quality of loan portfolio among deposit taking SACCOs in Starehe Sub County, Nairobi County.

1.4 Objectives of the study

The study was guided by the following objectives:

1. To establish the influence of character appraisal on the quality of loan portfolio among deposit taking SACCOs in Starehe Sub County.
2. To establish the influence of collateral appraisal on the quality of loan portfolio among deposit taking SACCOs in Starehe Sub County.
3. To determine the influence of capital appraisal on the quality of loan portfolio among deposit taking SACCOs in Starehe Sub County.
4. To establish the influence of capacity to pay appraisal on the quality of loan portfolio among deposit taking SACCOs in Starehe Sub County.

1.5 Research Questions

1. What is the influence of character appraisal on the quality of loan portfolio among deposit taking SACCOs in Starehe Sub County?
2. What is the influence of collateral appraisal on the quality of loan portfolio among deposit taking SACCOs in Starehe Sub County?
3. What is the influence of capital appraisal on the quality of loan portfolio among deposit taking SACCOs in Starehe Sub County?
4. What is the influence of capacity to pay appraisal on the quality of loan portfolio among deposit taking SACCOs in Starehe Sub County?

1.6 Research Hypothesis

The study was guided by the following hypothesis to be tested at 95% significance level:

$\mathbf{H_1}$: There is a significant relationship between character appraisal and the quality of loan portfolio among deposit taking SACCOs in Starehe Sub County.

$\mathbf{H_2}$: There is a significant relationship between collateral appraisal and the quality of loan portfolio among deposit taking SACCOs in Starehe Sub County.

$\mathbf{H_3}$: There is a significant relationship between capital appraisal and the quality of loan portfolio among deposit taking SACCOs in Starehe Sub County.

$\mathbf{H_4}$: There is a significant relationship between capacity to pay appraisal and the quality of loan portfolio among deposit taking SACCOs in Starehe Sub County.

1.7 Significance of the study

First, the study of lending policy and the quality on loan portfolio is critical in that the findings can be used to inform policy and procedure decisions and also identify the best lending policies that can be adopted by lending institutions in order to improve performance. Therefore, this study is of great significance and justified, owing to the need for improved and sustainable performance of lending institutions in Kenya.

Secondly, the study may add to the existing body of knowledge on lending policy and the performance of financial institutions in Kenya.

Thirdly, the study may help in bridging existing gaps identified from the previous studies and also act a basis for future studies based on its outcome and recommendation.

This study may also benefit the borrowers and, both individual and corporate project developers as well as businesses and the general public.

The findings of this study may provide useful insight to the general public on how lending institution undertakes clients' appraisal. More importantly the businessmen, borrowers and the public will get to know the most critical areas lending institutions consider during appraisal.

Finally, this study may help them in packaging their applications in manner likely to improve the chances of the application being considered positively, hence reducing incidences of cases being declined or pended.

1.8 Delimitation of the study

The study was delimited to Deposit Taking SACCOs in Starehe Sub County, Nairobi Kenya. The researcher settled on Starehe Sub County because of scope, limited time and resources available. The study was also delimited to the influence of lending policy on the quality of loan portfolio among the deposit taking SACCOs in Starehe Sub County, Nairobi, Kenya with critical examination on the variables namely: the independent variables, collateral appraisal indicated by value, ownership, margin and marketability; character appraisal as indicated by integrity, honesty and trustworthiness; capital appraisal, indicated by asset and liabilities, contribution and debt ratio; as well as capacity to pay appraisal as indicated by cash flow, household income and budget are conceptualized as influencing quality of loan portfolio indicated by bad debts, delinquent loans and period of loan repayment which forms the dependent variable.

1.9 Limitations of the study

The study faced limitations owing to bureaucracy on the part of the Savings and Credit Co-operatives and the time available for the respondents to complete the questionnaires due to their busy schedule. This posed a challenge during data collection since there was limited time to engage the staff to fill the questionnaires. This limitation was overcome by dropping questionnaires and picking them later at an appointed time which allowed respondents time to complete the questionnaires.

1.10 Assumptions of the study

The first assumption of this study was that the respondents would be available to answer the questions correctly. The second assumption was that variables other than the ones set out would not interfere with the research.

1.11 Definition of Significant Terms Used in the Study

The following are significant terms used in the study:

Bad Debts: Is an amount owed to a creditor that is unlikely to be paid and which the creditor is not willing to take action to collect because of various reasons, for example due to a borrower going into liquidation or insolvency.

Delinquent Loans: Refers to loans where the borrower is late or overdue on repayment. Such loans will remain in that status until the late instalment is paid.

Deposit Taking SACCOs: Refer to the Savings and Credit Co-operative Societies that have been licensed by the Regulator (SACCO Societies Regulatory Authority) to take withdrawable deposits from its members.

Lending Policy: Set of rules and regulations that guide and govern the loan administration practices in lending institutions.

Loan Portfolio: The sum total of the long term and short term loans issued by a lending institution to various categories of clients at any given time.

Non-Performing Loans: A non-performing loan (NPL) is the sum of borrowed money upon which the debtor has not made his scheduled payments for at least 90 days. A non-performing loan is either in default or close to being in default.

Quality of Loan Portfolio: Refers to the extent to which loans are free from the risk of non-repayment. The portfolio is said to be of good quality when loans are being repaid promptly as per the terms of agreement. On the other hand, the portfolio is said to be poor if part of the loan is in default and hence at a risk of non-repayment.

1.12 Organization of the study

The study is organized into five chapters. Chapter one discusses the background of the study, statement of the problem, research objectives, research questions and hypothesis, significance of the study, delimitation and limitations of the study, basic assumptions and definition of terms. Chapter two reviews the existing literature on lending policy and its relationship with the quality of loan portfolio. It also covers the independent and dependent variables, theoretical and conceptual framework and the knowledge gap. Chapter three covers the methodology of the study. The chapter also discusses the research design, target population, sampling procedure, sample size, research instruments, validity and reliability of the research instruments and data collection and analysis procedure, ethical considerations and operational definition of variables. Chapter four presents the data analysis, presentation and interpretation. Lastly, chapter five gives a summary of findings, discussions, conclusions and recommendations.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter reviews both theoretical and empirical literature pertaining to the study problem. Whereas the theoretical literature focuses on the theories and models underpinning the study, the empirical literature reviews previous scholarly work in relation to the present study's research objectives. The main variables of the study including character appraisal, collateral appraisal, capital appraisal and capacity to pay appraisal are explored in relation to the contribution of previous scholars as the gaps thereof are explored.

2.2 Character Appraisal on the Quality of Loan Portfolio

Character is concerned with the personal impression and personal trait exhibited by the borrower. Financial institutions make judgments on the basis of the trait demonstrated by the client. Financial institutions are interested with borrowers' reputation. During client character appraisal, financial institutions are interested in establishing if the client is trustworthy, has integrity and is honest. The information provided by the client in the application, combined with information secured from other sources play a critical role in appraising the clients' character. According to Gaitho (2013) character appraisal seeks to unearth the client borrowing history and the client reputation.

Previous history of default either of a credit facility or a utility bill payment is always a red flag to financial institutions. Thus clients with good character will have an easier access to credit compared to those who have a tainted past as demonstrated by their character. Empirical evidence shows that there are clients with the capacity to pay, but are not paying the advances due to their character. Character focuses on the willingness and commitment to pay even when the capacity to pay is limited (Njanike, 2009).

Akhigbe and McNully (2005), examined profit efficiency sources in large and small US banks. One of the significant finding of the study was that small banks can attain profitability by operating in a market with low default rates, and having more of their assets as loans as opposed to securities. This signifies the key role loans play in the profitability of financial institutions especially small banks. According to Balogun and Abraham (2012) there exists a laxity in data handling amongst MFIs in Nigeria. The consequence has been that MFIs are more vulnerable to loan repayment risk. Myers and Forgy (2005) as cited in Moti *et al*. (2012) argues that client character appraisal provides a tool of weighing values of the credit applicant. Financial institutions consider values such as honesty, sincerity, integrity and trustworthiness as vital in client character appraisal. According to Gaitho (2013) The use Credit Reference Bureau has enhanced microcredit extension in Kenya allowing low income clients who traditionally lacked access to formal banking to access credit and Financial institution have equally been able to grow their loan portfolio.

2.3 Collateral Appraisal on the Quality of Loan Portfolio

Financial institutions sometimes require borrowers to pledge security as a way of showing commitment towards repayment of the loan. Collateral can take the form of a property, large asset, stocks, insurance policies, motor vehicle among others. Lenders enter into agreement with the client to the effect that in case of a default the financial institution will exercise the right of disposing the security to recover monies owed.

According to Flessing (1995) lending in Kenya still relies more on security. Financial institutions analyze collateral ownership as evidenced by the document relating to the security such as log book, title deed, policy document or share certificate. Also of interest is the value of the collateral. In this case financial institutions engage professional valuers to ensure the value of security is sufficient for the anticipated risk.

Financial institutions also consider the collateral margin which refers to the difference between the loan to be granted and the value of the security. This gives financial institutions a cushion in case the marketability of the security is in question. Collateral undergoes a process of collateralization before they can be accepted. This process includes creation of security, perfection and enforcement in case of default (KBA, 2012). This is done to create a legal binding contract enforceable in court of law in case of non-repayment.

Gathuku (2013) examined the effect of cheque truncation system on the performance commercial banks in Kenya. From the study findings he concluded that Cheque Truncation System (CTS) reduced transaction cost therefore affecting the performance of commercial bank. The system made the clearing cycle more efficient and reduced fraud associated with the old system of clearing.

Macharia (2013) examined the effect of global crisis on the financial performance of commercial banks offering Mortgage in Kenya. He concluded that a negative relationship existed between inflation due to global financial crises and the financial performance of commercial banks offering mortgages in Kenya. Further the study established a positive relationship between foreign exchange rates due to global financial crises and the financial performance of commercial banks offering Mortgages in Kenya. Similar relationship was also noted with respect to interest rate, capital flow on the financial performance of commercial banks offering mortgages.

2.4 Capital Appraisal on the Quality of Loan Portfolio

Capital represents resources especially money the client has invested in the business or in the project. Financial institutions in Kenya expect clients to have contributed to the asset owned by the business. The major interest for financial institution is to assess the client commitment to the business. The higher the capital committed, the more comfortable financial institution are when granting credit. Net asset less liabilities reflects the amount of money a client has invested in the business and acts as an indicator of how much the client is likely to lose if the business fails. (Moti *et al*., 2012).

Client capital appraisal entail establishing the debt equity ratio (Portion of capital financed through long term loans), contribution in kind (excluding monetary capital), physical development and money contribution. Financial institutions are known to require clients to contribute part of the project cost especially when financing motor vehicles and machinery and equipment to be purchased or when advancing credit to purchase a house or a building. This is meant to mitigate risk and create sense of ownership to the client (Ala and Ngugi, 2013).

Chirwa (2003) established that a negative relationship exists between profitability and capital adequacy ratio and gearing ratio, while Yadollahzadeh, *et al*. (2013) examined effective factors on profitability of commercial bank in Iran. He established that a negative relationship exists between non-performing loans, return on assets (ROA) and profitability. Profitability is guaranteed if borrowers pay within stipulated time. Overall the study found that bank size, assets, management; capital adequacy all had positive significant relationship with Return on Equity (ROE). On the other hand, gearing ratio, non-performing loans and operating efficiency all had negative significant relationship with return on equity.

2.5 Capacity to Pay Appraisal on the Quality of Loan Portfolio

Capacity to pay can be considered one of the significant factors in client appraisal. It focuses on the source of income to provide basis of repayment. The main concern for any financial institution prior to advancing any credit is whether the client will be able to repay the principal amount plus interest as per the contract (Gatuhu, 2013).

Financial institutions therefore consider the cash flow anticipated from the business, household income, budget, (income and expenditure) among others. Critical consideration is also the timing of the income and the sources of income for repayment. Financial institutions rely on previous repayment record (credit relationship-personal or commercial) and client saving /banking culture. Financial institutions require to be convinced beyond any doubt that the client has income sufficient enough to guarantee the loan repayment and forestalling any default (Bologun and Abrahamm, 2012).

Nyamongo and Temesgen (2010) examined the effect of governance on the performance of commercial banks in Kenya. The finding of the study established that, though banks ownership in Kenya is important, it does not drive performance. However, the study established that asset quality (loans) is critical in the performance of commercial banks in Kenya. Thus according to the study, non-performing loans negatively affect performance of financial institutions.

Ala and Ngugi (2013) studied the influence of mobile banking on the growth of Micro Finance Institutions in Kenya. They concluded that the growth of MFIs has led to commercialization and integration of MFIs in to the mainstream banking. This has resulted to MFIs to offer nearly all the products and services offered by mainstream banks hence increasing competition.

Ombutora and Mugambi (2013) examined the role of agency banking on the performance of banking agent entrepreneurs. The study concluded that transaction cost affects the performance of agent entrepreneurs with high transaction cost lowering the performance of agent entrepreneurs and ultimately the performance of financial institutions in Kenya.

2.6 Theoretical Framework

Various theories underpin the understanding of lending policy and its influence on loan portfolio quality aspects. Prominent among these theories and of particular relevance to the present study are; The C's Model of Client Appraisal and Information Signaling Theory.

2.6.1 The C's Model of Client Appraisal

According to Moti *et al*. (2012) lending institutions use the 5Cs to increase loan performance, as they get to know their customers better. These 5Cs are: collateral, character, capacity, capital and condition. Collateral is the most basic consideration by financial institution in Kenya before extending credit to client (Mureithi, 2010). This implies that financial institutions in Kenya attach more weight on the availability of security or otherwise. FSD-Kenya (2009) describes collateral as asset or security given by a client (borrower) to a lender (financial institution), to be used in event of default to recover the debt.

According to Flessing (1995) one way of a client proving sincerity to pay is through offering a security to the funding institution. This is because failure by the client to pay results to client losing the collateral. Lending in Kenya heavily relies on collateral (FSD-Kenya 2009). The collateral requirement and over-reliance of collateral, results to limited capacity in new loans and thus reduces profitability (KBA, 2012). CBK (2011) report pointed out that financial sector in Kenya still operated under the traditional model with collateral being the most widely used credit risk mitigation technique. Larossi (2009) as cited in KBA (2012) further supports this assertion when he established that 90 percent of firms sampled reported collateral as requirement in loan appraisal.

Financial institutions have varying preference to collateral offered by clients. A survey by Kenya Bankers Association (2012) measured the popularity of collateral accepted by financial institutions in Kenya. The study established that Equipment and Machinery were the most popular with 60 per cent, followed by land and buildings at 50 per cent, and stocks at 45 per cent. Small business and individual face more challenge than medium and established large firms, when pledging collateral. They opt to get guarantee from other account holders because they do not have tangible collateral. Among small enterprises, 59 per cent of loan rejection was associated with collateral compared to only 19 percent in medium enterprises large firms' category (KBA 2012). On one hand, this is a clear indication that small businesses are likely to lose the opportunity of accessing credit due to lack of a collateral while on the other hand financial institutions loose opportunity to grow their vital asset (loans) hence affecting the profitability levels.

While appraising collateral, financial institutions in Kenya are interested with aspect of value, existence and ownership and marketability. Thus financial institutions ensure any collateral taken undergo the process of collateralization involving creation, perfection and enforcement in case of default (FSD- Kenya, 2009). Creation and perfection occurs when a borrower (client), who has interest and hold power of transfer, exchanges and transfers collateral through established mechanism (charge, joint registration or lien) to the lender in exchange of a loan facility. This gives the financial institution some rights over the collateral while placing obligation to pay upon the client (FSD-Kenya, 2009).

Myers & Forgy (2005) as cited by Moti *et al*. (2012) points out that character basically comprises of values and behavior of the credit applicant. Financial institution considers character values such as honesty, integrity and trust worthiness when appraising a client. Financial institutions in Kenya make use of the Credit Reference Bureau (CRB) reports to appraise clients' character. CRB is an information sharing system launched by CBK in July 2010 to provide a platform for information sharing among financial institutions in Kenya. Financial institutions in Kenya are interested in establishing previous incidences of default, poor repayment record or inconsistencies in information provided by client. Credit information sharing mechanism has further strengthened client character appraisal standards (Gaitho, 2013). Financial institution in Kenya have now incorporated credit reference reports in the credit risk appraisal with 1,774,185 credit reports being accessed in 2012 (CBK, 2012).

Capacity assess whether clients' cash flow from business and household can service repayment while capital evaluates client assets and liabilities. According to (Gatuhu, 2013) condition appraisal encompasses considering prevailing circumstances like competition, legal and economic circumstances prior to granting credit. Thus the 5C model of client appraisal focus both on internal condition relating to the client, while also takes into consideration the external environment.

2.6.2 Information Asymmetry Theory

According to Binks and Ennew (1997) there is normally information asymmetry in assessing and appraising clients' applications. The theory of information asymmetry was first introduced by George A. Akerlof's in 1970. The theory was further refined by studies of Michael Spence (1973), Stiglitz (1975) and Rothchild and Stiglitz (1976). Information asymmetry is a situation whereby information in question is not known by all the parties involved in the undertaking (Ekumah and Essel, 2003). In the case of a financial institution, the client has more information, personal and businesswise than the lender (financial institution). Within the financial sector, information asymmetry arises when a client seeking a credit facility has usually a better information about the potential risks and returns associated with the project or business the funds are earmarked (Gatuhu, 2013).

Financial institutions face a situation of information asymmetry when extending credit (KBA, 2012, Binks & Ennew, 1996, 1997). Information is required to assess clients' character, collateral, capital, ability to pay and existing business conditions. Binks *et al*. (1992) as quoted in Gatuhu (2013) asserts that information asymmetry poses two major challenges namely: moral hazard-monitoring entrepreneurial behavior (character), and adverse selection problem- making errors in lending like accepting an application of the wrong client or rejecting application of the right client with ability to pay.

The probability of success of the project or business being funded is unknown to the financial institution, but known to the client (Kimutai & Ambrose, 2013). The client has more information about the project being funded. Information asymmetry is a condition of imperfect credit market. This makes it too costly for financial institution to obtain accurate information about their client during appraisal (Kimutai & Ambrose, 2013).

There is also a probability of changing the business / project or diverting the funds to a project that yields a higher return but with a low probability of success. In this case the risk a financial institution faces is default associated with inability to pay both principal loan amount and interest, ultimately impacting on profitability. Financial institutions have no control of such happenings and thus they mitigate by ensuring a thorough appraisal focusing on character and capacity to pay is done.

2.7 Conceptual Framework

Figure 1 overleaf, is a diagrammatic conceptualization of the independent and dependent variables.

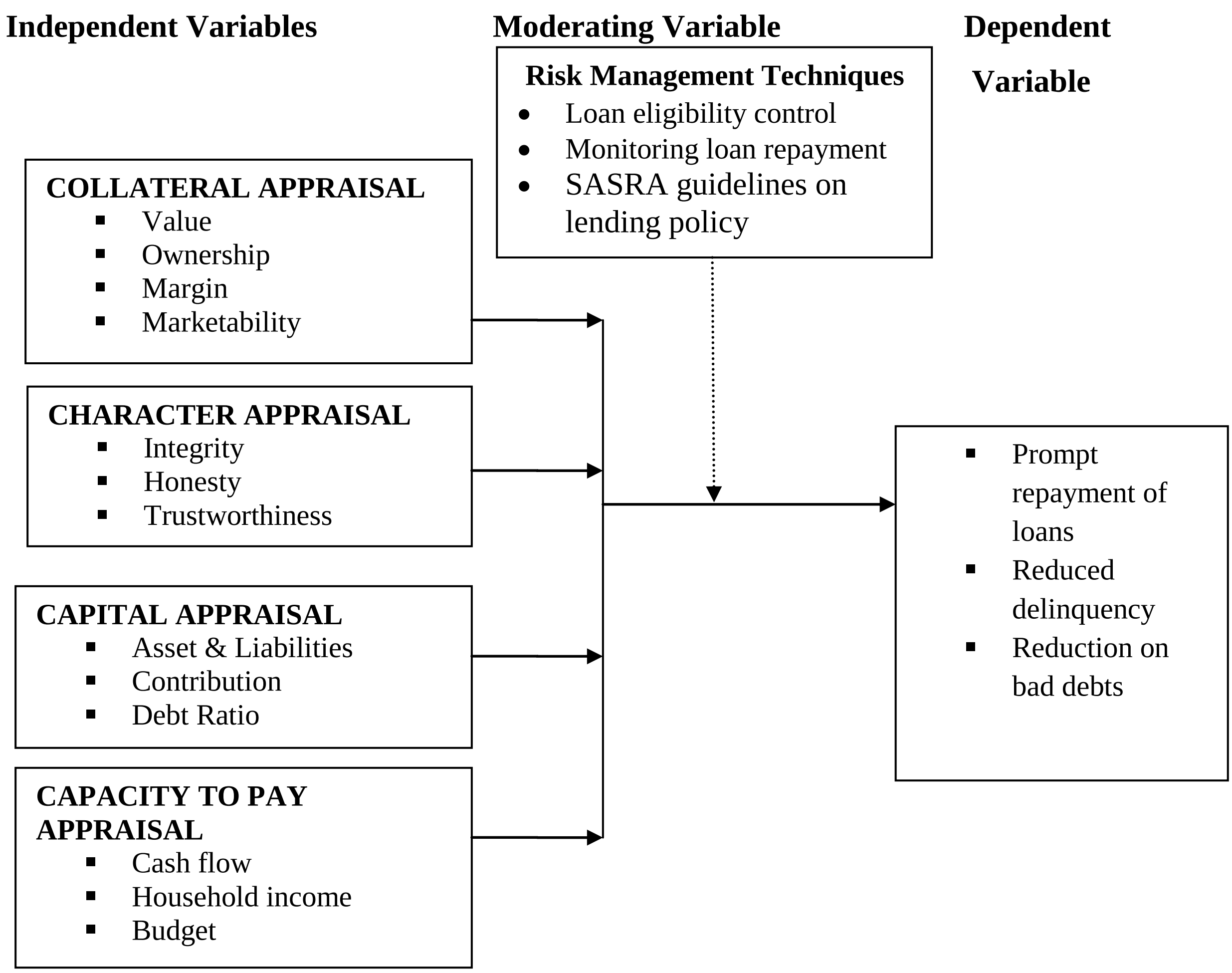

Figure 1: Conceptual Framework

From the figure, the independent variables: collateral appraisal, indicated by value, ownership, margin and marketability; character appraisal, indicated by integrity, honesty and trustworthiness; capital appraisal, indicated by asset and liabilities, contribution and debt ratio; as well as capacity to pay appraisal, indicated by cash flow, household income and budget are conceptualized as influencing quality of loan portfolio indicated by loan repayment period, loan delinquency and bad debts, which form the dependent variable. The relationship is further moderated by risk management techniques, including government guidelines on lending policy.

2.8 Knowledge Gap Summary

A summary of studies reviewed above together with associated research gaps are captured in Table 2.1 below.

Table 2.1: Knowledge gap summary

Variable	Author (Year)	Title of study	Findings	Knowledge gap
Character appraisal	Gaitho (2013).	Role of Credit Reference Bureau on Credit Access in Kenya: A Survey of Commercial Banks in Kenya.	The Study found out that Credit Reference Bureaus have helped reduce the borrowing cost to a moderate extent and has also reduced the defaulting rates among borrowers.	The study focusses on the customer reputation as a way of assessing credit-worthiness of borrowers leaving out other factors of credit appraisal. It also focusses on low-income earners leaving out other classes of customers. This study seeks to bridge this gap.
	Njanike (2009)	The Impact of Effective Credit Risk Management on Bank Performance	The study found out that the failure to effectively manage credit risks contributed to a greater extent to the banking crisis. The research also identified poor corporate governance, inadequate risk management systems, ill planned expansion drives, liquidity challenges as other factors that caused the crisis.	The study focusses on factors that cause credit risk management among banking institutions including poor credit scoring and insider lending. The study looks at institutional factors of credit risk management with little concentration on client character appraisal.
Collateral appraisal	Mureithi (2010)	The Relationship between Credit Appraisal Process and Level of Non-Performing Loans of Women Enterprises Fund Loans offered through Financial intermediaries in	The study found out that perfunctory credit approval such as insider lending to be single biggest contributor to the bad loans of many of the failed banks. Further that poor credit approval exacerbates non-performing loans since such loans are invested in speculative projects such as real estate development, breached large-loan exposure limits and were extended to projects which could not generate short-term returns, with the	The study focusses on credit management practices of banks and other financial institutions leaving out SACCOs. This study seeks to bridge this gap.

		Kenya	result that the maturities of the bank's assets and liabilities were imprudently mismatched.	
Capital appraisal	Moti, *et al* (2012).	Effectiveness of Credit Management System on Loan Performance: Empirical Evidence from Micro-Finance Sector in Kenya.	The study found out that credit terms formulated by the microfinance institutions do affect loan performance; the involvement of credit officers and customers in formulating credit terms affects loan performance.	Although the study recommends adoption of the 5 C's Model of client appraisal which entails consideration of the client character, capacity to pay, collateral attached as security and history of repayment, the focus of the study is in microfinance institutions and there is need to carry out a similar study among SACCOs. Hence this study seeks to bridge this gap.
	Ala and Ngugi (2013).	Influence of Mobile Banking on Growth of Micro-Finance Institutions in Kenya.	The study found out that access to financial services affects the growth of MFIs. That capital requirement affects access to financial services to a very great extent; that source of capital/loans affects access to financial services. It also found out that MFIs are able to have adequate collateral to obtain credit lines/wholesale funds from commercial banks; that the asset growth enables it to source finances more rapidly and increase leverage and that the growth of MFIs enables it to access capital markets as needed for loan portfolio expansion at a reasonable cost.	The study focusses on Micro Finance Institutions whose objective is to source funds for onward lending to individual clients. These institutions have the financial muscle to raise the required capital collateral in order to access funds from commercial banks unlike individual clients who have limited capital collateral. The present study focus on the ability of individual customers to raise capital collateral which is a criterion in credit appraisal among SACCOs.

Capacity to pay	Gatuhu (2013).	Effects of Credit Management on the Financial Performance of Micro-Finance Institutions in Kenya.	The study found out that client appraisal, credit risk control and collection policy had effect on financial performance of MFIs in Kenya. Further that there was a strong relationship between financial performance of MFIs and client appraisal, credit risk control and collection policy. Collection policy was found to have a higher effect on financial performance and that stringent policy is more effective in debt recovery that a lenient policy.	The study focusses more on loan collection and debt recovery strategies among micro finance institutions as opposed loan appraisal techniques among deposit taking SACCOs, which the focus of this study.
	Balogum and Abraham (2012).	Performance of Micro-Finance Institutions in Nigeria: An appraisal of self-reporting institutions to Mix Market.	The study found out that MFIs do not receive its revenue at the time of sale (loan disbursement) but afterwards, therefore these institutions must be concerned with the quality long after the sale. The expectation of the regulator is that MFIs should calculate portfolio at risk (PAR) because if a payment is late the entire loan balance is at risk, as the likelihood of recovering the balance of the loan is less if even one payment is late. The indicator reflects the management's ability to recover loans disbursed but system lapses and high delinquency make financial sustainability difficult.	The insufficient data provided by self-reporting MFIs do not allow for fair assessment of their performance. This does not allow independent researchers to assess the institution in order to promote improved services, profitability and comparison. The research relied on secondary data sources from publicly available third-party agencies such as World Bank. There was therefore a limit on the amount of data available for an independent research. In order to bridge this gap the present study relied on both primary and secondary data.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter presents the research design and methodology that was used to conduct the research. It presents the research design, the population, sample size and sampling procedure, data collection procedures and data analysis.

3.2 Research Design

This study adapted a descriptive research design. Descriptive research portrays an accurate profile of persons, events, or situations (Kothari, 2000). Therefore, the descriptive survey was the best strategy to fulfil the objectives of this study. According to Kombo and Tromp (2006) the basic purpose for descriptive research usually is to describe characteristics of the population of interest, make specific predictions and test associational relationships. Kothari (2000) further posits that quantitative research design is an excellent way of finalizing results and proving or disproving a hypothesis. After statistical analysis of the results, a comprehensive answer was reached, and the results were legitimately discussed and published.

3.3 Target Population

The target population refers to a group of individuals, objects or items from which samples are taken for measurement (Mugenda and Mugenda, 2003). The target population comprised of the credit managers, credit officers, CEOs and the members of the Board of Directors in charge of the credit function from all the twelve licensed deposit-taking SACCOs in Starehe Sub County, namely; Asili, Chai, Harambee, Kenya Police, Magereza, Mwalimu National, Nation, Sheria, Stima, Ufundi, Ukulima and Unaitas.

3.4 Sampling Technique

According to Mugenda and Mugenda (2003), at times the target population may be so small that selecting a sample is meaningless and therefore taking the whole population in such cases is advisable. Census technique was therefore used in this study.

3.5 Sample Frame

Kothari (2005) indicate that when all members of the target population are considered it becomes more representative of the population of interest. It fulfills the requirements of efficiency, representatives, reliability and other factors like nature of units, size of the population, size of the questionnaire and the time available for completion of the study.

All the 12 Deposit Taking SACCOs in Starehe Sub County were included in the study. To this end, respondents were drawn from all the CEOs, Credit Managers, Credit Officers and the Board of Directors in charge of the credit function from each of the targeted SACCOs making a total of 100 respondents.

Table 3.1 Sample Frame

SACCO	CEO	Credit Managers	Credit Officers	Board of Directors	Total
Asili	1	1	4	1	**9**
Chai	1	1	5	1	**9**
Harambee	1	1	10	1	**17**
Kenya Police	1	1	5	1	**11**
Magereza	1	1	3	1	**9**
Mwalimu National	1	1	4	1	**11**
Nation	1	1	4	1	**8**
Sheria	1	1	4	1	**9**
Stima	1	1	8	1	**15**
Ufundi	1	1	3	1	**9**
Ukulima	1	1	8	1	**15**
Unaitas	1	1	6	1	**13**
Total	**12**	**12**	**64**	**12**	**100**

3.6 Data Collection Procedures

The study used both primary and secondary data. Primary data is the information the researcher obtained from the field using structured questionnaires. The questionnaire was administered using drop and pick method. The questionnaire was used because it allowed the respondents to give their responses in a free environment and help the researcher gather information that would not have been given out had interviews been used. The questionnaire was both self - administered and researcher administered depending on the respondent. Secondary data refers to the information obtained from articles, books, newspapers, internet and magazines. Secondary data was collected from the financial statements of deposit taking SACCOs regulated by SASRA as well as their other periodic publications by the union of SACCOs and regulators.

3.7 Validity of Research Instruments

Validity is the extent to which a test measures what it is supposed to measure or the subject matter of the study. The question of validity is raised in the context the form of the test, the purpose of the test and the population for whom it is intended. The pilot test sought to answer the question "how valid is this test for the decision the researcher need to make?" or "how valid is the interpretation to the researcher for the test?" For the purpose of this study, content validity was tested. Content validity refers to the extent to which a measuring instrument (questionnaire) provides adequate coverage of the topic under study. Thus emphasis was on the content of the questionnaire and whether it addresses the entire study variables.

3.8 Reliability of Research Instruments

A pilot test sampled 10% of the projected study sample. It was conducted in two SACCOs in Kajiado County and specifically targeting the middle and senior management staff and Board of Directors in charge of the credit function. This ensured that the instrument was clear and free from error. This was in line with Connelly (2008) who suggested that the pilot study sample should be at least 10% of the study sample. A Pilot test was necessary as it enabled the researcher to come face to face with realities and anticipated problems during the actual research. The pilot test was aimed at assisting the researcher in pre-testing the questionnaire as a data collection tool.

Focus of the pilot test was on the effectiveness of the questionnaire, its reliability and validity of data collected, correctness of data and identification of necessary modification required. In addition, the pilot test enabled the researcher to gauge the level of cooperation or resistance expected during the actual study. The pilot-test gauged the level to which the questionnaire met the objectives of the study.

The study used the Cronbach alpha formulae to test the reliability of the data collection tool. The alpha was developed in 1951 by Lee Cronbach and lie between negative infinity and 1. However it is only the positive value that makes sense and hence the range used for the Cronbach alpha is between 0 and 1. A Cronbach alpha score of greater than 0.6 is considered to be good enough to assure reliability of the data collection tool. The test enhanced reliability by ensuring a representative sample was obtained and the sample was selected randomly with due diligence being exercised in the process of sampling. After the pilot study was conducted a Cronbach alpha score of 0.73 was obtained confirming that the instrument used was reliable.

3.9 Data Analysis

After data collection, the filled-in and returned questionnaires were edited for completeness, coded and entries made into statistical package for social sciences (SPSS version 21). This ensured that the data are accurate, consistent with other information, uniformly entered, complete and arranged to simplify coding and tabulation. With data entry, the data collected was captured and stored. Both descriptive and inferential statistics was further conducted. Descriptive analysis involved the use of frequencies in their absolute and relative forms (percentage). Mean and standard deviations was also used as measures of central tendencies and dispersion respectively. Inferential statistics was done to show the nature and magnitude of relationships established between the independent and dependent variables using regression analysis to make inferences from the data collected to more generalized conditions. The regression analysis took the following model:

$Y= \alpha +\beta_1x_1 +\beta_2x_2+\beta_3x_3+ \beta_4x_4+\varepsilon$

Y = Quality of loan portfolio

α =Constant term

β= Beta Coefficients

X_1 = character appraisal

X_2= collateral appraisal

X_3= capital appraisal

X_4= capacity to pay appraisal

ε = standard Error

3.10 Ethical Considerations

Ethical issues are norms governing human conduct which have a significant impact on human welfare. It involves making a judgment about right and wrong behavior, Kothari (2007). Before data collection, permission to carry out research was sought from the National Commission for Science, Technology and Innovation. The researcher ensured that confidentiality of the information obtained was only used for the purpose of the study. Individuals had the option to refuse to participate. The dignity, privacy and interest of the participants was respected and protected. Research data remained confidential and all participants remain anonymous. Appropriate credit was given to all parties contributing to the research. Bryman (2007) states that it was the responsibility of the researcher to carefully assess the possibility of harm to research participants, and the extent that it is possible; the possibility of harm was minimized.

3.11 Operational definition of the variables

Table 3.2: The operational definition of the variables of the study

Objectives	Variable	Indicator	Scales of Measurement	Source of Data	Instrument	Data Analysis Tools
	Dependent variable Quality of loan portfolio among deposit taking SACCOs in Starehe Sub County, Nairobi County	Bad debts	String	Credit Managers, Credit Officers	Financial statements	Mean; Pearson correlation; Regression
		Delinquent loans	String	Credit Managers, Credit Officers	Financial statements	Mean; Pearson correlation; Regression
		Repayment period	String	Credit Managers, Credit Officers	Financial statements	Mean; Pearson correlation; Regression
	Independent Variables					
Objective 1: To establish the influence of character appraisal on the quality of loan portfolio among deposit taking SACCOs in Starehe Sub County, Nairobi County	Character Appraisal	Integrity	Ordinal, Likert	Credit Managers, Credit Officers, Directors	Questionnaire	Mean; Pearson correlation; Regression
		Honesty	Ordinal, nominal	Credit Managers, Credit Officers, Directors	Questionnaire	Mean; Pearson correlation; Regression
		Trustworthiness	Ordinal, Likert	Credit Managers, Credit Officers, Directors	Questionnaire	Mean; Pearson correlation; Regression
Objective 2: To establish the influence of collateral appraisal on the quality of loan portfolio among	Collateral Appraisal	Value	Ordinal, Likert	Credit Managers, Credit Officers	Questionnaire	Mean; Pearson correlation; Regression
		Ownership	Ordinal, Likert	Credit Managers, Operations Managers Finance Managers	Questionnaire	Mean; Pearson correlation; Regression

deposit taking SACCOs in Starehe Sub County, Nairobi County		Margin	Ordinal, Likert	Credit Managers, Credit Officers	Questionnaire	Mean; Pearson correlation; Regression
Objective 3: To determine the influence of capital appraisal on the quality of loan portfolio among deposit taking SACCOs in Starehe Sub County, Nairobi County	Capital Appraisal	Asset & Liabilities	Ordinal, nominal	Credit Managers, Credit Officers	Questionnaire	Mean; Pearson correlation; Regression
		Contribution	Ordinal, Likert	Credit Managers, Credit Officers	Questionnaire	Mean; Pearson correlation; Regression
		Debt Ratio	Ordinal, Likert	Credit Managers, Credit Officers	Questionnaire	Mean; Pearson correlation; Regression
Objective 4: To establish the capacity to pay appraisal on the quality of loan portfolio among deposit taking SACCOs in Starehe Sub County, Nairobi County	Capacity to Pay	Cash flow	Ordinal, Likert	Credit Managers, Credit Officers, Directors	Questionnaire	Mean; Pearson correlation; Regression
		Household income	Ordinal, nominal	Credit Managers, Credit Officers, Directors	Questionnaire	Mean; Pearson correlation; Regression
		Budget	Ordinal, Likert	Credit Managers, Credit Officers, Directors	Questionnaire and document analysis	Mean; Pearson correlation; Regression

CHAPTER FOUR

DATA PRESENTATION, ANALYSIS AND INTERPRETATION

4.1 Introduction

This chapter presents the findings of the study and analysis from data collected from directors and employees of SACCOs in Starehe Sub County, Nairobi County. The response rate and the demographic characteristics of the respondents are presented. The operational definition of variables in section three guided the formulation of the questionnaire items which subsequently addressed the study objectives.

The four themes on the influence of the lending policy on the quality of loan portfolio among deposit taking SACCOs in Starehe Sub County, Nairobi County were addressed by the study. These factors include influence of character appraisal on the quality of loan portfolio; influence of collateral appraisal on the quality of loan portfolio; influence of capital appraisal on the quality of loan portfolio and influence of capacity to pay appraisal on the quality of loan portfolio. The analysis and discussion in this section focuses on these themes. After validation, the questionnaires were used for gathering data. Simple descriptive statistics such as frequencies, percentages, mean averages were used where appropriate for data analysis. The findings are presented in tables.

4.2 Questionnaire Return Rate

A total of 100 self-administered questionnaires were sent to the respondents of the 12 SACCOs in Starehe Sub County of Nairobi County involved in running of the SACCOs. Of these, 75 were completely filled and returned the questionnaires making a return rate of 75%. Baruch (2004) analyzed 175 surveys as reported in academic journals and found an average response rate of 36.1% with a standard deviation of 13.1%. The questionnaire response rate was therefore acceptable.

4.3 Demographic Characteristics of Respondents

The study needed to establish the age, gender and educational level of respondents. This was necessary to determine whether the respondents had the right qualifications to benefit from any training on lending policy and quality of loan portfolio amongst the deposit taking SACCOs. The gender characteristics would determine whether both genders would be represented equitably in the study. The other analyses were done according to the themes based on the objectives of the study.

Table 4.1: Position of respondent

Position of respondents	Frequency	Percentage
CEO	5	7
Directors	8	11
Credit Managers	20	27
Credit Officers	42	55
Total	**75**	**100**

From Table 4.1 most respondents were Credit Officers 55% (42), others were Credit Managers 20 (27%), Directors 8 (11%) and CEOs 5(7%). From the above findings most respondents were Credit Officers 55% (42) and Credit Managers 20 (27%), since they are the ones who implement policies and determine who gets the loans. Directors 8 (11%) and CEOs 5 (7%) are the least respondents since they are charged with policy formulation.

Table 4.2: Gender

Gender of respondents	Frequency	Percentage
Male	39	52
Female	36	48
Total	**75**	**100**

According to Table 4.2, the male respondents were 39 (52%) while female were 36 (48%). It appears the opinion of women is fairly represented in Deposit Taking Savings and Credit Cooperatives.

Table 4.3: Age Group

Age of respondents	Frequency	Percentage
20-30 years	25	33
31-40 years	26	35
41-50 years	18	24
51 years and Above	6	8
Total	**75**	**100**

Table 4.3 shows that most respondents were between the ages of 31- 40 years at 26 (35%). Respondents between 20-30 years were second in response at 25 (33%). The second least response was noted in ages above 40 years where 41-50 years at 18 (24%) and the least response was ages above 51 years. Because of the new technology older employees are finding it hard to cope in these organizations and they opt to retire to other work.

Table 4.4: Work Experience

Experience in years of respondents	**Frequency**	**Percentage**
0-5 years	20	27
6-10 years	28	37
11-15 years	12	16
16-20 years	9	12
Above 20 years	6	8
Total	**75**	**100**

Table 4.4 above shows that most respondents have worked for between 6-10 years 28 (37%), 0-5 years 20 (27%) and the least response have worked for between 16-20 years 9 (12%) and above 20 years 6 (8%). From the above responses, Deposit Taking Savings and Credit Saving Cooperatives are managed by experienced employees with experience of above 6 years recording a high response rate of 73%.

In order to participate meaningfully in Deposit Taking Savings and Credit Saving Cooperatives altogether, the employee’s level of education determines the ease with which the study was done. The respondents were asked to state their level of education according to Table 4.5.

Table 4.5 :Level of education

Level of education	**Frequency**	**Percentage**
Secondary	15	20
College	35	47
University	25	33
Total	**75**	**100**

The majority of the respondents had college education 35 (47%) and university education 25 (33 %). College education and university education constituted 80% thus Diploma and Degree holders were mainly the credit managers, head of departments and credit officers who participated in the study. It appears these officers were capable of making gainful contribution to Deposit Taking Savings and Credit Cooperatives as exhibited by the majority of the respondents.

4.4 Client Collateral Appraisal

The respondents were requested to indicate whether availability of collateral was a significant factor when extending credit to them as customers of Deposit Taking Savings and Credit Cooperatives.

Table 4.6: Availability of collateral when extending credit to customers

Responses	Frequency	Percentage
Yes	72	96
No	3	4
Total	**75**	**100**

In Table 4.6 above, most respondents 72 (96%) reported that Deposit Taking Savings and Credit Saving Cooperatives consider availability of collateral a significant factor when extending credit to customers while 3 (4%) did not consider availability of collateral a significant factor when extending credit to customers.

Table 4.7: Extending credit to client with collateral

Extending credit to clients with Collateral	Frequency	Percentage
Yes	72	96
No	3	4
Total	**75**	**100**

From Table 4.7 above, most respondents indicated that Deposit Taking Savings and Credit Cooperatives consider extending credit to clients with collateral 72 (96%) and least respondents indicated that Deposit Taking Savings and Credit Cooperatives do not consider extending credit to clients with collateral 3(4%).

Table 4.8: Clients who have pledged collateral have better repayment than those who have not pledged collateral

Pledged collateral have better repayment	Frequency	Percentage
Yes	74	99
No	1	1
Total	**75**	**100**

From Table 4.8 above, most respondents indicated that clients who have pledged collateral have better repayment than those who have not pledged collateral 74(99%) and least respondents indicated that clients who have not pledged collateral have better repayment than those who have not pledged collateral 1(1%). The findings from the Table 4.8 shows that Deposit Taking Savings and Credit Cooperatives consider pledged collateral before granting loans to borrowers.

Table 4.9: Collateral appraisal in the SACCO

Indicate your responses of the following statements regarding collateral appraisal in your SACCO

strongly disagree=1; disagree=2; not sure=3; agree=4; strongly agree=5.

	Mean	SD
Client collateral in your SACCO mostly lays emphasize on the value of collateral	3.876	0.7999
The major focus on collateral appraisal is on the ownership	3.864	0.7953
The SACCO allow a margin between loan amount and collateral value	3.859	0.7890
Client collateral appraisal lays emphasize on the marketability of the collateral	3.765	0.7437
Client collateral appraisal reduces delinquency rate, loan provisions and bad debts	3.946	0.8523
Collateral appraisal enhances prompt repayment of loans	3.6544	0.685
Loans with collateral performs better than those without collateral	3.7442	0.734
Collateral appraisal can improves income levels and profitability	3.643	0.647

From Table 4.9, most of the respondents strongly agreed that client collateral appraisal reduces delinquency rate, loan provisions, and bad debts, M=3.946 (SD=0.8523) and client collateral appraisal mostly lay emphasize on the value of collateral, Agree M=3.876 (SD=0.7999). Least of the respondents strongly disagree that collateral appraisal can improve income levels and profitability M=3.643 (SD=0.647).

4.5 Client Character Appraisal

Table 4.10: Does the SACCO consider client character a significant factor when extending credit to a customer

The SACCO consider client character a significant factor when extending credit to customer	Frequency	Percentage
Yes	57	75
No	18	25
Total	**75**	**100**

From Table 4.10 above most respondents indicated that SACCOs consider client character a significant factor when extending credit to customer 57 (75%) and least respondents indicated that SACCOs do not consider client character a significant factor when extending credit to customer, 18 (25%). The findings from Table 4.10 show that Deposit Taking Savings and Credit Cooperatives consider client character a significant factor when extending credit to customers.

Table 4.11: Client character plays a significant role on how a client repays credit granted

character plays a significant role on how a client repays credit granted	Frequency	Percentage
Yes	60	80
No	15	20
Total	**75**	**100**

Table 4.11 above indicates that client character plays a significant role on how a client repays credit granted with most respondents, 60 (80%) and least respondents indicated that SACCOS do not consider client character a significant factor when extending credit to customers, 15 (20%). The findings from the Table 4.11 show that Deposit Taking Savings and Credit Cooperatives consider client character a significant factor when extending credit to customer.

Table 4.12: Indicate your responses of the following statements regarding client character appraisal in your SACCO

strongly disagree=1; disagree=2; not sure=3; agree=4; strongly agree=5.

	Mean	SD
Client character is an important consideration in client appraisal	3.826	0.816
During client character appraisal, the client integrity is evaluated	3.848	0.827
Character plays important role in loan repayment	3.875	0.8631
Loan amount and period is determined by the client character	3.889	0.8654
Client character appraisal improves profitability	3.532	0.554
Client character appraisal reduces delinquency rate, loan provisions and bad debts	3.662	0.611
Loan quality and growth has been achieved through client character appraisal	3.524	0.535
Loan repayment rate has improved due to client character appraisal	3.532	0.554
Client character appraisal lay emphasize on borrowers honesty	3.649	0.602
During appraisal efforts are made to establish whether client is trustworthy	3.705	0.699

From Table 4.12, most of the respondents strongly agreed that loan amount and period is determined by the client character M=3.889 (SD=0.8654) and character plays important role in loan repayment, agree M=3.875 (SD=0.8631). Least of the respondents strongly disagree that loan repayment rate has improved due to client character appraisal, M=3.532 (SD=0.554).

4.6 Client Capacity to Pay Appraisal

Table 4.13: Client has to demonstrate capacity to pay before credit is advanced

Client has to demonstrate capacity to pay before credit is advanced	Frequency	Percentage
Yes	74	99
No	1	1
Total	**75**	**100**

Table 4.13 above indicates that a client has to demonstrate capacity to pay before credit is advanced with most respondents at 74 (99%) and least respondents indicated that client need not demonstrate capacity to pay before credit is advanced 1 (1%). The findings from Table 4.13 show that Deposit Taking Savings and Credit Cooperatives require that a client has to demonstrate capacity to pay before credit is advanced.

Table 4.14 Indicate your responses on the following statements regarding client capacity appraisal in your SACCO

strongly disagree=1; disagree=2; not sure=3; agree=4; strongly agree=5.

	Mean	SD
During client appraisal, client income is examined to establish capacity to pay	4.3112	0.9821
Clients with high income are likely to pay their loans better than those with low income	4.2999	0.9801
Clients are required to provide cash flow statements to demonstrate ability to pay	4.1985	0.9763
For corporate clients profit and loss statements are evaluated to establish capacity to pay	4.065	0.9642
Client Capacity to pay appraisal reduces loan delinquency, loans provisions and bad debts	3.9761	0.8889
Client Capacity to pay is the most significant consideration when advancing credit	3.7842	0.7322
The growth and quality of loans in the SACCO has improved due to capacity to pay appraisal	3.643	0.694
Client Capacity to pay has increased prompt repayment of loans	3.6883	0.696
Capacity to pay appraisal increased revenue and profitability of the SACCO	3.7110	0.7220

From Table 4.14 above, most of the respondents strongly agreed that during client appraisal, client income is examined to establish capacity to pay M=4.3112 (SD=0.9821) and clients with high income are likely to pay their loans better than those with low income, M=4.2999 (SD=0.9801). Least of the respondents strongly disagree that growth and quality of loans in the SACCO has improved due to capacity to pay appraisal, M=3.643 (SD=0.694).

4.7 Client Capital Appraisal

Table 4.15: Our SACCO performs client capital appraisal when advancing credit

Our SACCO performs client capital appraisal when advancing credit	Frequency	Percentage
Yes	74	99
No	1	1
Total	**75**	**100**

From Table 4.15 above, almost all respondents indicated that SACCOs performs client capital appraisal when advancing credit 74 (99%) and least respondents indicated that SACCOs do not perform client capital appraisal when advancing credit 1 (1%). The findings in Table 4.15 show that Deposit Taking Savings and Credit Cooperatives performs client capital appraisal when advancing credit.

Table 4.16 Does the SACCO consider client capital a significant factor when extending credit to customer?

Our institution consider client capital appraisal a significant factor when advancing credit	Frequency	Percentage
Yes	60	80
No	15	20
Total	**75**	**100**

From Table 4.16 above, almost all respondents indicated that SACCOs consider client capital appraisal a significant factor when advancing credit 60 (80%) and least respondents indicated that SACCOs do not consider client capital appraisal a significant factor when advancing credit 15 (20%). The findings from Table 4.16 show that Deposit Taking Savings and Credit Cooperatives consider client capital appraisal a significant factor when advancing credit to customers.

Table 4.17: Indicate your responses on the following statements regarding capital appraisal in your SACCO

strongly disagree=1; disagree=2; not sure=3; agree=4; strongly agree=5.

	Mean	SD
Client capital outlay is considered in approving or declining applications	4.378	0.887
At times the SACCO require clients to make contribution or finance a certain percentage to demonstrate capital commitment	4.198	0.872
Level of client investment is used to assess client capital	4.002	0.8653
Client with high capital outlay pays their loans better than those with low capital outlay	4.001	0.8648
The growth and quality of loans in the SACCO has gone up due to client capital appraisal	3.892	0.7779
The market share of the SACCO has gone up due to client capital appraisal	3.8734	0.7765
High level of debt (borrowed capital) is associated with poor loan repayment	3.7632	0.7290
Client capital appraisal increases revenue and profitability levels	3.7426	0.7184

From Table 4.17, most of the respondents strongly agreed that client capital outlay is considered in approving or declining applications, M=4.378 (SD=0.887) and at times the SACCO require client to make contribution or finance a certain percentage to demonstrate capital commitment, M=4.198 (SD=0.872). Least of the respondents strongly disagree that capital appraisal increases revenue and profitability levels M=3.7426 (SD=0.7184).

4.8 Quality of Loan Portfolio

Table 4.18: Indicate your responses on the following statements regarding the quality of loan portfolio of your SACCO

not at all=1; little extent=2; moderate extent =3; great extent=4; very great extent=5.

	Mean	SD
Level of Delinquency		
Improper client appraisal leads to poor collection rates and increases the portfolio at risk	3.996	0.867
Poor client appraisal has resulted to low or decline on return on loans	3.933	0.822
Revenues (income) have decreased due to delinquencies arising from poor client appraisal	3.896	0.835
Bad Debts		
Poor credit appraisal leads to increase in bad debts in the SACCO	3.996	0.867
Bad debts has resulted to decline in profits and led to losses in the SACCO	3.894	0.830
Bad debts leads to a decline in the amount and quality of the loan portfolio	3.886	0.841
The number of loans granted has decreased as a result of poor client appraisal	3.877	0.803
Loan Repayment Period		
Poor client appraisal leads to poor credit rating thus leading to long repayment period	3.745	0.783
Improper project viability analysis leads poor credit appraisal and prolonged loan repayment period	3.785	0.786
Clients are usually allowed to re-negotiate the repayment terms when they face difficulties in loan repayment	3.704	0.703
Client appraisal improves the quality of loan portfolio in the SACCO	3.7426	0.7184

From Table 4.18 above, most of the respondents strongly agree to a great extent that improper client appraisal leads to poor collection rates and increases the portfolio at risk, M=3.996 (SD=0.867) and that revenues (income) have decreased due to delinquencies arising from poor client appraisal, M=3.933 (SD=0.822).

Most respondents strongly agreed to a great extent that bad debts have resulted to a decline in profits and led to losses in SACCOs, M=3.894 (SD=0.830) and the number of loans granted has decreased as a result of poor client appraisal, M=3.877 (SD=0.803).

The respondents were asked a whether client appraisal improve the quality of loan portfolio and most of them agree to a great extent that client appraisal improves the quality of loan portfolio, M=3.7426 (SD=0.7184). Most of the respondents agreed to a great extent that poor client appraisal leads to poor credit rating thus leading to long repayment period, M=3.745 (SD=0.783) and that improper project viability analysis leads to poor credit appraisal and prolonged loan repayment period, M=3.785 (SD=0.703).

4.9 Regression Analysis and Hypothesis Testing

A regression analysis between the dependent variable and the independent variables was performed; independent variables being the influence of the lending policy and quality of loan portfolio among deposit taking SACCOs being dependent variable.

Table 4. 19: Regression Model Summary

R	R Square	Adjusted R Square	Std. Error of the Estimate	Sig
0.755a	0.570	0.522	0.468	0.0021

R Square; Adjusted R Square; Std. Error of the Estimate; Sig 0.755a 0.570 0.522 0.468 0.0021

a) Independent Variables: (Constant), character appraisal, collateral appraisal, collateral appraisal, capacity to pay appraisal.

b) Dependent Variable: quality of loan portfolio among deposit taking SACCOs Adjusted R^2 is called the coefficient of determination and indicated the quality of loan portfolio among deposit taking SACCOs varied with variation in influence of the lending policy. From Table 4.19 above, the value of adjusted R^2 is 0.570. This implies that, there was a significant variation of 57.0% of quality of loan portfolio among deposit taking SACCOs hence varied with variation in influence of the lending policy with confidence level of 95%, P = 0.0021 < 0.05.

Table 4. 20: Analysis of Variances in the Regression Model

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	7.035	5	1.759	8.184	0.001a
Residual	72.827	70	1.893		
Total	80.663	75			

a) Independent Variables: (Constant), character appraisal, collateral appraisal, Capital appraisal, capacity to pay appraisal.

b) Dependent Variable: quality of loan portfolio among deposit taking SACCOs.

The Results in Table 4.20 gives the analysis of variances in the regression model. These results indicate that the model had an F-ratio of 8.184 P=0.001<0.05. This result indicates that the overall regression model had a significant goodness of fit as F calculated, 10.545 was greater than critical F at 8.184. This further indicates that the influence of the lending policy would be statistically significant in predicting the quality of loan portfolio among deposit taking SACCOs.

Table 4.21: Regression Model Coefficients

Model	Unstandardized Coefficients		Standardized	t	Sig.
			Coefficients		
	B	Std. Error	Beta		
(Constant)	2.03	2.845		5.978	0.0106
Character appraisal	0.710	0.301	.612	10.336	0.0061
Collateral	-0.483	0.132	-0.338	13.587	0.042

appraisal					
Capital appraisal	-0.685	0.251	-0.376	12.703	0.0018
Capacity to pay appraisal	-0.351	0.012	-0.187	7.980	0.0028

a) Independent Variables: (Constant), character appraisal, collateral appraisal, Capital appraisal, capacity to pay appraisal

b) Dependent Variable: quality of loan portfolio among deposit taking SACCOs.

The resultant regression model took the form of:

$Y = 2.03 -0.485 X1 -0.681X2-0.354X3-0.569X4+ 0.714X5+ e$

The Character appraisal led to significant positive influence on the quality of loan portfolio t as r = 0.710, P=0.0061, t =10.336. This clearly indicates that character appraisal results in increased quality of loan portfolio among deposit taking SACCOs.

Proper collateral appraisal led to increased quality of loan portfolio among deposit taking SACCOs as r=0.483, P=0.042, t=13.587. This clearly indicates that proper collateral appraisal leads to increased quality of loan portfolio among deposit taking SACCOs.

The study found that Capital appraisal to a very great extent led to quality of loan portfolio among deposit taking SACCOs r = 0.685, P =.0018, t =12.703. This clearly indicates capital appraisal to a very great extent improves the quality of loan portfolio among deposit taking SACCOs.

The study found that capacity to pay appraisal to a very great extent led to quality of loan portfolio among deposit taking SACCOs. R =0.351, P =.0.0023, t =7.980. This clearly indicates that capacity to pay appraisal to a very great extent leads to increased quality of loan portfolio among deposit taking SACCOs.

CHAPTER FIVE
SUMMARY OF FINDINGS, DISCUSSIONS, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This section presents the summary of the findings of the data collected, discussions, conclusions and recommendations. They are based on the four objectives of the study namely: to establish the influence of character appraisal on the quality of loan portfolio among deposit taking SACCOs in Starehe Sub County; to establish the influence of collateral appraisal on the quality of loan portfolio among deposit taking SACCOs in Starehe Sub County; to determine the influence of capital appraisal on the on the quality of loan portfolio among deposit taking SACCOs in Starehe Sub County and to establish the influence of capacity to pay appraisal on the on the quality of loan portfolio among deposit taking SACCOs in Starehe Sub County.

5.2 Summary of Findings

The findings of the study address both the research questions and objectives. The study set out to establish the influence of the lending policy on the quality of loan portfolio among deposit taking SACCOs in Starehe Sub County, Nairobi County. The study found that most respondents, 72 (96%) reported that Deposit Taking Savings and Credit Cooperatives consider the availability of collateral a significant factor when extending credit to customers.

5.2.1 The influence of character appraisal on the quality of loan portfolio among deposit taking SACCOs in Starehe Sub County

Findings in Table 4.10 show that most respondents indicated that deposit taking SACCOs consider client character a significant factor when extending credit to customers, 57 (75%) and least respondents indicated that SACCOs do not consider client character a significant factor when extending credit to customer, 18 (25%). The findings in Table 4.10 show that Deposit Taking Savings and Credit Cooperatives consider client character a significant factor when extending credit to customers. The findings in Table 4.12 shows that client character appraisal improves loan repayment rate as indicated by most respondents, M=3.532 (SD=.553), and reduces loan delinquency as indicated by most of the respondents, M=3.662 (SD=0.611).

5.2.2. The influence of collateral appraisal on the quality of loan portfolio among deposit taking SACCOs in Starehe Sub County

Findings in Table 4.9, indicate that most of the respondents strongly agreed to a great extent that client collateral appraisal reduces delinquency rate, loan provisions and bad debts, M=3.946 (SD=0.8523) and client collateral appraisal mostly lay emphasis on the value of collateral, M=3.876 (SD=0.7999). Least of the respondents strongly disagree that client collateral appraisal can improve income levels and profitability M=3.643 (SD=3.647).

5.2.3 The influence of capital appraisal on the quality of loan portfolio among deposit taking SACCOs in Starehe Sub County

The findings in Table 4.15 show that almost all respondents indicated that deposit taking SACCOs perform client capital appraisal when advancing credit 74 (99%) and least respondents indicated that deposit taking SACCOs do not perform client capital appraisal when advancing credit 1 (1%). The findings in Table 4.17 shows that the growth and quality of loans has gone up due to client capital appraisal, as indicated by most respondents, M=3.892 (SD=0.779).

5.2.4 The influence of capacity to pay appraisal on the quality of loan portfolio among deposit taking SACCOs in Starehe Sub County

Findings in Table 4.13 indicate that clients have to demonstrate capacity to pay before credit is advanced with most respondents, 74 (99%) and least respondents indicated that client need not demonstrate capacity to pay before credit is advanced 1 (1%). The findings in Table 4.13 show that deposit taking SACCOs require that clients have to demonstrate capacity to pay before credit is advanced. Further, the findings in Table 4.14 shows that client capacity to pay appraisal reduces loan delinquency, loan provisions and bad debts, as indicated by most respondents, M=3.9761 (SD=0.8889) and that client capacity to pay appraisal increases prompt repayment of loans as indicated by most of the respondents, M=3.6883 (SD=0.696).

5.3 Discussions

The purpose of this study was to establish the influence of the lending policy on the quality of loan portfolio among deposit taking SACCOs in Starehe Sub County, Nairobi County. The study objectives and the findings thereof are discussed below:

5.3.1 The influence of character appraisal on the quality of loan portfolio among deposit taking SACCOs in Starehe Sub County, Nairobi County

The study sought to find out the influence of character appraisal on the quality of loan portfolio among deposit taking SACCOs. The study found out that client character plays a significant role on how a client repays credit granted 60 (80%). According to Gaitho (2013) character appraisal seeks to unearth the client borrowing history and the client reputation.

H_1: There is a significant relationship between character appraisal and the quality of loan portfolio among deposit taking SACCOs in Starehe Sub County.

The study confirms the above hypotheses where there was significant relationship between character appraisal and the quality of loan porfolio among deposit taking SACCOs in Starehe Sub County.

The Character appraisal led to significant positive influence on the quality of loan portfolio as r = 0.710, P = 0.0061, t =10.336. This clearly indicates that character appraisal would lead to increased quality of loan portfolio among deposit taking SACCOs.

5.3.2 The influence of collateral appraisal on the quality of loan portfolio among deposit taking SACCOs in Starehe Sub County, Nairobi County

The study sought to find out the influence of collateral appraisal on the quality of loan portfolio among deposit taking SACCOs. It found that most of the client collateral appraisal reduces delinquency rate, loan provisions and bad debts, M=3.946 (SD=0.8523). Deposit taking SACCOs require borrowers to pledge security as a way of showing commitment towards repayment of the loan. According to Flessing (1995) lending in Kenya still relies more on security. Financial institutions analyze collateral ownership as evidenced by the documents relating to the security such as log book, title deed, policy document or share certificate. Also of interest is the value of the collateral. In this case, financial institutions engage professional valuers to ensure the value of security is sufficient for the anticipated risk.

H_2: There is a significant relationship between collateral appraisal and the quality of loan portfolio among deposit taking SACCOs in Starehe Sub County.
The study confirms the above hypotheses where there was significant relationship between collateral appraisal and the quality of loan portfolio among deposit taking SACCOs in Starehe Sub County.

Proper collateral appraisal led to improved quality of loan portfolio among deposit taking SACCOs as r = 0.483, P = 0.042, t =13.587. This clearly indicates that proper collateral appraisal would lead to improved quality of loan portfolio among deposit taking SACCOs.

5.3.3 The influence of capital appraisal on the quality of loan portfolio among deposit taking SACCOs in Starehe Sub County, Nairobi County

The study sought to find out the influence of capital appraisal on the quality of loan portfolio among deposit taking SACCOs. From the study almost all respondents indicated that deposit taking SACCOs perform client capital appraisal when advancing credit 60 (80%). Capital represents resources especially money the client has invested in the business or in the project. Financial institutions in Kenya expect clients to have contributed to the asset owned by the business. Net asset less liabilities reflects the amount of money a client has invested in the business and acts as an indicator of how much the client is likely to lose if the business fails. (Moti *et al*., 2012). Client capital appraisal entail establishing the debt equity ratio (Portion of capital financed through long term loans), contribution in kind (excluding monetary capital), physical development and money contribution.

H_3: There is a significant relationship between capital appraisal and the quality of loan portfolio among deposit taking SACCOs in Starehe Sub County.
The study confirms the above hypotheses where there was significant relationship between capital appraisal and the quality of loan portfolio among deposit taking SACCOs in Starehe Sub County.

The study found that Capital appraisal to a very great extent led to increased quality of loan portfolio among deposit taking SACCOs r = 0.685, P =.0018, t = 12.703. This clearly indicates that capital appraisal to a very great extent would result in improved quality of loan portfolio among deposit taking SACCOs.

5.3.4 The influence of capacity to pay appraisal on the quality of loan portfolio among deposit taking SACCOs in Starehe Sub County, Nairobi County

In the assessment of the influence of capacity to pay appraisal on the quality of loan portfolio among deposit taking SACCOs. The findings show that almost all respondents indicated that a client has to demonstrate capacity to pay before credit is advanced 74 (99%). Capacity to pay can be considered one of the significant factors in client appraisal. It focuses on the source of income to provide basis of repayment. The main concern for any financial institution prior to advancing any credit is whether the client will be able to repay the principal amount plus interest as per the contract (Gatuhu, 2013). Financial institutions therefore consider the cash flow anticipated from the business, household income, budget, (income and expenditure) among others.

H_4: There is a significant relationship between capacity to pay appraisal and the quality of loan portfolio among deposit taking SACCOs in Starehe Sub County. The study confirms the above hypotheses where there was significant relationship between capacity to pay appraisal and the quality of loan portfolio among deposit taking SACCOs in Starehe Sub County.

The study found that capacity to pay appraisal to a very great extent led to increased quality of loan portfolio among deposit taking SACCOs as r = 0.351, P =.0.0023, t = 7.980. This clearly indicates that capacity to pay appraisal to a very great extent would lead to increased quality of loan portfolio among deposit taking SACCOs.

5.4 Conclusions

It can be deduced from the findings that there exists relationship between the lending policy and the quality of loan portfolio among deposit taking SACCOs. SACCOs observe the existing policies to avoid incidence of loan defaulting and to boost loan portfolio quality, productivity, and subsequently performance. From the findings, the study concludes that there is a significant relationship between the lending policy and the quality of loan portfolio. The results indicate that lending policy variables namely, character, collateral, capital and capacity to pay appraisals are statistically significant, it implies that all the variables are important determinants of quality of loan portfolio in SACCOs and therefore SACCOs should put a lot of emphasis on loan appraisal procedures and processes.

5.5 Recommendations

The study recommends that SACCOs should ensure full compliance with the lending policies in advancing loans to clients and also balance between collateral requirements and the individual capacity to pay when making their lending decisions.

The study also recommends that SACCOs should continuously review their lending policies to enhance the evaluation of loan applications and ensure applications are ranked according to merit. Adoption of sound policies will ensure timely repayment of loans, reduce default and enhance the quality of the loan portfolio and profitability.

5.6 Suggestions for further research

The researcher suggests further studies be done on the influence of the lending policy on the quality of loan portfolio among deposit taking SACCOs in other Counties to establish if the findings will be the same.

The researcher also recommends that a further study should be done to establish the relationship between loan appraisal process and the level of non-performing loans among deposit taking SACCOs in Kenya.

REFERENCES

Akhigbe, A. and McNulty, J. (2005). Profit efficiency sources and differences among small and large US commercial banks. *Journal of Economics and Finance,* vol. 29 No. 3.

Al- Tamimi, H.A. & Hosni C. (2011). Multiple approaches in the performance assessment of UAE commercial Banks. *International journal for Islamic and Middle Eastern finance management*, vol. 4 No. 1.

Ala, M. O. & Ngugi, P. K. (2013). Influence of mobile banking on growth of Micro Finance Institutions in Kenya. *International Journal of Social Science and Entrepreneurship*. Vol. 1 (2).

Balogun I.O. & Abraham H. (2012). Performance of Microfinance Institutions in Nigeria: An appraisal of self-reporting institutions to mix markets. *Journal of Humanities and social science,* vol. 2 No. 15.

CBK – Central Bank of Kenya. (2012). *Financial Sector Stability Report 2012*. Issue No. 4. Nairobi.

CBK (2013), prudential guidelines. *Government of Kenya*. Nairobi.

CBK, (2012). Bank supervision annual report. *Government of Kenya*. Nairobi.

CBK, (2013). Bank Supervision Annual Report. *Government of Kenya*. Nairobi.

Central Bank of India (2009) annual report. *Republic of India.* Delhi India.

Cheruiyot, K.T., Kimeli, C.M., & Ogendo, S.M. (2012). Effect of savings and credit co-operative society’s strategies on member’s savings mobilization in Kenya, *International Journal of Business and Commerce,* 1(11), 40-63.

Chirwa, E.W. (2003), Determinants of commercial banks’ profitability in Malawi: a co-integration approach, *Applied Financial Economics*, vol. 13.

Connelly, L. M. (2008). Pilot studies. *Medsurg Nursing*, Vol. 17(6).

Coyle B. (2009). *Framework for credit risk management;* Chartered Institute of Bankers.

Eco bank audited financial statement (2013). Nairobi, Kenya.

Ekumah, E.K. & Essel T.T. (2011). Information is power. The problem of credit accessibility in rural banks in Ghana. *IFLIP Research paper,* Vol. 3.

Equity Bank Ltd audited financial Statement (2013). Equity bank limited and subsidiaries annual report and financial statements 31 December 2013. *Equity Group.* Nairobi.

Family Bank audited financial statement, (2013). Family Bank Ltd, Nairobi.

Fredrick, N. K. (2014). Factors affecting performance of commercial banks in Uganda. A case for domestic commercial banks. *Proceedings of 25th International Business Research Conference* 13 - 14 January, 2014.

FSD (2009). *Costs of collateral in Kenya opportunities for reform.* The Kenya Financial Sector Deepening.

Gaitho, N. W. (2013). Role of credit reference bureau on credit access in Kenya. A survey of commercial banks in Kenya. *European Scientific Journal*, vol. 9. No. 1.

Gathuku, M. (2013). Effects of the cheque truncation System on the performance of commercial banks, *International Journal of Economics and Finance*, vol.1 (2).

Gatuhu, R. N. (2013). The effect of credit management on the financial performance of microfinance institutions in Kenya. *Unpublished.*

Gyemibi, K. (2011). *Credit management practices of micro financial institution. Unpublished.*

Haron, S. & Azim (2012). Determinants of Islamic banks profitability. *The global journal of finance and economics*, vol. 2 (3).

Kamau, A. &Were, M. (2008). What drives banking sector in Kenya? *Global business and Economics Journal*, vol. 2(4).

Kariuki, J &Wanjiri, N. (1994). *Interest rate liberalization and allocative efficiency of credit.* Institute of Development Studies, University of Sussex.

KCB (2011). KCB investor presentation full year 2011. Group financial results, KCB. Nairobi.

KCB (2013) KCB investor presentation full year 2013. *Group Financial Results*. Nairobi.

Kimutai, C. & Akuku, N. (2013). *The effects of the microfinance institutions on small scale business growth*: a survey of Uasin-Gishu County, Kenya.

Kenya Bankers Association (2012) collateral lending: Are there Alternatives for the Kenyan Banking Industry? *Working Paper Series*. Nairobi Kenya.

Kenya Bankers Association-KBA (2011). Costs of collateral in Kenya. *opportunities for reform*. The Kenya Financial Sector Deepening Kenyan Banking Industry. *Working series Paper.* Nairobi Kenya

Kimutai, C.J. & Ambrose J. (2013). Factors influencing credit rationing by commercial banks in Kenya. *Journal of Humanities and Social Science*, vol. 3 No. 20.

KIPPRA (2012). Kenya institute of public policy research analysis report. *Government of Kenya* Nairobi

KIPPRA (2013). Kenya institute of public policy research analysis report. *Government of Kenya* Nairobi

Kothari, C. R. (2004). *Research methodology*. *methods and techniques*. New Delhi. New Age International (P) Limited Publishers.

Kroszner, P. (2010). Non-Performing loans, monetary policy and deflation: the industrial country experience. *Economic and Social Research Institute Cabinet Office, Government of Japan.*

Kumbirai, M. & Webb, R. (2010). A financial ratio analysis of commercial performance in South Africa. *Journal African Centre for Economics and Finance*, vol. 2 (1).

Larossi, G. (2009). An assessment of the investment climate in Kenya. Washington DC: *The International Bank for Reconstruction and Development*/ World Bank.

Macharia, E. W. (2013). The effects of global financial crisis on the financial performance of commercial banks offering mortgage finance in Kenya. *International Journal of Social Sciences and Entrepreneurship,* vol.1, Issue 2.

Mikiko, F. (2013). Mounting NPLs weigh heavily on bank management; Stock Prices Continue to fall. *Research Institute of Economy, Trade and Industry (RIETI*), Japan.

Moti H. O. *et al.* (2012) Effectiveness of credit management system on loan performance: empirical evidence from Micro Finance Sector in Kenya. *International Journal of Business, Humanities and Technology,* vol. 2 No. 6.

Mugenda M. O. & Mugenda A. (2003), *Research methods: qualitative and quantitative approaches,* African Centre for Technology Studies, Nairobi, Kenya.

Mureithi, A.W. (2010). Relationship between credit appraisal process and the level of non-performing loans of the women enterprise fund loans offered through financial intermediaries in Kenya. *Unpublished.*

Myers, J.H. & Forgy, E.W. (2005). Development of numerical credit evaluation system. *Journal of the American Association,* vol. 58(303).

Njanike, K. (2009). The Impact of Effective Credit Risk Management on Bank Survival. *Annals of the University of Petroşani, Economics,* vol. 9 (2).

Nyamongo and Temesgen (2010). The effects of governance on the performance of commercial banks in Kenya. A panel study. *Emerald Group Publishing*. vol. 13 no. 3.

Ombutora, E. K. & Mugambi, F. (2013). Role of agency banking on the performance of banking agent entrepreneurs: A case study of Co-operative Bank Co-op Jirani in Kibera, Nairobi. *International Journal of Social Sciences and Entrepreneurship,* vol. 1 (5).

Ongore, V.O. & Kusa G.B. (2013). Determinants of Financial Performance of Commercial Banks in Kenya. *International Journal of Economics and Financial Issues*vol.3. No.1.

Pafula, K. (2009). Financial institutions loan portfolio in Uganda, A Comparative study of commercial banks and microfinance institutions. *Unpublished.*

Regression and Multilevel/ Hierarchical Models. Cambridge University Press.

SASRA. (2013). *Sacco Supervision Annual Report 2014 (Deposit Taking Sacco's).* Nairobi.

SASRA. (2012). *Sacco Supervision Annual Report 2013 (Deposit Taking Sacco's).* Nairobi.

SASRA. (2014). *Licensed Sacco's 2014*. Retrieved from http://www.sasra.go.ke/regulation/licensed-saccos#.U707yHnlrIU.

SASRA. (2014). *Our Mandate*. Retrieved from http://www.sasra.go.ke/about-us/our-mandate#.U707kXnlrIU.

Schiniotakis, N.I. (2012). Profitability factors and efficiency of Greek banks, *EuroMed Journal of Business,* vol. 7 No. 2.

Stiglitz J. E., and Weiss, A. (1981) Credit rationing in markets with imperfect information; *The American Economic Review,* vol. 71(3).

Stiglitz; J.E. (1975). The theory of 'screening,' education, and the distribution of income; *The American Economic Review,* vol. 65(3).

Turyahebwa, A. (2013). Financial performance in the selected microfinance institutions in Uganda (*unpublished master's thesis*) Kampala International University.

UBA Audited financial statement (2013). Nairobi.

Waweru, N. M. & V. M. Kalani (2009). *Commercial banking crises in Kenya: causes and remedies*. Canada: York University Press.

Yadollahzadeh, N. A. *et al*. (2013). The effective factors on the profitability of commercial Banks in Iran. *World of Sciences Journal,* Vol. 1 Issue: 9.

APPENDICES

Appendix I: Letter of Transmittal

Joash Kiprotich Ngeno
P.O. Box 21564-00100
NAIROBI

Dear Respondent,

I am conducting a research for my Master of Arts in Project Planning and Management, of the University of Nairobi. This research is intended to provide information that will be useful in examining the *Influence of Lending Policy on the Quality of Loan Portfolio among Deposit Taking SACCOs in Starehe Constituency, Nairobi County*. This questionnaire is purely for academic purpose and information provided will be treated with utmost confidentiality.

Thank you.

JOASH KIPROTICH NGENO
REG. L50/71359/2014

Appendix II: Research Questionnaire

SECTION A-GENERAL INFORMATION

1) Position of respondent

   (a) CEO ☐ *(b)* Director ☐

   (c) Credit Manager ☐ *(d)* Credit Officer ☐

   (e*)* Other……………………………………………… (Specify)

2) Gender

   (a) Male ☐ (*b)* Female ☐

3) Age Group

   (a) 20-30 years ☐ (*b)* 31-40 years ☐ *(c)* 41-50 years ☐

   (d) 51 years and Above ☐

4) Experience in years the job

   (a) 0-5years ☐ *(b)* 6-10 years ☐ 11-15 years ☐

   (d) 16-20 years ☐ *(f)* Above 20 years ☐

5) Level of education

   (a) Secondary ☐ (*b)* College ☐ *(c)* University ☐

SECTION B-CLIENT COLLATERAL APPRAISAL

6) Does the SACCO consider availability of collateral a significant factor when extending credit to customer? Yes ☐ No ☐

7) If no in question (6) above what does your SACCO consider significant in client appraisal…………………………….

8) Our loan policy emphasizes on extending credit to client with collateral? Yes ☐ No ☐

9) Clients who have pledged collateral have better repayment than those who have not pledged collateral? Yes ☐ No ☐

10) Indicate your responses of the following statement regarding collateral appraisal in your SACCO using the following scales:

strongly disagree=1; disagree=2; not sure=3; agree=4; strongly agree=5.

	1	2	3	4	5
Client collateral in your SACCO mostly lays emphasize on the value of collateral					
The major focus on collateral appraisal is on the ownership					
The SACCO allows a margin between loan amount and collateral value					
Client collateral appraisal lays emphasize on the marketability of the collateral					
Client collateral appraisal reduces delinquency rate, loan provisions and bad debts					
Collateral appraisal enhances prompt repayment of loans					
Loans with collateral performs better than those without collateral					
Collateral appraisal can improve income levels and profitability					

SECTION C-CLIENT CHARACTER APPRAISAL

11) Does the SACCO consider client character a significant factor when extending credit to customer? Yes ☐ No ☐

12) If no in question (11) above what does your SACCO consider significant in client appraisal…………………………….

13) Client character plays a significant role on how a client repays credit granted Yes ☐ No ☐

14) Indicate your responses of the following statement regarding client character appraisal in your SACCO using the following scales:

strongly disagree=1; disagree=2; not sure=3; agree=4; strongly agree=5.

	1	2	3	4	5
Client character is an important consideration in client appraisal					
During client character appraisal, the client integrity is evaluated					
Character plays important role in loan repayment					
Loan amount and period is determined by the client character					
Client character appraisal improves profitability					
Client character appraisal reduces delinquency rate, loan provisions and bad debts					
Loan quality and growth has been achieved through client character appraisal					
Loan repayment rate has improved due to client character appraisal					
Client character appraisal lay emphasize on borrowers honesty					
During appraisal efforts are made to establish whether client is trustworthy					

SECTION D-CLIENT CAPACITY TO PAY APPRAISAL

15) Client has to demonstrate capacity to pay before credit is advanced?

Yes ☐ No ☐

16) Does the SACCO consider client character a significant factor when extending credit to customer? Yes ☐ No ☐

17) If no in question (16) above what does your SACCO consider significant in client appraisal……………………………

18) Indicate your responses on the following statements regarding client capacity appraisal in your SACCO using the following scales:

strongly disagree=1; disagree=2; not sure=3; agree=4; strongly agree=5.

	1	2	3	4	5
During client appraisal you examine client income to establish capacity to pay					
Clients with high income are likely to pay their loans better than those with low income					
Clients are required to provide cash flow statements to demonstrate ability to pay					
For corporate clients profit and loss statements are evaluated to establish capacity to pay					
Client capacity to pay appraisal reduces loan delinquency, loans provisions and bad debts					
Client Capacity to pay is the most significant consideration when advancing credit					
The growth and quality of loans in the SACCO has improved due to capacity to pay appraisal					
Client capacity to pay has increased prompt repayment of loans					
Capacity to pay appraisal has increased revenue and profitability of the SACCO					

SECTION E-CLIENT CAPITAL APPRAISAL

19) Our SACCO performs client capital appraisal when advancing credit?

Yes ☐ No ☐

20) Does the SACCO consider client capital a significant factor when extending credit to customer?

Yes ☐ No ☐

21) If No in question (20) above what does your SACCO consider significant in client appraisal…………………………….

22) Indicate your responses on the following statement regarding capital appraisal in your SACCO using the following scales:

strongly disagree=1; disagree=2; not sure=3; agree=4; strongly agree=5.

	1	2	3	4	5
Client capital outlay is considered in approving or declining applications					
At times the SACCO require client to make contribution or finance a certain percentage to demonstrate capital commitment					
Level of client investment is used to assess client capital					
Client with high capital outlay pays their loans better than those with low capital outlay					
The growth and quality of loans in the SACCO has gone up due to client capital appraisal					
High level of debt (borrowed capital) is associated with poor loan repayment					
Client capital appraisal increases revenue and profitability levels					

SECTION F - QUALITY OF LOAN PORTFOLIO

Indicate your responses on the following statements regarding loan repayments and performance in your SACCO using the following scales:

not at all=1; little extent=2; moderate extent =3; great extent=4; very great extent=5.

	1	2	3	4	5
Level of Delinquency					
Improper client appraisal leads to poor collection rates and increases the portfolio at risk					
Poor client appraisal has resulted to low or decline on return on loans					
Revenues (income) have decreased due to delinquencies arising from poor client appraisal					
Bad Debts					
Poor credit appraisal leads to increase in bad debts in the SACCO					
Bad debts has resulted to decline in profits and led to losses in the SACCO					
Bad debts leads to a decline in the amount and quality of the loan portfolio					
The number of loans granted has decreased as a result of poor client appraisal					
Repayment Period					
Poor client appraisal leads to poor credit rating thus leading to long repayment period					
Improper project viability analysis leads to poor credit appraisal and prolonged loan repayment					
Clients are usually allowed to re-negotiate the repayment terms when they face difficulties in loan repayment					
Client appraisal improves the quality of loan portfolio in the SACCO					

Appendix III: Introduction Letter

UNIVERSITY OF NAIROBI
COLLEGE OF EDUCATION AND EXTERNAL STUDIES
SCHOOL OF CONTINUING AND DISTANCE EDUCATION
DEPARTMENT OF EXTRA-MURAL STUDIES
NAIROBI EXTRA-MURAL CENTRE

Your Ref:

Our Ref:

Telephone: 318262 Ext. 120

Main Campus
Gandhi Wing, Ground Floor
P.O. Box 30197
N A I R O B I

26th September 2016

REF: UON/CEES/NEMC/24/257

TO WHOM IT MAY CONCERN

RE: JOASH KIPROTICH NGENO - REG NO L50/71359/2014

This is to confirm that the above named is a student at the University of Nairobi, College of Education and External Studies, School of Continuing and Distance Education, Department of Extra- Mural Studies pursuing Master of Arts in Project Planning and Management.

He is proceeding for research entitled **"influence of lending policy on the quality of loan portfolio among deposit taking savings and credit co-operatives in starehe sub-county, Nairobi Kenya"**

Any assistance given to him will be appreciated.

UNIVERSITY OF NAIROBI CEES
Box 30197
26 SEP 2016
NAIROBI
NAIROBI EXTRA MURAL CENTRE

DR. JOHN MBUGUA
RESIDENT LECTURER,
NAIROBI EMC

Appendix IV: Research Permit

THIS IS TO CERTIFY THAT:
MR. JOASH KIPROTICH NGENO
of UNIVERSITY OF NAIROBI, 21546-100
Nairobi,has been permitted to conduct
research in *Nairobi County*

Permit No : NACOSTI/P/17/13624/16109
Date Of Issue : 15th March,2017
Fee Recieved :Ksh 1000

on the topic: *INFLUENCE OF LENDING POLICY ON THE QUALITY OF LOAN PORTFOLIO AMONG DEPOSIT TAKING SAVINGS AND CREDIT CO-OPERATIVES IN STAREHE SUB-COUNTY, NAIROBI, KENYA*

for the period ending:
15th March,2018

....
Applicant's Signature

....
Director General
National Commission for Science, Technology & Innovation

CONDITIONS

1. You must report to the County Commissioner and the County Education Officer of the area before embarking on your research. Failure to do that may lead to the cancellation of your permit.
2. Government Officer will not be interviewed without prior appointment.
3. No questionnaire will be used unless it has been approved.
4. Excavation, filming and collection of biological specimens are subject to further permission from the relevant Government Ministries.
5. You are required to submit at least two(2) hard copies and one (1) soft copy of your final report.
6. The Government of Kenya reserves the right to modify the conditions of this permit including its cancellation without notice

REPUBLIC OF KENYA

NACOSTI

National Commission for Science, Technology and Innovation

RESEACH CLEARANCE PERMIT

Serial No.A 13254

CONDITIONS: see back page

**NATIONAL COMMISSION FOR SCIENCE,
TECHNOLOGY AND INNOVATION**

Telephone:+254-20-2213471,
2241349,3310571,2219420
Fax:+254-20-318245,318249
Email:dg@nacosti.go.ke
Website: www.nacosti.go.ke
when replying please quote

9th Floor, Utalii House
Uhuru Highway
P.O. Box 30623-00100
NAIROBI-KENYA

Ref. No.
NACOSTI/P/17/13624/16109

Date
15th March, 2017

Joash Kiprotich Ngeno
University of Nairobi
P.O.Box 30197-00100
NAIROBI.

RE: RESEARCH AUTHORIZATION

Following your application for authority to carry out research on ***"Influence of lending policy on the quality of loan portfolio among deposit taking Savings and Credit Co-Operatives in Starehe Sub-County, Nairobi, Kenya,"*** I am pleased to inform you that you have been authorized to undertake research in **Nairobi County** for the period ending **15th March, 2018.**

You are advised to report to **the County Commissioner and the County Director of Education, Nairobi County** before embarking on the research project.

On completion of the research, you are expected to submit **two hard copies and one soft copy in pdf** of the research report/thesis to our office.

BONIFACE WANYAMA
FOR: DIRECTOR-GENERAL/CEO

Copy to:

The County Commissioner
Nairobi County.

The County Director of Education
Nairobi County.