

**THE RELATIONSHIP BETWEEN LOAN POLICY AND
FINANCIAL PERFORMANCE IN SACCOs IN NAIROBI COUNTY,
KENYA**

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DECLARATION

This research project is my original work and has not been presented in any other institution.

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This research project has been submitted with my approval as university supervisor.

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DEDICATION

I dedicate this research project to my departed mother Matilda Ondiko, family members and friends for their support, patience, encouragement and understanding. They gave me the will and determination to complete this project.

ABSTRACT

The purpose of this study was to establish the relationship between loan policy and financial performance in Nairobi County in Kenya. According to the Ministry of Cooperative Development and Marketing Annual Reports, Nairobi County has the majority of SACCOs in Kenya and thus the area of focus in this study. SACCOs play a crucial role in socio-economic development by promoting thrift among its members and affording them an opportunity for accumulating their savings and obtaining loan at fair and reasonable rates of interest. This study sought to enlighten SACCOs on the importance of loan policies for improved financial performance. The researcher sampled 36 SACCOs using stratified sampling. The research was carried out using both primary and secondary data. The data collected was processed and analyzed using statistical packages for social sciences (SPSS) software. Correlation and multiple linear regression analysis were used to test the relationship between dependent and independent variables. The findings of the study recommended that SACCOs should continuously review credit policies to enhance the evaluation of loan applications and ensure that loan applications are appraised and ranked according to merit. The findings also recommended that SACCOs to ensure timely loan disbursement to facilitate loan recovery and minimize administrative costs which would lead to growth of SACCOs' wealth. Further, it was recommended that SACCOs should establish irrecoverable loan provision policies that make adequate loan provisions to promote safety of funds and ensure that loan assets are not overstated. Additionally, the government should review legal framework for the SACCOs to ensure sound loan policies are put in place for improved financial performance.

TABLE OF CONTENTS

DECLARATION	ii
ACKNOWLEDGEMENT	iii
DEDICATION	iv
ABSTRACT	v
LIST OF TABLES	ix
LIST OF FIGURES	x
LIST OF ABBREVIATIONS.....	xi
CHAPTER ONE	1
INTRODUCTION	1
1.1 Background of the Study	1
1.1.1 Loan Policy	1
1.1.2 Financial Performance	3
1.1.3 Relationship between Loan Policy and Financial Performance	4
1.1.4 SACCOs in Nairobi County.....	5
1.2 Statement of the Problem.....	7
1.3 Research Objective	9
1.4 Research Question	10
1.5 Significance of the Study	10
CHAPTER TWO	11
LITERATURE REVIEW	11
2.1 Introduction.....	11
2.2 Theoretical Review	11
2.3 Loan Evaluation Models	14

2.3.1	Credit Scoring Model.....	14
2.3.2	Accounting-based Model.....	15
2.3.3	Survival-based Credit Scoring Model.....	16
2.4	Empirical Review.....	16
2.5	Summary of Literature Review.....	18
CHAPTER THREE		20
RESEARCH DESIGN AND METHODOLOGY		20
3.1	Introduction.....	20
3.2	Research Design.....	20
3.3	Target Population.....	20
3.4	Sample.....	21
3.5	Data Collection	21
3.5.1	Data Validity and Reliability	21
3.6	Data Analysis and Reporting	22
CHAPTER FOUR.....		24
DATA ANALYSIS AND INTERPRETATION.....		24
4.1	Introduction.....	24
4.2	Data Presentation	24
4.2.1	Profile of SACCOs	24
4.2.2	Number of Branches	26
4.2.4	Loan Policy	28
4.3	Regression Analysis.....	31
4.4	Correlation Analysis	33
CHAPTER FIVE		35

SUMMARY, CONCLUSION AND RECOMMENDATIONS	35
5.1 Introduction.....	35
5.2 Summary	35
5.3 Conclusion	36
5.4 Policy Recommendations.....	37
5.5 Limitations of the Study.....	37
5.6 Suggestions for Further Research	38
REFERENCES	39

LIST OF TABLES

Table 1: Profile of the SACCOs.....	24
Table 2: Loan Policy Procedures.....	28
Table 3: Model's Goodness of Fit Statistics	31
Table 4: Analysis of Variance (ANOVA)	32
Table 5: Regression Coefficients.....	32
Table 6: Correlation Analysis.....	34

LIST OF FIGURES

Figure 1: SACCOs Membership	25
Figure 2: Years in Existence.....	26
Figure 3: SACCOs Number of Branches	27
Figure 4: SACCOs Savings	28

LIST OF ABBREVIATIONS

KUSCCO	-	Kenya Union of Savings & Credit Co-operatives
MDA	-	Multiple Discriminant Analysis
MOIED	-	Ministry of Industrialization and Enterprise Development
OECD	-	Organization for Economic Co-operation and Development
SACCOs	-	Savings and Credit Co-operatives
SAGA	-	Semi-Autonomous Government Agency
SASRA	-	SACCO Societies Regulatory Authority

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

1.1.1 Loan Policy

Loan policy is the primary means for guiding lending activities. It forms the credit philosophy in addition to imposing standards for achieving earnings objective and risk tolerance levels (Comptroller Handbook, 1998).

There is no ideal format of loan policies. They vary in degree of detail, length and organization. Certain aspects of the policy may vary because of factors such as economic conditions, geographic location or portfolio objectives. They are tailored to fit the needs of an institution and the scope should be commensurate with the lending activities involved. Responsibilities of those involved should also be clearly established (Comptroller Handbook, 1998).

Loan policy involves 3 decision variables namely, credit terms (interest charge, loan size, loan period), collateral requirement and eligibility criteria) credit standards and collection effort (Pandey, 1995). It is therefore important to scrutinize the 3 loan policy decision variables in order to enhance loan repayment.

SACCO Societies Act, 2008 requires SACCOs (Savings and Credit Cooperatives) to have a written loan policy consistent with the relevant provisions of the Act, Regulations and any other applicable laws. The loan policy contains loaning procedures and their documentation, requirements for grant of a loan, loan concentration limits, maximum

loan size, loan types, interest rates, and guaranteeing requirements among others.

Financial Policies and Procedures provided by the Department of Co-operative Development and Marketing provide guidelines for the development of loan policies by SACCOs.

Generally SACCOs offer long term loans, short term loans and deposit facilities. Long term loans are granted for development purposes usually for a period over 12 months at an interest rate of 1% per month on reducing balance method. The amounts are limited by the deposits held by a member and secured by guarantorship. In addition, there is a provision for top up after the repayment of some amount. Some SACCOs offer group lending usually for manageable group sizes. Examples of these types of loan are the development loans commonly referred to as normal loans. Short term loans are granted for education and emergency purposes usually for a period not exceeding 12 months at an interest rate of 1% per month on reducing balance method. The amounts are limited by deposits held and secured by guarantorship. Examples of these types of loan are school fees, emergency loans and advances. However, advances are normally at a higher interest rate than the school fees and emergency and at times given outside the deposit threshold. Deposit facilities include fixed deposit accounts, savings account, short/call deposits and special accounts such as children and holiday accounts (Cooperative Bank, 2008).

The law has been silent on reporting requirements to facilitate compliance monitoring. This omission has had potential dangers for SACCOs because early warning signs have been missed. The Co-operative Societies Act No.12 of 1997 saw the exit of direct government control of co-operatives that led to the collapse of many SACCOs due to

loan defaults and mismanagement among others. The Cooperative Societies (Amendment) Act, 2004 came into being to curb the cases of mismanagement among others (Manyara, 2003). Recently the government identified the unique needs of SACCOs and the volumes of financial responsibilities and enacted the SACCO Act No.14 of 2008. The implementation of the Act led to the establishment of SACCO Societies Regulatory Authority (SASRA) (KUSCO, 2008). Through this legal framework, prudential regulations have been introduced to guide SACCOs' growth and development. It places the licensing, supervision and regulation of deposit taking SACCOs under the armpit of SASRA (Procasur, 2012).

1.1.2 Financial Performance

How best a firm is performing can be looked at in terms of profitability and/or rate of return. Financial performance measures the results of a firm's policies and operations in monetary terms. In SACCOs, it is the efficiency with which loans are granted and repaid at maximum possible return. Broadly it looks at the number of clients applying for loans, how much they are borrowing, timely payment of installments, security pledged against the borrowed funds and rate of arrears recovery.

SACCOs sustainability and levels of development basically depend on high recovery of their loans. Loan policies therefore have unquestionable importance and must be carried out constantly and with consistency (Kablan, 2010). Eales and Bosworth (1998) state that Institutions financial viability is weakened by the loss of principal and interest, the cost of recovery and the opportunity cost of management time taken to recover defaulted loans.

Organization for Economic Co-operation and Development (OECD) provides the measure for performance as 'SCALE'. This measure determines Self-sufficiency ratio, Capital adequacy ratio, Asset quality, Liquidity and Earnings quality (OECD, 1996).

1.1.3 Relationship between Loan Policy and Financial Performance

In the recent past, new developments and intense competition in lending industry in Kenya's economy has been witnessed since the introduction of economic liberalization which has posed serious challenges to the SACCOs which are restricted in terms of where to invest their funds of deposits (SACCO Act, 2008). Therefore loan policies very much contribute to the sustainability and financial viability of SACCOs given that issuance of loans is their major activity. They operate under the objective of maximizing benefits to members by providing loans and paying a return on their investments. It is the loan performance that guarantees returns on the deposits. Puxty and Dodds (1991) stated that the essence of loan policy is to maximize the value of a firm.

Mutesasira et al., (1997) in agreement with Pandey (1993) stated that when there is evidence or plausible reason to assume that a client is unable to make profitable investments with their loans and repay, they should not receive credit and if they deliberately refused to pay loans in the past they should be excluded from future lending. GTZ reports (1997) state that weaknesses in loan policies encourage delinquency or delay in repayment which can result in loan loss. This is to say that proper policy should be applied in lending for enhanced financial performance.

The main objective of application of loan policy is to maximize earnings over the short term and long range within managed risk limitations and generating sound and profitable long term loan and deposit customers (Morsman, 1982). SACCOs are therefore expected to generate profits with proper application of loan policies.

A study by Shaffer in 1998 on Credit union policies and performance in Latin America established that performance depended on incentives of borrowers to repay and incentives for the Credit union's ability to screen loans.

A study by Owizy on impact of credit management on financial performance of banks in Nigeria it was recommended that management cautiously set up credit policy that could not negatively affect profitability.

1.1.4 SACCOs in Nairobi County

According to Saccol Magazine of September 2008, a SACCO is a democratic, unique member driven, self-help cooperative. It is owned, governed and managed by its members who have the same common bond. It could be working for the same employer, belonging to the same church, social fraternity or living/working in the same community. A SACCO's membership is open to all who belong to the bond regardless of race, religion, colour, creed, gender or job status. These members agree to save their money together in the SACCO and to make loans to each other at reasonable rates of interest. Interest is charged on loans to cover the interest cost on members' deposits and the costs of administration in the SACCO. The members are the owners and customers at the same time, and they decide how their money will be used for the benefit of each other. This

type of set-up has tended to make cooperatives adopt a conservative approach in managing their business.

The principal activity of SACCOs is to promote thrift among its members by affording them an opportunity to accumulate their savings to create thereby a source of funds from which loans can be made to them exclusively for provident and productivity purpose at fair and reasonable rates of interest (Cooperatives Digest 2008). Section 43 of the Cooperative Societies Act (Amendment) 2004 prohibits a cooperative society from giving loans to non – members, unless the by-laws of the society provide for giving such a loan. Therefore the law gives SACCOs the leverage to develop a policy framework for lending. The main requirement across all SACCOs is that their members have to have some source of income before qualifying to join the SACCOs. The SACCOs mobilize funds from the members and give them access to financial services like loans, savings facility, front office services which is otherwise inaccessible to them through the main banks that are either unaffordable or physically inaccessible.

SACCOs registration was formerly under the Ministry of Cooperative Development and Marketing which is now a department under the Ministry of Industrialization and Enterprise Development (MOIED). Registration of SACCOs is now under the mandate of the MOIED as per the Executive Order No. 2 of 2013. SASRA a Semi Autonomous Government Agency (SAGA) under the MOIED is charged with the responsibility of licensing and supervising Deposit Taking SACCO Societies in Kenya (SACCO Societies Act 2008).

As per the Ministry of Cooperative Development and Marketing Nairobi County Annual Report of the year 2011/12, there were 1247 SACCOs registered in Nairobi County. These were spread in 9 administrative units referred to as Sub Counties in the County namely; Kamukunji, Makadara, Njiru, Kasarani, Langata, Starehe, Westlands, Embakasi and Dagoretti.

As per Procasur report on overview of SACCOs in Kenya of March 2012, there were 2959 active SACCOs in Kenya as at 31 December, 2010 out of which over 45% of them were registered in Nairobi County. It therefore follows that Nairobi County constitute the highest proportion of SACCOs registered in Kenya.

SACCOs both with and without FOSAs offer loans as per their loan policies which are expected to give a return to the SACCOs for survival and sustainability. This study seeks to establish the relationship between the loan policies and financial performance to enlighten the SACCOs on the importance of loan policies.

1.2 Statement of the Problem

Effectiveness of loan policy for enhanced financial performance is based on the minimization or elimination of defaults on loan. According to the Ministry of Cooperative Development and Marketing Nairobi Province Annual Report of the year 2011/2012, loans granted amounted to kshs. 155.9 billion against an outstanding amount of kshs. 108.5 billion giving a repayment rate of 30%. Loan defaulted amounted to kshs. 387.4Million. Compared to the year 2009/2010, loans granted amounted to kshs. 130.5

Billion against an outstanding amount of kshs. 87.3 Billion. Loan defaulted amounted to kshs. 625 Million.

Most of the liquidation recommendation reports in Nairobi County indicate loan defaults as one major cause of withdrawal by members for lack of trust and confidence in the SACCOs. Most of the SACCOs' income is from loans. The income caters for the expenses of the society and in case of surplus, members are paid dividend and interest on deposits therefrom. Aryeetey (1997) indicated that SACCOs raise savings from and make loans to members from which revenue is generated. The repayments facilitate the continuation of lending to other members. When loan repayments are delayed and defaults arise, loan disbursement is affected, expenses accrue and in the long term services dwindle.

A study by Bangsoyao in Nigeria on control practices of loan delinquency of La Trinidad vegetable trading post multipurpose cooperative, it was established that there was continuous strict implementation of the loan policy and project monitoring to ensure that borrowers did not divert funds. This explained the popularity of the agricultural loan and its impact on the farmers' activities.

In a research carried out by Wakuloba in 2008 in Uasin Gishu on the causes of loan default in Uasin Gishu District Trade Development Joint Loan Board (UGTDJLB) scheme, it was noted that government micro-credit programs perform poorly in terms of low amounts of repayment and high default rates. Although UGTDJLB performed

relatively well, it was noted that some of the practices in place needed to be enhanced. These were strict enforcement of the loan policy and timely disbursement of loans.

A research carried out by Lagat on the effect of credit risk management practices on lending portfolio among SACCOs in Kenya, it was highlighted that SACCOs sustainability and levels of development basically depended on high recovery of its loan portfolio which depended on loan policies in place.

Citing from the financial policies and procedures manual template, cooperatives that fail to manage their debtors portfolio soon or later run the risk of being managed by the debtors as they gradually lose control due to reduced cash flow and increased incidences of bad debts. An overall look at the audited annual accounts, SACCOs have low loan repayment rates and significant amounts of loan defaulted.

The researches obtained did not establish the relationship between loan policy and financial performance in SACCOs so as to enlighten them on the need to put in place sound loan policies for improved financial performance.

The researcher sought to establish the relationship between loan policy and financial performance in SACCOs in Nairobi County in Kenya.

1.3 Research Objective

The research objective was to establish the relationship between loan policy and financial performance of SACCOs in Nairobi County in Kenya.

1.4 Research Question

The research question was to establish the relationship between loan policy and financial performance in Nairobi County in Kenya.

1.5 Significance of the Study

This study is of great significance to both the management committee and staff in understanding the importance of loan policy that enables them seek solutions to the loan defaults and low rates of loan repayment. It provides a basis of re-engineering and rejuvenating the SACCOs for accelerated growth.

It provides the government with a basis of policy formulation and decision making in respect of loan administration in SACCOs.

This research contributes to the existing body of literature and form a basis for further research.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter reviews the various literatures on loan policy and financial performance in SACCOs. In particular it reviews the theoretical and empirical studies on loan policies in SACCOs and their relationship to financial performance.

2.2 Theoretical Review

Crouhy et. al. (2001) suggests that SACCOs should analyze 3 different categories of variables. Financial base based on financial reports whereby SACCOs assess the funds available against the loans to be issued such that funds cater for the different loan products with a balance between the most profitable and less profitable loan products. It is important that SACCOs establish if the individuals requesting for a loan can be held legally liable for the loan they are requesting. Legally the borrower should have the authority and legal understanding to sign a binding agreement. For example the individual may have ceased membership. Quality of the borrower should as well be considered by the management. For example if it is school fees loan, it should be sent directly to the school if the borrower is considered to be irresponsible in usage of funds.

Stearns (1995) argued that it is the lender, not the borrower, who causes or prevents high levels of delinquency in credit programmes. She noted the importance of ‘uncontrollable’ factors such as natural disasters and personal crises in affecting the ability to repay a loan. Copisarow (2000) observed that defaults generally arise from poor programme design or implementation, not from any essential problems with the borrowers. Hulme and Mosely

(1996) described design features for ensuring high repayment rates on loans. They include individual lending, self-selecting group lending, market interest rates, intensive supervision, peer group monitoring, borrower and staff incentives, progressive lending in addition to character referencing.

Credit risk rating is a summary indicator of risk for institution's individual credit exposures and is generally assigned at the time of credit approval and reassessed during the credit review process. It reduces the number of potential default on loans as well as minimizing the cost associated with bad debt recovery. Credit rating reduces losses due to defaults, monitoring cost, administration costs with debt collection. Most institutions use credit scoring model to evaluate the loan applicants. They develop their own interest credit scoring models against which loan requests can be assessed within the shortest time possible. Usually the credit scoring systems are based on discriminant model in which variables are used jointly to establish a numerical score of ranking for each credit applicant. If the applicant's score exceeds the prescribed and defined cut off level, the loan application is likely to be denied (Davis, 1987).

Bannock and Partners (1997) stated timely and full reporting of an institution's activities and results as a key criterion of good governance. The collection of more complete information for each loan type will allow SACCOs to more accurately and effectively monitor loan repayment to realize full repayment.

According to Hulme and Mosely (1996), of particular importance are the design features of the loan. They categorize the design features into access methods, screening methods

and incentives to repay. Access methods generally ensure that those in need access the loans. Features include loan ceilings and interest rates. Screening methods are used to screen out bad borrowers whose main feature is peer lending. According to Ghatak (2000), less risky borrowers are more likely to select less risky borrowers into the group. The peer pressure effect encourages the repayment of loans. The third provides incentives to both the borrowers and lending officers to encourage repayment and foster the collection of loans, respectively. For the borrowers, rebates on interest on loans repaid early and the provision of larger loans when earlier ones are repaid encourages borrowers to repay. On the lender side, financial bonuses can be used as incentives to lending officers to chase up loans.

The legal framework that surrounds the protection of deposits and the availability of recourse action to lenders in case of default offers caution against default. The scope of the legal provisions differs from one country to another depending on the financial system in the country. The informal institutions are not regulated by financial authorities but are usually licensed and supervised by other government agencies (Ledgerwood, 1999).

World Bank (1995) and Sobhan (1991) found that a high interest rate was one of the contributing factors to loan default. This suggests that loan default could not solely be attributed to borrowers' unwillingness to repay loans but was also an inbuilt problem of the interest rate policy. As high interest rates increase costs of borrowing, debt burden grows which leads borrowers to default. As loan default becomes persistent, institutions lose income and become undercapitalized. They resort to high interest rates in order to

recover their financial position and the cycle is repeated hence borrowers are to bear the brunt of this inconsistent interest rate policy. Hoque in 2008 on flawed interest rate policy advanced the hypothesis that lenders' failure to pay loans is related to persistent flawed interest rate policy applied by the financiers.

Several authors (Greenbaum, et al. (1991) suggested that when a loan is not repaid it may be due to the policies applied in credit assessment procedures, which in turn decides who is granted a loan. The traditional lenders would not lend if the transaction costs are too high and or if they perceive the borrower to be too risky and would not repay the loan. This is referred to as credit risk which Coyle (2000) defines as the potential loss from the refusal or inability of credit customers to pay what is owed in full or in time.

2.3 Loan Evaluation Models

2.3.1 Credit Scoring Model

The most widely used credit measure to predict future loan performance is credit scoring model. Feldman (1997) explained credit scoring as “the process of assigning a single quantitative measure, or score, to potential borrower representing an estimate of the borrower's future loan performance”. The models are statistical in nature such as logistical regression analysis or discriminant analysis and more recently neural networks and Support Vector Machine (SVM). Credit scoring methods are used to estimate the likelihood of default based on historical data on loan performance and characteristics of the borrower. In the small business environment, if the customer statistics produce a score above the cut-off score, the application is considered for further assessment by specialized small business units and then later progresses to the small business credit

department for approval or otherwise. The basic assumption is that there exists a metric which can distinguish between good and bad credits and segregate them into two separate distributions. Credit scoring has its limitations. Feldman (1997) considered the credit scoring models used in Sacco's and MFI lending to be more intricate than those used in consumer lending and have a propensity of placing substantial weight on factors related to the financial history of the business owner. Some studies (Frame, Srinivasan and Woosley, 2001; Berger & Frame, 2005) have found that credit scoring is associated with an increase in overall lending because of the inclusion of more marginal classes of borrowers.

2.3.2 Accounting-based Model

Accounting ratios are also widely used by banks in a bid to limit adverse selection and moral hazard problems in loan advancements. The methodology of the accounting-based approach is based on Multiple Discriminant Analysis (MDA) and logistic models that are the most useful in accounting based variables for classifying company default. Khorasgani (2009) argued that although there are numerous drawbacks to using accounting ratio based models in predicting defaults, SACCOs' financial ratios derived from balance sheets and profit and- loss accounts are regarded as good predictors of default. In addition, liquidity and activity are the most crucial factors in predicting an SME's and individual default, as well as the positive effect of age and size variables on Sacco's default prediction.

2.3.3 Survival-based Credit Scoring Model

Some banks take the process to another level by making use of the survival analysis method to measure response or time of an occurrence of an event. Luoma and Laitinen (1991) pointed out that the aim of the survival analysis method is to measure the link between illustrative variables and survival. Investigating the timing when customers are likely to go “bad” is important for effective credit management policies. The bank can manage and monitor profitability of clients to the bank over a customer’s lifetime. It has been shown previously by Narain (1992:109) and Banasik et al. (1999) that survival analysis can be useful to estimate default and repayment.

2.4 Empirical Review

A study by Baliwen on loan delinquency control practices of primary cooperatives in Nigeria in 2009, it was established that almost all of the cooperatives had written policies which they implemented strictly to their members. Each cooperative had a credit committee; however, only few staff engaged in loans. The requirements of the Cooperatives for borrowing loans were share capital, guarantors, collaterals, and savings deposit and business plan. Most of the cooperatives conducted credit investigation and monitored the projects of their borrowers to ensure that the loans were used properly. The cooperatives forced the borrowers to pay or return immediately their loans or they would not be granted loans once the cooperative found out that the loan was not being used for the intended purpose.

Koopahi and Bakhshi (2002) used a discriminate analysis to identify defaulters from non-defaulters of agricultural bank recipients in Iran. Results showed that use of machinery,

length of repayment period, bank supervision on the use of loan had significant and positive effect on the agricultural credit repayment performance. On the other hand, waiting time for loan reception had a significant effect on its repayment.

In a study by Paxton on determinants of successful loan repayment, in order to avoid delays in repayment, 100% rule was applied i.e. no new credit was granted until the former had been repaid in full. This rule was later relaxed and loans granted as long as the payment rate reached 90% of outstanding loan. Every borrower had to have savings amounting to 20% of the loan in order to access credit. Every member had to subscribe to a number of shares in order to access credit. Guarantorship was also required for credit beyond specified amounts (Paxton, 1996).

In a research carried out by Wakuloba in Uasin Gishu, Kenya on the causes of loan default in Uasin Gishu District Trade Development Joint Loan Board (UGTDJLB) scheme, it was noted that it had high and rising default rates over the period. The main causes of default were poor business performance, diversion of funds and domestic problems. The recommendations were that the board be strengthened through capacity building in computer applications to speed up loan processing and ensure timely disbursements.

A study by Pollio and Obuobie in 2008 in Ghana on Microfinance Default Rates concluded that the probability of default decreased with the frequency of monitoring, the availability of non-business income, years in business, the number of guarantors and whether the client was a first time borrower.

Yaron, Benjamin, and Piprek (1997) reported that one of the challenges SACCO's in India face is that during election years and even at other times, there is considerable propaganda from political platforms for the postponement of loan repayment or pressure on the credit institutions to grant extensions to avoid or delay loan repayment. A second challenge reported by Aryeetey (1997) is that there is a risk of a cooperative society turning into a pyramid scheme if the regulatory framework fails, giving rise to questionable management, which does not observe conventional financial management practices. This is a malpractice which has since occurred in the country, leaving many investors devastated by loss of their money.

In empirical studies it is reported that most of the defaults arose from poor management procedures. For this reason, lenders devise various institutional mechanisms aimed at reducing the risk of loan default. Although a vast body of literature supports the view that borrower characteristics are highly influential, institutional characteristics are equally important and both factors need to be taken into account if financial performance is to be improved.

2.5 Summary of Literature Review

From the literature review above, the loan policies employed are varied. Their effectiveness is based on the minimization or elimination of defaults on loan repayment.

Research has shown that Kenya has a well-developed cooperative movement compared to most of Africa and the rest of the world. However it still faces challenges of loan administration and from the review of literature and studies undertaken, there was no

research obtained on the relationship between loan policy and financial performance in SACCOs in Kenya. It was therefore important to establish the relationship between loan policy and financial performance in SACCOs in Kenya.

CHAPTER THREE

RESEARCH DESIGN AND METHODOLOGY

3.1 Introduction

This chapter discusses the research design, sample selection and research instruments used during the study.

3.2 Research Design

The researcher used Descriptive Research method. This method is used when the researcher wants to obtain large body of data or to perform statistical analysis in order to produce results that can be generalized to the target population. The researcher infers information about a population based on responses of a sample drawn from the population.

3.3 Target Population

The researcher focussed on SACCOs registered in Nairobi County because Nairobi County has the majority of the SACCOs in Kenya with 1247 SACCOs (Ministry of Cooperative Development and Marketing 2011/2012 Annual Report for Nairobi Province). In addition, there are a large number of financial institutions operating in Nairobi County that offer competition providing a more ideal environment of operation since the SACCOs have to offer competitive services to avoid losing members to the other institutions.

3.4 Sample

The researcher took a sample of 36 SACCOs out of the sample frame of 1247 SACCOs using stratified sampling. All the SACCOs were homogenous having registered in Nairobi County and offered credit facilities hence stood equal chance of being selected. However, Nairobi County was subdivided into 9 administrative Sub Counties hence 4 SACCOs were randomly selected from each of the 9 Sub Counties.

3.5 Data Collection

The research was carried out using secondary data extracted from the SACCOs inspection reports, by-laws, loan policies, audited annual accounts, annual general meeting minutes and annual reports from the Department of Co-operative Development and Marketing. The data collection source was justified by the fact that all the SACCOs filed the above stated documents with the Department of Co-operative Development and Marketing.

3.5.1 Data Validity and Reliability

The data used was from the reports and documents prepared and submitted in accordance with stipulated rules and regulations and hence valid and reliable source. Additionally, the sources were by persons who were in authority hence representing the official position of the various recorded aspects on the SACCOs.

3.6 Data Analysis and Reporting

The data collected was processed and analyzed to facilitate answering the research objective. Inferential statistics was used in making deductions and generalizations about the whole population using the sample data.

Regression analysis was used to test the relationship between Net Profit as proxy dependent variable for financial performance and Loan outstanding, Loan repayment and Savings as proxy independent variables for loan policy. The regression model was represented as follows.

$$NP = \beta_0 + \beta_1 LO + \beta_2 LR + \beta_3 S + \varepsilon$$

Where; NP – Net Profit

LO – Loan outstanding

LR – Loan repayment

S – Savings

ε – error term

β – slope coefficients of each of the independent variables

The Pearson Product Moment Correlation Coefficient was used to test the direction and magnitude of the relationship between the dependent and independent variables at 95% confidence level. It was represented as follows;

$$Y = \frac{n \sum xy - \sum x \sum y}{\{(n \sum x^2 - (\sum x)^2)(n \sum y^2 - (\sum y)^2)\}^{1/2}}$$

Where; Y – the product moment correlation coefficient

n – the number of scores

x and y – the variables being correlated

The scores obtained for Net Profit as proxy dependent variable for financial performance with the scores of Loan outstanding, Loan repayment and Savings as proxy independent variables for loan policy.

The interpretation was given in statistical figures between -1.00 and +1.00. A value of $Y=-1.00$ representing a perfect negative relationship while a value of $Y= +1.00$ representing a perfect positive relationship. The values in between were interpreted accordingly.

CHAPTER FOUR

DATA ANALYSIS AND INTERPRETATION

4.1 Introduction

This chapter covers data presentation and analysis. It presents the regression results for the relationship that exists between loan outstanding, loan repayment and savings as proxy variables for loan policy and net profit as proxy variable for financial performance.

4.2 Data Presentation

4.2.1 Profile of SACCOs

A representative sample of 36 SACCOs was considered and as shown in table 1 below, all the SACCOs offered development loan, school fees loan, emergency loan, advance loan and other types of loan. 11% of the SACCOs had been in existence for less than 5 years, 53% for over 5 years and 36% over 10 years. Regarding membership, 55% of the SACCOs had less than 100 members, 31% between 100 and 200 members and 14% more than 200 members. The study found it necessary to establish number of members in order to give the researcher an insight into the member base and intensity of operations therein which would be reflective of the financial performance among the SACCOs. This is graphically presented in figure 1 and 2 below.

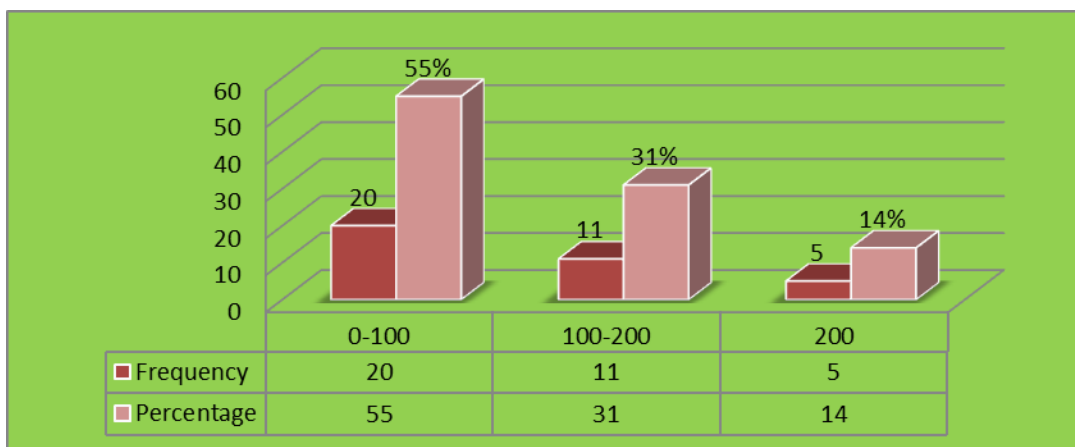
Table 1: Profile of the SACCOs

Profile		Number of SACCOs	Percentage
Years in existence	0-5	4	11%
	5-10	19	53%

	+10	13	36%
Membership	0-100	20	55%
	100-200	11	31%
	+200	5	14%
Loan Products	Development	36	100%
	School fees	36	100%
	Emergency	36	100%
	Advance/Quick	36	100%
	Others	36	100%

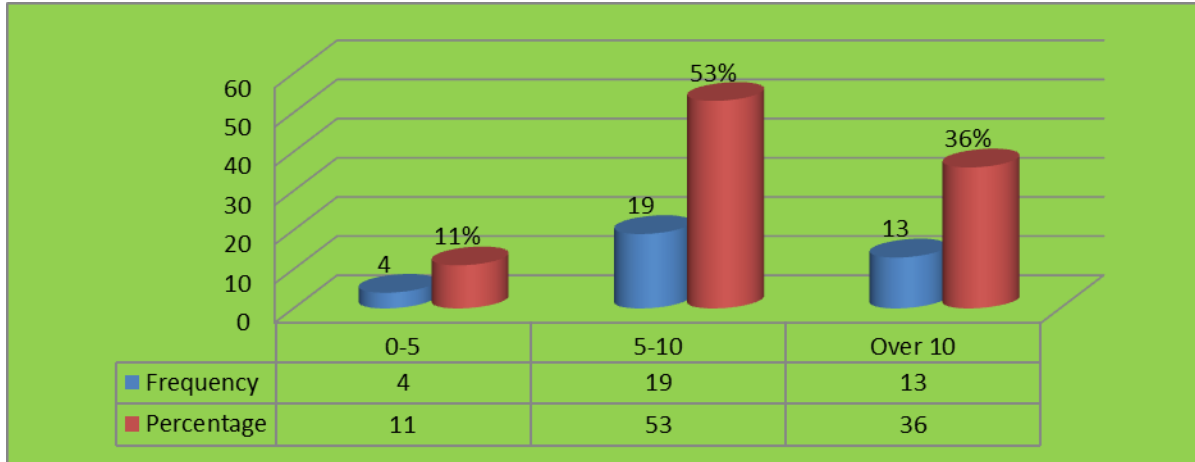
Source: Researcher, 2013

Figure 1: SACCOs Membership



Source: Researcher, 2013

Figure 2: Years in Existence

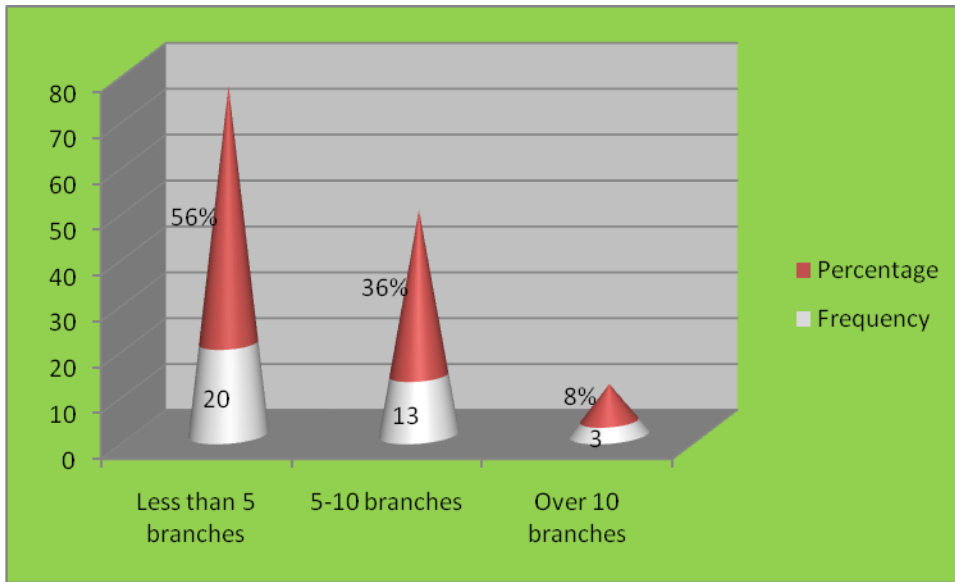


Source: Researcher, 2013

4.2.2 Number of Branches

The study sought to establish the number of branches respondent SACCOs had distributed within the country. This served to determine the level of establishment, which has a bearing on financial performance among the SACCOS. Results as indicated in figure 3 below shows that most SACCOs at 56% had less than 5 branches distributed around the country, 36% had between 5-10 branches followed by 8% of the SACCOs having over 10 branches.

Figure 3: SACCOs Number of Branches

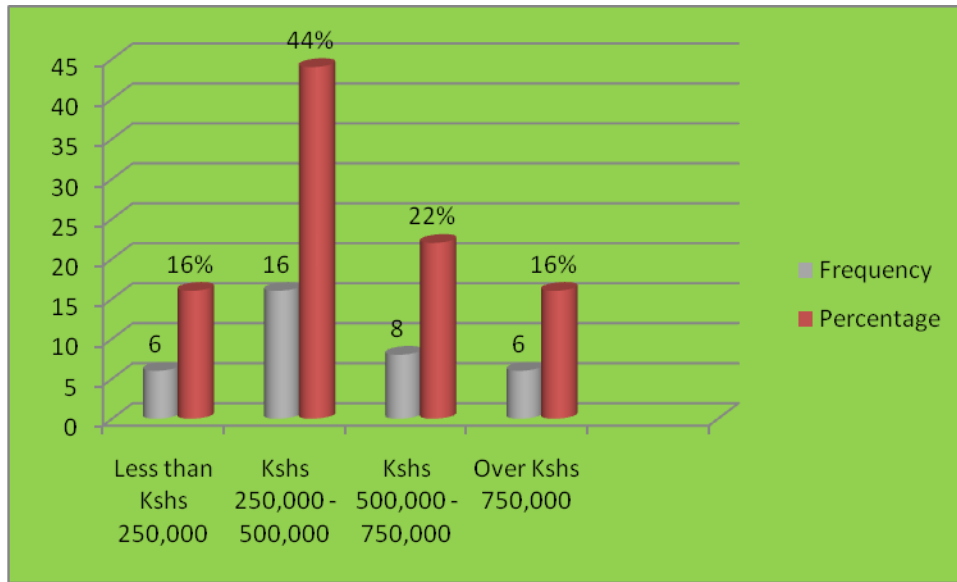


Source: Researcher, 2013

4.2.3 Approximate Savings per Month

Approximate savings per month would serve to show the financial standing of the SACCOS under study in order to get an insight into their possible financial performance as affected by various variables. Findings as presented in figure 2 below shows that a majority of the SACCOS at 44% saved between KShs 250, 000 – 500,000. This is followed by 16% that saved less than Kshs250, 000 and over KShs 750, 000. Only 22% of the SACCOS affirmed to the KShs 500,000 - 750,000 category.

Figure 4: SACCOs Savings



Source: Researcher, 2013

4.2.4 Loan Policy

To achieve its objective, the study sought to assess the SACCOs loan policies as regards access to the credit service, credit orientation, basis for granting loans, loan repayment, protecting the loan portfolio, loan competitiveness and timeliness as well as loan level based on the assets. A five-point likert scale was used to rate the levels of agreement with the statements posited by the researcher as factors loan policies seek to address. Results are as presented in table 2 below.

Table 2: Loan Policy Procedures

Statement	Mean	Standard Deviation
The SACCO offers its credit services to individuals or entities that meet the requirements for membership and comply with the Policy and requirements of creditworthiness	5.259	0.8317

The SACCO orients its loans primarily toward productive purposes, provided the membership demands this type of credit	3.430	0.6315
Granting of loans is based primarily on the member's ability or capacity to repay, and not only on the quality of the security offered by the borrower	4.918	1.0092
Every loan is amortized or paid off according to the original agreement and, for no reason or circumstance, will the due dates set forth in the initial contracts be restructured, extended or amended	4.142	1.3718
An adequate balance between safety in granting a loan and the competitiveness and quality of the service offered by the SACCO in terms of disbursement installments and record processing is maintained	5.285	0.6347
The SACCO periodically evaluates the quality of its portfolio and, at the same time, make adequate provisions for its protection	4.349	0.9130
The total amount of the SACCO's disbursed and outstanding loans must are not less than 70% nor exceed 80% of the SACCO's total assets	4.513	1.0431

Source: Researcher, 2013

The scale was: Applicable (3), Somehow applicable (2) and Not applicable (1). The scores of not applicable has been taken to present a variable which mattered to a Small Extent to the SACCO (equivalent to mean score of 0 to 2.5 on the continuous Likert scale: $0 \leq S.E < 2.4$). The score of 'somehow applicable' has been taken to represent a variable that mattered to a moderate extent (equivalent to a mean score of 2.5 to 3.4 on the continuous Likert scale: $2.5 \leq M.E. < 3.4$). The score of 'applicable' have been taken

to represent a variable that mattered to a Large Extent (equivalent to a mean score of 3.5 to 5.4 and on a continuous Likert scale: $3.5 \leq L.E. < 5.4$).

A standard deviation of >1.5 implies a significant difference on the impact of the variable among SACCOs. It can therefore be said that most SACCOs either apply or do not apply the various statements as regards the loan policy.. From the results, notable findings from the responses were agreements to statements such as: the SACCO offers its credit services to individuals or entities that meet the requirements for membership and comply with the Policy and requirements of creditworthiness ($X=5.259$, $S.D=0.8317$); Granting of loans is based primarily on the member's ability or capacity to repay, and not only on the quality of the security offered by the borrower($X = 4.918$, $S.D = 1.0092$); every loan is amortized or paid off according to the original agreement and, for no reason or circumstance, will the due dates set forth in the initial contracts be restructured, extended or amended ($X=4.142$, $S.D=1.3718$); an adequate balance between safety in granting a loan and the competitiveness and quality of the service offered by the SACCO in terms of disbursement installments and record processing is maintained ($X=5.285$, $S.D= 0.6347$); the SACCO periodically evaluates the quality of its portfolio and, at the same time, make adequate provisions for its protection ($X=4.349$, $S.D=0.9130$); the total amount of the SACCO's disbursed and outstanding loans must not exceed a set percentage of the SACCO's total assets ($X=4.513$, $S.D= 1.0431$). It can be deduced from this finding that most SACCOs cautiously invest in loan policies formulated to avoid defaulting and to boost productivity, competitiveness and subsequently performance.

4.3 Regression Analysis

The study sought to establish the relationship between loan policy and financial performance of SACCOs in Nairobi County in Kenya. To achieve this, a multiple linear regression was done on net profit proxy dependent variable for financial performance against Loan outstanding (LO), Loan repayment (LR) and Savings (S) as proxy independent variables of loan policy. The regression model was as follows:

$$NP = \beta_0 + \beta_1 LO + \beta_2 LR + \beta_3 S + \varepsilon$$

Whereby NP is Net Profit financial performance (Net Profit), β_0 is regression constant, $\beta_1 - \beta_3$ regression coefficients, LO is Loan outstanding, LR is Loan repayment, S is Savings, and ε model's error term.

Table 3: Model's Goodness of Fit Statistics

R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
.887 ^a	.787	.764	.757	2.104

a. Predictors: (Constant), Loan outstanding, Loan repayment and Savings

b. Dependent Variable: financial performance (Net Profit)

Table 4.5 above shows that there is a good linear association between the dependent and independent variables used in the study. This is shown by a correlation (R) coefficient of 0.887. The determination coefficient as measured by the adjusted R-square presents a moderately strong relationship between dependent and independent variables given by a value of 0.764. This depicts that the model accounts for 76.4% of the variations in financial performance (Net Profit), while 33.6% remains unexplained by the regression model.

Durbin Watson test was used as one of the preliminary test for regression which to test whether there is any autocorrelation within the model's residuals. Given that the Durbin Watson value was close to 2 (2.104), there was no autocorrelation in the model's residuals.

Table 4: Analysis of Variance (ANOVA)

	Sum of Squares	df	Mean Square	F	Sig.
Regression	120.450	5	20.075	35.037	.000 ^b
Residual	32.659	32	.573		
Total	153.109	37			

a. Predictors: (Constant), Loan outstanding, Loan repayment, and Savings

b. Dependent Variable: financial performance (Net Profit).

The ANOVA statistics presented in Table 4.6 was used to present the regression model significance. An F-significance value of $p < 0.001$ was established showing that there is a probability of less than 0.1% of the regression model presenting false information. Thus, the model is very significant.

Table 5: Regression Coefficients

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	2.653	.861		10.055	.983
Loan outstanding	-0.316	.097	.270	3.268	.002
Loan repayment	.003	.137	.002	.022	.023
Savings	1.403	.141	.998	9.925	.000

a. Dependent Variable: financial performance (Net Profit).

From the findings in Table 5, the multiple linear regression equation becomes:

$$Y = 2.653 + -0.316X_1 + 0.003X_2 + 1.403X_3 \quad p < .001$$

4.4 Correlation Analysis

The study sought to establish the relationship between loan policy and financial performance in Nairobi County in Kenya. Pearson Correlation analysis was used to achieve this end at 95% confidence level ($\alpha = 0.05$).

Table 4.4 shows that there were significant correlation coefficients established between loan policy and financial performance (Net profit). Very good and positive linear relationships were established between financial performance (net profit) and: Loan repayment ($R = 0.719$, $p = .005$); and Savings ($R = 0.691$, $p = .041$). The study further revealed there Loan outstanding correlated negatively with financial performance (Net profit) by (-0.686 , $p = .002$). Strong and positive relationship was established between financial performance (Net profit) and Loan repayment ($R = 0.719$, $p = .005$). This depicts that loan policies influences financial performance (Net profit) of SACCOs.

$$NP = \beta_0 + \beta_1 LO + \beta_2 LR + \beta_3 S + \varepsilon$$

Where; NP – Net Profit

LO – Loan outstanding

LR – Loan repayment

S – Savings

ε – error term

$\beta_1 - \beta_3$ slope coefficients of each of the independent variables

Table 6: Correlation Analysis

Loan policy variables	financial performance (net profit)	
Loan outstanding	Pearson Correlation	-0.686**
	Sig. (2-tailed)	.002
Loan repayment	Pearson Correlation	0.719**
	Sig. (2-tailed)	.005
Savings	Pearson Correlation	0.691*
	Sig. (2-tailed)	.041

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

Correlation is significant at the 0.01 level (2-tailed)**

Table 6 shows that Loan repayment and Savings had positive coefficients while non-Loan outstanding had a negative coefficient. This shows that Loan outstanding it is inversely proportional to financial performance (Net Profit). This shows that any increase in Loan repayment and Savings leads to increase in financial performance (Net Profit) of SACCOs'. A decrease in Loan outstanding leads to increase in financial performance (Net Profit) of SACCOs' because Loan outstanding do not generate returns but only decrease cash generating units.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter summarizes the study and makes conclusion based on the results of the analysis of data and findings under the literature review. Policy recommendations have been presented as well as limitations encountered in the study and areas for further research.

5.2 Summary

The main objective of this study was to establish the relationship between loan policy and financial performance of SACCOs in Nairobi County in Kenya. The SACCOs play a major role in granting credit to its members and they offer a variety of types of loans with the main ones being the traditional types. That is, development, school fees and emergency loans. Development loan is the major proportion of the loans offered followed by school fees and emergency loans. This is an indication of the role of SACCOs of providing Development Avenue for its members. The SACCOs most preferred customers are members within the common bond and hence the membership of less than 100 for most of the SACCOs. It was also noted that a majority of the SACCOs had less than 5 branches meaning that they lacked the capacity to expand. The SACCOs offered their credit services to individuals or entities that meet the requirements for membership and comply with the policy and requirements of creditworthiness. An adequate balance between safety in granting a loan, the competitiveness, quality of the service offered by the SACCO in terms of disbursement installments and record processing is maintained.

The regression results showed that there exists a strong relationship between loan outstanding, loan repayment and savings, the independent variables and net profit, the dependent variable given by a value of 0.764 implying that the model explains 76% of the variations in financial performance while 34% remains unexplained.

The study also further revealed that there was a significant correlation between loan policy and financial performance whereby we had very good and positive linear relationships established between financial performance (net profit) on Loan repayment ($R = 0.719$, $p = .005$); and Savings ($R = 0.691$, $p = .041$) while inverse relationship was established on loan outstanding by (-0.686 , $p = .002$). The results showed that Loan repayment and Savings had positive coefficients while Loan outstanding had a negative coefficient. This means that increase in loan repayment and savings leads to increase in net profit hence directly proportional to financial performance. Loan outstanding was inversely proportional to financial performance (Net Profit). A decrease in Loan outstanding leads to increase in financial performance (Net Profit) because Loan outstanding does not generate returns but only decreased cash generating units.

5.3 Conclusion

It can be deduced from the findings that there exists linear relationship between loan policy and financial performance. SACCOs cautiously invest in loan policies formulated to avoid defaulting and to boost productivity, competitiveness and subsequently performance. From the findings, the study concludes that there is a significant relationship between loan policy and financial performance. Loan outstanding, loan repayments and savings are statistically significant. The results posting that loan policy

variables are statistically significant, it implies that all the variables are important determinants of financial performance to SACCOs and therefore SACCOs should put a lot of emphasis on loan repayments and mobilization of savings.

5.4 Policy Recommendations

SACCO should continuously review their credit policies. This would enhance the evaluation of loan applications and ensure that loan applications are appraised and ranked according to merit. SACCOs should ensure timely loan disbursement to facilitate loan recovery and minimize administrative costs for sustainable growth of SACCOs.

SACCOs should establish irrecoverable loan provision policies, make adequate loan provisions to promote safety of funds. This will ensure that loan assets are not overstated. SACCOs should also adopt sound loan policies to ensure performance of loans as they increase disbursement of loans to increase the loan book from which the interest will be paid.

The Government should review legal framework for the SACCOs to ensure sound loan policies are put in place for improved financial performance.

5.5 Limitations of the Study

The study was limited by the inconsistency of financial information where all published sources seemed to have different figures from the other. Documents heavily relied on statistical reports and annual reports by the Ministry of Co-operative Development and

Marketing disregarding any other source that differed with the figures in these documents.

The re-organization of government structure leading to creation of Counties and merging of Ministries also limited the study as the area of study; Nairobi County assumed the previous jurisdiction of Nairobi Provincial Boundaries as availed in the information obtained.

The department of Co-operative Development and Marketing assumed the mandate of the former Ministry under the newly created Ministry of Industrialization and Enterprise Development hence the reliance on the department for information.

5.6 Suggestions for Further Research

The study suggest that further studies be done on other SACCOs in Kenya as each SACCO has their own loan policy and would influence financial performance differently. These studies can also widen their scope to include Rotating Savings and Credit Associations which are management slightly different from SACCOs. Factors affecting financial performance of the SACCOs could also be researched on to identify constraints in the realization of maximum returns.

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