

**EFFECT OF CREDIT INFORMATION SHARING ON LOAN PERFORMANCE
AMONG SAVINGS AND CREDIT COOPERATIVE SOCIETIES IN NAIROBI
COUNTY**

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DECLARATION

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

Signature

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D61/72832/2014

The Research project has been submitted with my approval as university supervisor.

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DEDICATION

This research document is a dedication to my family for their undying support and encouragement throughout my course.

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ABSTRACT

This study was set out to establish the effects of credit information sharing on the loan performance among SACCOs in Nairobi County. It sought to determine the effects credit information sharing have in relation to loan performance among SACCOs since the adoption of the concept in Kenya in the year 2013. Theoretical models predict that information sharing reduces moral hazard and adverse selection in financial institutions. The study adopted descriptive research design where data on loan performance was retrieved from the balance sheets and notes of 42 SACCOs during 2013-2015. Data on credit reports was obtained from CRB. Multiple regressions was applied to assess the effect of credit information sharing on loan performance among SACCOs in Nairobi County. The findings of the study show that there was negative relationship between number of credit reports accessed from CRB and default rate. There was a negative relationship between loan credit reports forwarded from CRBs and default. The findings shows Sacco were using the information provided by CRBs to analyze the borrowers past credit history. The study concluded that. Credit Information Sharing, increases transparency among SACCOs, helps them lend prudently, lowers the risk level to the SACCOs, acts as a borrowers discipline against defaulting and it also reduces the borrowing cost.

LIST OF ABBREVIATIONS

CBK	-	Central Bank of Kenya
CIS	-	Credit Information Sharing
CRB	-	Credit Reference Bureaus
GDP	-	Gross Domestic Product
NPA	-	Non-Performing Assets
NPL	-	Non-Performing Loans
SACCO	-	Savings and Credit Cooperative
SMEs	-	Small and Medium Enterprises

CHAPTER ONE

INTRODUCTION

1.1 Background of Study

Information sharing remains a crucial input in lending institutions. The institutions are faced with asymmetric information when assessing the character of the borrower due to borrowers' informational opacity. Recent development in technology and information sharing institutions provide possibilities for expanding exchange of information. When information is shared by an information exchange institution, such as credit bureaus and public credit registers, the higher competition drives down interest rates and reduces benefits derived from monopolistic information (Jappelli and Pagano, 1993). Theoretical models predicts that the size of the market, borrowers mobility and heterogeneity all increase the incentives for lenders to share information. Most importantly under severe adverse selection, information sharing systems facilitates lending. Moral hazard is mitigated too as information sharing serves as a disciplining device that increases borrower's effort to pay (Jappelli and Pagano, 1993).

SACCOs play an important role in intermediation process and due to the nature of their business they expose themselves to the credit risk. Poorly managed credit risk leads to Non-Performing Loans (NPLs) which pose a threat to the financial profitability of an institution and can lead to collapse of SACCOs. Lending is the principle activity of SACCOs and the loan portfolio is the largest asset and the predominant source of revenue for the lending institutions. SACCOs thus need to place measures against the effects of credit risk. The demand for information by financial institutions on one hand and the pressure from the regulator to improve risk management and the government objective of

financial deepening on the other has led to emergence of credit reference bureau to collate information from lenders (Gachora, 2014).

1.1.1 Credit Information Sharing

According to Pagano and Jappelli (2002) credit Information Sharing (CIS) is a process where credit providers such as banks and licensed Microfinance Banks submit information about their borrowers to licensed Credit Reference Bureaus (CRBs) so that it can be shared with other credit providers. The CRBs are licensed by the Central Bank of Kenya. CIS enables lenders to know how borrowers repay their loans. In other markets, CIS is also referred to as Credit Scoring, Credit Referencing or Credit Reporting, among other terms. In Kenya, as per the Credit Reference Bureau Regulations 2013, commercial and microfinance banks are mandated to share information on their full loan books, meaning both good and bad repayment details of a borrower are shared. This data is submitted electronically on a monthly basis to the CRBs (Gachora, 2014).

A credit report makes it easier for financial institutions to distinguish good customers' persistent defaulters, hence making good financing decisions. Additionally, it consolidates a customer's positive credit information from various lenders in an official, credible database accessible by both the customer and the credit provider. This makes it easier for customers to negotiate credit terms on the strength of their good repayment history (Brown, Jappelli & Pagano, 2008). CRBs make credit reports available as evidence of good performance which could translate to a lower cost of credit, flexible repayment periods, and lower reliance on tangible collateral such as land and buildings amongst other preferential terms. Credit providers have online access to credit reports generated by the CRBs resulting in reduced paper work for the customer and faster

processing of loans. The need to use 3rd party investigators to confirm details of the loan applicant is eliminated. The costs associated with this (called search costs) will no longer be passed to the borrower. By making credit histories more portable, customers are able to easily change credit providers and thereby take advantage of competition to secure better credit terms (Nelson, Waweru & Victor, 2009).

CIS strengthens the risk management processes used by lenders. The character of a customer is important in assisting a credit provider to determine whether the loan will be repaid. To arrive at this, various elements come into play, and these are often summarized into the 5 Cs of credit, namely: Character, Capacity; Capital; Collateral and Conditions (Peterson & Rajan, 2012). Assessment of character can be a nightmare where there is no formal, independent source of information on a customer's management of past loans. This arises because of information asymmetry. Information asymmetry means that customers have more information than the credit providers and may take advantage of the situation. However, CRBs offer a better solution. CRBs however offer a better solution. A customer's information on previous loan repayments with credit providers is made available on one document called a credit report. The credit report makes it easier for credit providers to review a customer's credit or loan application faster and more efficiently (Kioko, 2014).

The linkage between access to credit and economic development of a country is clear. CIS creates an opportunity for a wider cross section of the population to access credit, particularly those with no access to tangible collateral (Babihuga, 2014). A functioning credit reference system is known to reduce transactions costs in lending to small and

medium enterprise (SME) which will have the effect of making credit more available while helping to reduce price not only through reduced costs but also enhanced competition. The ratio of Private Sector Credit to GDP will rise, hence improving efficiency in financial intermediation that comes with reduced cost of operations. This would in turn enhance stability of the financial system hence faster economic growth (Bazibu, 2013).

1.1.2 Loan Performance

Loan performance refers to financial soundness of a Sacco that depends on the performance of their disbursed loans to the members. It is one the most important factor to consider when analyzing Sacco performance. There are lots of factors responsible for this ratio. Some of them belong to firm level issues and some are from macroeconomic measures (Boot & Thanker, 1994). Stiglitz & Weis (1981) outlines the main factors that determine loan repayment performance as loan size, enterprise size, income, age, number of years of business experience, distance between home and source of loan, education, household size, adoption of innovations, and credit needs.) . Akerlof (1970) identified two problems as major causes of poor loan recovery performance: credit project design problems and credit project implementation problems.

Survival of most financial institutions depends entirely on any successful lending program that revolves on funds and loan repayments made to them by the clients (Berger & Udell, 1990). This therefore requires a proper credit control system to be put in place so as to avoid unnecessary lending thus, improving on profitability of the Sacco institutions. It is the executive responsibility to ensure a proper credit management by determining customer's credit ratings as part of the credit control function. The Sacco

subsector remains a significant player in the provision of financial services to the Kenyan households and small businesses segments (SASRA, 2013).

Without information sharing between lenders, borrowers perceive a lower cost of default when competition increases as defaulting borrowers can now more easily get a loan from another lender. Impatient borrowers have an incentive to take multiple smaller loans from different lenders instead of applying for one larger (more expensive) loan from one lender. If they can hide their outstanding debt, these loans will be considered less risky and cheaper. This will increase average debt levels, eventually leading to worse repayment rates and higher interest rates (Pagano and Jappelli, 2002).

1.1.3 Credit Information Sharing and Loan Performance

In lending the problem of asymmetric information occurs from the fact that lender's knowledge of borrower's likelihood to repay is imprecise and must be inferred based upon available information. Theoretical work by Jappelli and Pagano (1993) highlight that when lenders share information about outstanding loans, the incentive of borrowers to over-borrow from multiple lenders is significantly reduced, and as a result, the repayment probability may increase. The theory predicts that information sharing among lenders reduces adverse selection and moral hazard, and can therefore increase lending and reduce default rates.

Padilla and Pagano (1997) show that information exchange can lead to lower interest rates and increased loan supply. They further note that exchange of past default information of the lender increases loan repayment probability as default becomes a bad signal of bad credit quality for outsider hence the borrower exerts more efforts to avoid

high prices rates and penalties in future. However in contrast to negative information, the exchange of positive information such as borrower quality and characteristics may not produce a disciplinary effect since a high quality borrower is less concerned about the consequences of default as long as they can remain high quality borrowers.

A study in the United States simulated individual credit scores using only negative information and then using both negative and positive information. The negative-only model produced a 3.35% default rate among approved applicants while the use of both positive and negative information led to a 1.9% default rate. A study of Latin American economies suggests that where private credit bureaus distribute both positive and negative information and have 100% participation from banks, lending to the private sector is greater-at least 47.5% greater (Peterson & Rajan, 2012).

1.1.4 Savings and Credit Cooperative Societies in Kenya

The SACCOs in Kenya sub-sector is considered the fastest growing in the cooperative movement. SACCOs in Kenya have rapidly grown to be the largest in Africa, accounting for 60, 64, and 63 per cent of the continent's savings, loan and assets, respectively. Six percent offering deposit taking services commonly referred as Front Office Services Activity(Fosa),(Kioko, 2014).Membership has for long been based on common bonds and knowledge about the borrower. This mechanism, SACCOs argue, has enabled them to manage risk, enforce lending contracts and reduce the transaction costs of delivering credit (SASRA, 2013).

With changes that at some stage saw use of SACCOs drop from 13.1 per cent in 2006 to 9.0 per cent in 2009 because of stiff competition from banks and other financial institutions, and other factors such as declining membership because of retrenchment and deaths, SACCOs were forced to come up with strategies and products to assist them cope with these challenges (KUSCCO, 2009). Some of these strategies included changing rules of membership and coming up with a new range of products. Sacco loan defaulters have been put on notice after the sub-sector's regulator, Sacco Societies Regulatory Authority (SASRA) said it has now given SACCOs the green light to start blacklisting offenders and file their names with Credit Reference Bureaus (CRBs). The defaulters will not only be banned from SACCOs, but it will also make it difficult for them to access loans from other financial institutions including commercial banks, micro-finance institutions and Higher Education Loans Board. The regulator has also cautioned SACCOs to be wary of members who are out to take loans with the intention of not repaying them, even when they are in a position to pay off their debt obligations (Kioko, 2014)

According to SASRA, the personality of an individual should also be given priority when evaluating the potential borrowers. The character of an individual is more important than just the ability to repay the loan. The latest move is part of efforts by the Sacco movement to weed out serial loan defaulters from the sub-sector and to ensure SACCOs have enough funds for on-lending. The biggest challenge the regulator deal with is the loan portfolio that is not performing. About 80 per cent of the assets of the Sacco comprise of loans to members.

1.2 Research Problem

Many borrowers that are potentially good credit risk fail to get funding because the lenders cannot objectively establish their credit history due to the underlying challenge of information asymmetry. Also, some bad loan borrowers, who know that SACCOs operate in isolation, have exploited the information asymmetry to create multiple bad debts in the industry in Kenya (KCSI, 2013).

The SACCOs report that the bureau data is of significant benefit, both in avoiding risky clients and in causing clients to pay up on arrears. The latest move is part of efforts by the Sacco movement to weed out serial loan defaulters from the sub-sector and to ensure SACCOs have enough funds for on-lending (Mullei, 2013). SACCOs in Kenya have been slow to embrace credit information sharing which has led to high default rate on loans. Upsurge of nonperforming loans has caused a spiral effect on the interest charged to all borrowers across the market.

A number of scholars have dealt on information sharing e.g. Pagano and Japelli (1993) focused on Information sharing in credit markets, role and effects of credit information sharing; Kioko (2014) specialized on Effect of credit information sharing on performance of SACCOs in Kenya; Gachora (2014) studied the effect of credit information sharing on loan performance of commercial banks in Nairobi County; Kipyegon studied the effect of credit information sharing on loan performance in Kenyan commercial banks. Most of these studies focused on commercial banks leaving behind SACCOs which play an important role in extending financial services while those that touched Sacco used a different approach i.e. Kioko analyzed the CAMEL rating model guideline that looks at

capital adequacy, Asset quality, management, earnings and liquidity he found that credit information sharing greatly affects the performance of a Sacco.

No known study have been conducted to establish the effect of credit information sharing on loan performance among SACCOs in Nairobi County. There the researcher saw the need to carry out the study to answer the question. What is the effect of credit information sharing on loan performance among SACCOs in Nairobi County?

1.3 Objective of the Study

1.3.1 General objective

The objective of the study was to establish the effect of credit information sharing on loan performance among SACCOs in Nairobi County.

1.3.2 Specific Objectives

- i.** To determine the effect of credit information sharing on loan performance among SACCOs in Nairobi County?
- ii.** To assess the extent to which SACCOs have embraced CRB.

1.4 Value of the Study

The findings of this study will be used in the Sacco sector to improve their operations this is because sharing of information about borrowers' characteristics and their indebtedness will; improve the Sacco's knowledge of applicants' characteristics and permits a more accurate prediction of their repayment probabilities.

This area of study will add to the pool of knowledge on the under researched area of the credit information sharing in the Sacco sector. Future researchers will have a reference point from the information gathered that will contribute to understanding the factors as well as contributing to subsequent studies. It forms a basis for and stimulates research in order to develop a better understanding of the effect of credit information sharing on loan performance among SACCOs in Nairobi County.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

The literature review provides the reader with an explanation of the theoretical rationale of the problem being studied as well as what research has already been done and how the findings relate to the problem at hand. The main purpose of the literature review is to avoid unnecessary or intentional duplication of materials already covered.

2.2 Theoretical Review

The study sought to determine the effect of credit information sharing on loan performance among SACCOs in Nairobi County. The study was guided by asymmetric information theory, adverse selection theory and moral hazard theory.

2.2.1 Asymmetric Theory of Information

The theory of asymmetric information as explained in Arkelof (1970) deals with study of decisions in transactions where one party has more or better information than the other. The theory indicates that it may be complex to distinguish between good and bad borrowers (Auronen, 2013). It expounds that in the market, the person that possesses more information on a particular item to be transacted (in this case the borrower) is in a position to negotiate optimal terms for the transaction than the other party (in this case, the lender) (Auronen, 2013). The party that knows less about the same specific item to be transacted is therefore in a position of making either right or wrong decision concerning the transaction. Adverse selection and moral hazards have led to significant accumulation of nonperforming loans in lending institutions. Very existence of SACCOs is often

interpreted in terms of its superior ability to overcome three basic problems of information asymmetry, namely ex ante, interim and ex post (Nkusu, 2011).

2.2.2 Adverse Selection Theory

Pagano and Jappelli (2002) show that information sharing reduces adverse selection by improving Sacco information on credit applicants. In their mode of doing business, each bank has private information about local credit applicants, but has no information about foreign applicants. If banks exchange information about their clients' credit worth, they can assess also the quality of foreign credit applicants and lend to them as carefully as they lend to local customers. By reducing information asymmetry between lenders and borrowers, credit registries allow loans to be extended to safe borrowers who had previously been priced out of the market, resulting in higher aggregate lending. When SACCOs exchange credit information about borrowers' kinds, the increase in lending to good credit borrowers may fail to compensate for an eventual reduction in lending to risky types.

The adverse selection problem signals that when lenders cannot distinguish well from wicked borrowers, all borrowers are charged a normal interest rate that reflects their pooled experience. If this rate is higher than worthy borrowers deserve, it will push some good borrowers out of the borrowing market, forcing in turn to banks charging even higher rates to the remaining borrowers (Pagano and Jappelli, 1993). Through sharing of the credit information, the lender is able to distinguish bad borrowers from good borrowers in the market. Better access to information helps lenders measure borrower risk more accurately and to set loan terms and conditions accordingly.

Good borrowers with low risk would be given more attractive prices, stimulating credit demand, and fewer higher-risk borrowers would be rationed out of the market because of lenders inability to offer these borrowers accommodating rates (Peterson & Rajan, 2012). Padilla and Pagano (2002) show that if banks exchange credit information on defaults, borrowers are encouraged to apply more energy in their projects. In both models non-payment is a sign of bad quality for outside banks and carries the penalty of higher interest rates, or no future access to credit facility.

2.2.3 Moral Hazard Theory

Moral hazard refers to the risk that one party to a transaction fail to enter into a contract in good faith therefore, problem implies that a borrower has the incentive to default unless there are consequences for his future applications for credit. This theory apply to lending scenario in that bad borrowers knowing well there are no consequences will not make any effort to service their loans leaving the lender disadvantaged. If lenders cannot assess the borrower's wealth, the latter will be tempted to default on the borrowing. Forestalling this, lenders will increase rates, leading eventually to the breakdown of the market (Ahmed, 2010).

2.3 Determinants for Loan Performance

The various determinants of loan performance of SACCOs are; information asymmetry, interest rates, management of loans and legal framework and credit criteria.

2.3.1 Information Asymmetry

Information asymmetry refers to a situation where business owners or managers know more about the scenario, for and risk facing, their business than do lenders. Information asymmetry describes the condition in which relevant information is not known to all parties involved in an undertaking. It has been used extensively to explain a diversity of concept, including those in different market condition (Ahmed, 2010).

Auronen (2013) noted that the realization of credit information sharing in the financial institution sector not only bring good news to the banks and the banking sector but also to the borrowers and the economy as a whole. This national success stands to significantly benefit the economy and is bound to stir changes in the way credit is managed in the industry in the sense that lenders will be in a position to access comprehensive credit data and will be able to price risk accordingly for both good and bad borrowers hence reducing their bad debt portfolios.

2.3.2 Interest Rates

Interest rate is the price a borrower pays for the use of money they borrow from a lender or financial institutions or fee paid on borrowed assets. According to Crowley (2007), Interest can be thought of as "rent of money". Interest rates are fundamental to a 'capitalist society' and are normally expressed as a percentage rate over one year. Interest rate as a price of money indicates market information concerning probable change in the purchasing power of money or future inflation. Financial institutions facilitate mobilization of savings, diversification and pooling of risks and allocation of resources (Bloem and Gorter, 2012). However, since the receipts for deposits and loans are not harmonized, intermediaries like SACCOs incur certain costs. They charge a price for the

intermediation services offered under uncertainty and set the interest rate levels for deposits and loans. The disparity between the gross costs of borrowing and the net return on lending defines the intermediary costs which include information costs, transaction costs, administration, default costs and operational costs.

2.3.3 Management of Loans and Legal framework

An important element of sound credit risk management is analyzing what could potentially go wrong with individual credits and the overall credit portfolio if environment in which borrowers operate change radically. The result of this analysis should then be factored into the assessment of the adequacy of provisioning and capital of the organization. Such stress analysis can disclose earlier undetected areas of potential credit risk exposure that could arise in times of crisis. Possible scenarios that banking institutions should consider in carrying out stress testing include: significant economic or industry sector downturns; adverse market-risk events; and unfavorable liquidity conditions (Crowley, 2007).

Babihuga (2014) opined that horizon of development of credit, better credit culture, positive macroeconomic and business conditions lead to lowering of NPAs. In its annual report (2013) SASRA noted that management of NPA by SACCOs remains an area of concern, particularly, due to the likelihood of worsening of the quality of restructured loans. The loan performance of SACCOs is an important criterion to assess the financial health of Sacco's sector. It reflects the asset worth, credit risk and competence in the allocation of resources to the productive sectors. SACCOs have envisaged the greatest renovation in their operation with the introduction of new concepts like prudential accounting norms, income recognition and capital adequacy ratio which have placed

them in new platform. The growing competition from internal and external constituents and sluggish growth in economy coupled with poor credit-deposit ratio, the large volume of NPAs in the balance sheet and lack of automation and professionalization in the operation have been affecting the SACCOs situation in the country.

2.3.4 Credit Criteria

Credit criteria are factors used to determine a credit seeker's creditworthiness or ability to repay debt. The factors include income, amount of existing personal debt, number of accounts from other credit sources and credit history. Collins and Wanjau (2011) suggested that the most pervasive area of risk is an overly aggressive lending exercise. It is a hazardous practice to extend lending term beyond the useful life of the corresponding collateral. Besides that, giving out loans to borrowers who are already overloaded with debt or possess unfavorable credit history can expose SACCOs to unnecessary default and credit risk. In order to decrease these risks, lending institution need to take into consideration several common applicants' particulars such as debt to income ratio, business and credit history and performance record and for individual loan applicants their time on the job or length of time (Mullei, 2013).

2.4 Empirical Evidence

Ahmed (2010) did a study to investigate corruption and CIS as determinants for loan performance in Pakistan banks. The study investigated the impact of corruption at economy level and institution level on the non-performing loans. The study also examined the association of information sharing between depositors, lenders and financial institutions. The study used time series data over the period of 2001 to 2010 and employed OLS (ordinary least square) method. The results provide no significant

association of corruption and information sharing with loan performance. In summary the nature of the data used may have guided the results, but literature provides significant impact of credit information sharing on non-performing loans, therefore Pakistan lending institutions can reduce the level of loan performance by reducing the chance of corrupt practices by following the rules and regulation of credit allocation, supervision and loan monitoring.

Experimental evidence by Peterson & Rajan (2012) shows that a public credit reference bureaus can motivate borrowers to repay loans, when they would otherwise default. The impact of information sharing on the level of non-performing loans has been tested by two cross-country studies. Based on their own survey of credit reporting in 43 countries. Brown, Japelli and Pagano (2008), show that SACCOs lending to the private sector are larger and default rates are lower in countries where positive and negative information sharing is more solidly established and extensive. These cross-sectional relations persist also controlling for other economic and institutional determinants of Sacco lending, such as country size, GDP, growth rate, and variables capturing respect for the law and protection of creditor rights.

Peterson & Rajan (2012) confirm that private sector credit relative to GDP is positively correlated with information sharing in their study of credit market performance and institutional arrangements in 129 countries for the period 2005–2010. Firm-level data suggest that information sharing may indeed have a differential impact on credit availability for different firm types. Brown, Jappelli and Pagano (2008) also find that in Chile positive and negative information in credit reports contributes to predict defaults.

Bazibu (2013) did a research on information asymmetry and borrower's performance on loan performance in commercial banks in Uganda, the study suggests a threefold effect of lenders' exchanging information on the credit history of borrowers. First, credit bureaus improve financial institutions knowledge about applicants' characteristics and permit more accurate prediction of repayment probability. This allows lenders to target and price their loans better based on the information, easing adverse selection and moral hazard problems. In this respect the benefit of establishing a credit bureau is greatest where each bank is confronted by a large number of customers on which it has no previous information that is where borrowers are very mobile.

Secondly, credit bureaus reduce the informational rents that institutions could otherwise extract from their customers. They tend to level the informational playing field within the credit market and force lenders to price loans more competitively. Lower interest rates increase borrowers' net return and augment their incentive to perform. Third, credit bureaus work as a borrower discipline device: every borrower knows that if he defaults his reputation with all other potential lenders is ruined, cutting him off from credit or making it much more expensive. This mechanism also heightens borrowers' incentive to repay, reducing moral hazard.

Kipyegon (2011) studied credit information sharing and bank performance in Kenya. A case study of Kenya Commercial Bank was done whereby a sample population of 50 branches was used. A sample was of 69 employees in all the branches was randomly selected. The study established that complete information about the borrowers' payment characteristic helps the banks to estimate their chance of recovering the loans is 50% , those who strongly agreed is 36.4%, those who were uncertain are 13.6%. This was

therefore interpreted to mean that when bank have information concerning the payment of a borrower, then they can use such past information to calculate on their chances of recovering such loans from them. The study also established that showed that when the banks get quality information about the borrowers' credit history it helps the bank assess its risk princely and reduce the search costs.

Gachora (2011) studied the effect of credit information sharing on loan performance in commercial banks in Nairobi county .The research was exploratory and used descriptive design .The study demonstrated that, after establishing Credit Reference Bureaus, banks are able to issue smaller and shorter-term loans and to acquire more guarantees. This showed that sharing information allowed lenders to see the entire indebtedness of their borrowers. The study also found that credit sharing between lenders is associated with increased and cheaper credit for the borrowers. It was also established that introduction of CIS improves the quantity of small business loans and helped to expand credit to riskier borrowers.

Kioko (2014) assessed the impact of credit information sharing influence on financial performance of licensed deposit taking Sacco. The study used explanatory design to explain the relationship between the two variables. The study targeted 60 deposit taking SACCOs and data was collected using questionnaires. Regression analysis was also used to find out if an independent variable predicts a given dependent variable. Based on the findings, the study concluded that credit information sharing significantly affects performance Sacco.

2.5 Summary of Literature Review

This chapter discusses the literature review of the study, a number of studies have been carried out about aspects of credit information sharing. Theory and empirical analysis so far, all predict that in one form or another, CIS tend to reduce defaults and therefore equilibrium interest rates at economy level. Empirical analysis of CRB data also confirm that credit reporting reduces the selection costs of lenders by allowing them to more accurately predict individual loan defaults.

From review of literature most of studies focused on the effect of CIS on financial performance of banks as the major lending institution but none has focused on effect of CIS on loan performance of SACCO's in Nairobi County and comprehensively. This study seeks to establish the effect of credit information sharing on loan performance among SACCO's in Nairobi County to fill the gap left as the sector plays an important role of financial intermediation and greatly contributes to the growth of Kenyan economy

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter highlights the methodology which was used in data collection, analysis and presentation. It also highly depicts the research design, target population, data collection and data analysis techniques.

3.2 Research Design

This study employed a descriptive research design. A descriptive study is concerned with determining the frequency with which something occurs or the relationship between variables. According to Cooper (2003), a descriptive study finds out who, what, where, and how of a phenomenon which is the aim of this study. The method was appropriate because the study sought to establish a relationship between two variables.

3.3 Population and Sampling Design

The population of study consisted of all SACCOs Licensed by SASRA in Nairobi County. According to SASRA (2015) there are 42 licensed SACCOs in Nairobi County (Appendix 2). Census survey methodology of all the licensed were used in order to increase accuracy and reliability of data collected in this research.

3.4 Data Collection

For the purpose of this study the researcher used secondary data. The data on loan performance was obtained from documents that included financial reports of SACCOs and while credit information sharing was obtained from CRBs.

3.5 Data Analysis

Regression analysis was used to link between the loan performance and credit information sharing. Data was analyzed using Statistical Package for Social Sciences (SPSS) .This was done by tallying, computing percentages as well as explaining and interpreting the data in line with the study objectives and assumptions. Tables and other graphical presentations as appropriate were used to present the data collected for ease of understanding and analysis.

3.6 Data Presentation

Data was presented using chart and tables in order to elaborate and establish the effect of credit information sharing on loan performance among SACCOs in Nairobi County from the year 2012 to the year 2015.

3.7 Analytical Model

Credit information sharing was used as the independent variable while loan performance was the dependent variable. The study used analytical model to test the effect of credit information sharing on loan performance among SACCOs in Nairobi County. Credit information sharing was measured by the volume credit records accessed and forwarded to CRB. Adoption of CIS mechanism among SACCOs was measured by the number of years a SACCO has been registered with CRB. Loan performance was measured by loan default rate which was computed as:

$$\text{Loan default} = \frac{\text{Total non-performing Loan}}{\text{Total Loans and Advances}}$$

The relationship equation is as shown below-

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \varepsilon$$

Where Y is the Loan performance

$\beta_0, \beta_1, \beta_2$ and β_3 represent the beta co-efficient

X_1 is the number of credit reports accessed to CRB

X_2 is the number of credit reports forwarded from CRB

X_3 is number of years that a given Sacco has been registered with CRB

ε = Error term

3.8 Test of Significance

The significance of each variable was tested with t- test at a confidence level of 95%. If p-values were small (less than 0.05) there is a significant relationship whereas if the p-values were large (greater than 0.05) there is no significant relationship.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This chapter presents the results and findings of the study based on the research objectives. The results are presented in the form of summary tables. Regression and Correlation analysis were used to analyze the data to answer the research objective.

4.2 Descriptive Statistics

Table 4.1: Number of Years of Using Credit Reference Reports

Category	Response	Percentage
Below 1 year	2	5
1-2 years	18	43
Over 3 years	22	52
Not Using	0	0
Total	42	100

Figure 4.1: Number of Years of Using Credit Reference Reports

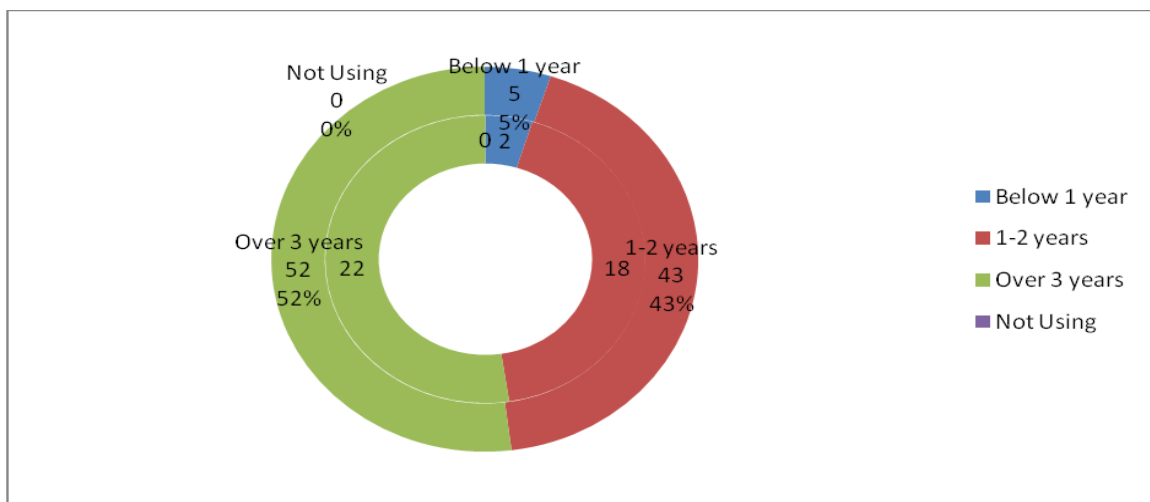


Table and Figure 4.1 above shows the number of years SACCOs have been using credit reference reports. Majority of SACCOs who were 52% have been using CRB for over 3 years, 43% (1-2) years and 5% below 1 year.

4.2 Descriptive Statistics

Table 4.2 below summarizes the descriptive statistics of the variables included in the regression models as presented. It represents the variables of the 42 SACCOs in Nairobi County who were using credit information sharing between the years 2013 to the year 2015.

Table 4.2: Descriptive Statistics

Descriptive Statistics

	Mean	Std. Deviation	N
Loan Default	1.4957	3.05580	42
Credit Report Accessed	1.1066	3.34560	42
Credit Report Forwarded to CRBs	375073.8333	8.60583	42
No. of Years	2.4524	.63255	42

Source: Research Findings

The mean value of default rate was low with the mean of (M=1.4957) and a standard deviation of 3.05580 which shows that SACCOs had low cases of loan default since the introduction of credit information sharing. The mean value of the credit report accessed was (M=1.1066) which shows that SACCOs did not enquire much from CRB when advancing loans to the members. High number of credit reports were forwarded to CRB

which is evidenced by (M=375073.8333) and standard deviation of (8.60583) which shows Sacco had members who were defaulting in loan repayment and hence their reports forwarded to CRB. Most SACCOs have been using credit information sharing for a significance period of time as evidenced by mean (M=2.4524) and a standard deviation of 0.63255 which shows that most SACCOs have embraced CRB.

4.3 Inferential Statistics

For quantitative analysis the study used regressions model. These models were used to identify various credit information sharing variables influencing the dependent variable. The regression analysis is used to investigate the effect of credit information sharing on loan performance among SACCOs in Nairobi County. When using multiple regression analysis, there is a possibility of endogeneity occurring whereby when certain variables are omitted, it leads to measurement errors (Gill and Beger 2012). Therefore to minimize endogeneity issues, the most important variables on effect of credit information sharing on loan performance are default rate, Credit Report accessed, Credit Report Forwarded to CRBs and No. of Years SACCOs have been using CRB.

4.3.1 Correlation Coefficient

Table 4.3 below shows the Pearson correlation coefficient generated from the data. If credit information sharing contributed to loan performance, one should expect a negative relationship between the measures of credit information sharing and loan default variable. The correlation matrix (as shown in Table 4.3) depicts that there was a negative relationship between loan default, Credit Report accessed from CRBs and Credit Report Forwarded to CRBs.

Table 4.3: Correlation Coefficient

Correlations

		Loan Default	Credit Report accessed	Credit Report Forwarded to CRBs	No. of Years
Loan Default	Pearson	1	-.008	-.116	-.230
	Correlation				
	Sig. (2-tailed)		.962	.466	.142
	N	42	42	42	42
Credit Report accessed	Pearson	-.008	1	.038	-.375*
	Correlation				
	Sig. (2-tailed)	.962		.812	.014
	N	42	42	42	42
Credit Report Forwarded to CRBs	Pearson	-.116	.038	1	-.334*
	Correlation				
	Sig. (2-tailed)	.466	.812		.030
	N	42	42	42	42
No. of Years	Pearson	-.230	-.375*	-.334*	1
	Correlation				
	Sig. (2-tailed)	.142	.014	.030	
	N	42	42	42	42

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

Table 4.3 shows that there was a negative relationship between credit reports accessed and default rate. The relationship is significant at ($r = -0.008$, $P < 0.05$), thus shows credit reports significantly influenced the level of loan default. Firm-level data suggest that information sharing may indeed have a differential impact on credit availability for different firm types. Brown, Jappelli and Pagano (2008) also find that in Chile positive and negative information in credit reports contributes to predict defaults.

There was a negative relationship between credit report forwarded to CRB and loan default, this agrees with Kioko (2014) who argued that credit information sharing influenced financial performance of licensed deposit taking SACCOs. The findings depicts that credit information sharing significantly improves financial performance by enhancing capital adequacy. The relationship is significant at ($r = -0.116$, $P < 0.05$), thus the introduction of CRB among SACCOs has significantly contributed to reduced cases of loan default. There was a negative relationship between loan default and the number of years SACCOs have used CRBs since most SACCOs had embraced CRB. The relationship is significant at ($r = -0.230$, $P < 0.05$), thus the number of years the SACCOs have used CRB did determine default rate.

4.3.2 Multiple Regressions Analysis

Table 4.4 shows the results of multiple regressions. The value of R^2 is 0.110, revealing 11% variability in loan performance accounted for by the credit information sharing variables in the model developed. This means that 89% in variance in the level of loan default among SACCOs in Nairobi County was influenced by other factors other than credit information sharing.

Table 4.4: Multiple Regressions Analysis

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.331 ^a	.110	.039	2.99497E8

Predictors: (Constant), No. of Years, Credit Report Forwarded to CRBs, Credit Report access

4.3.3 Multiple Regression Model

The estimates of the regression coefficients, t-statistics, standard errors of the estimates and p values are as shown below.

Table 4.5: Multiple Regression Model

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	6.1638	2.2858		2.697	.010
	Credit Report Accessed	-.121	.152	-.133	-.799	.429
	Credit Report Forwarded to CRBs	-81.597	57.962	-.230	-1.408	.167
	No. of Years	-1.7248	8.5007	-.357	-2.028	.050

a. Dependent Variable: Loan Default

4.4 Interpretation of Findings

There was negative relationship between loan default and credit reports accessed from CRB. There was a negative relationship between loan default and credit reports forwarded from CRBs. There was a negative relationship between loan default and the number of years SACCOs have used CRBs.

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \varepsilon$$

Where;

Y= is the dependent Variable (Loan performance), **X₁** is number of credit reports accessed from CRB, **X₂** is number of credit reports forwarded from CRB, **X₃** is number of years that a given Sacco has been registered with CRB. **B₀** is the regression constant; **B₁**, **B₂**, and **B₃** are the coefficients variables. Using the results, we have the regression equation as; **Y = 6.1638 - 0.121X₁ - 81.597X₂ - 1.7248X₃**

The regression equation above has established that taking all factors into account (number of credit reports accessed from CRB, number of credit reports forwarded to CRB and number of years that a given Sacco has been registered with CRB) constant at 6.1638. The findings presented show that taking all other independent variables at 6.1638, a unit increase in credit accessed from CRB would lead to a -0.121 decrease in default rate, a unit increase in credit reports forwarded to CRB would lead to a -81.597 to decrease in default rate. A unit increase in number of years SACCOs have accessed CRB would lead to a -1.7248 decrease in default rate.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents a summary of the key findings of the study as well as the conclusions, limitations of the study, and recommendations for further research

5.2 Summary

The secondary data in this analysis covered a period of 3 years from the year 2013 to the year 2015. The population of study was SACCOs using CRB in Nairobi County which were found to be 42. In the table 4.2, there was negative relationship between number of credit reports accessed from CRBs and default rate since SACCOs were using the information provided by CRBs to analyze the borrowers past credit history advancing the loans to the members which affected the loan performance by reducing the level of NPLs. Credit bureaus improve financial institutions knowledge about applicants' characteristics and permit more accurate prediction of repayment probability.

There was a negative relationship between credit reports forwarded to CRBs and loan default the findings depicts that SACCOs were listing their members who failed to service their loan accounts to the CRBs. This greatly affected the loan performance by reducing the cases of loan defaults. There was a negative relationship between numbers of years SACCOs have used been registered with CRBs and loan default. The findings show that SACCOs which have been using CRB for a long time experienced cases of less loan default. The study found out that credit information sharing reduces cases of loan default and hence improved loan performance.

5.3 Conclusion

The study concludes that the main factors that lead to bad loans in the SACCOs are; lending to borrowers with questionable characters, serial loan defaulters, high interest rates that make it hard for some to pay, management and legal framework. These causes make many borrowers not to honor their obligations hence leading to many nonperforming loans. Most of these factors are due to information asymmetry in the SACCOs industry. Credit information sharing has for sometime been embraced in the banking industry. This has been replicated in the Sacco sector. The aim of credit information sharing among SACCOs is to improve loan performance.

Credit information sharing and level of loan performance are indeed related. Credit Information Sharing, increases transparency among SACCOs, helps them lend prudently, lowers the risk level to the SACCOs, acts as a borrowers discipline against defaulting and it also reduces the borrowing cost i.e. interest charge on loans. CRB has come of age and has helped the SACCOs to lend with care. The effect of it therefore has led to reduced non-performing loans. Credit Report forwarded was found to have the most significant positive influence on default rate. Number of years the Sacco has used CRB was found to have the least influence on loan performance.

Credit Information sharing affects non-performing loans by Lowering SACCOs risk level hence reducing the portfolio at risk and the provisioning for NPLS which in turn reduces the profitability. By choosing the right customer for lending through prudent lending which in turn reduces the level of NPL as the character of the borrower is checked through the credit information obtained and this ensures that banks only lend to customers whose credit history is favorable.

There is need for CRB to provide all information of the borrower to the SACCOs to enable them make accurate decisions. Credit reports forwarded to the SACCOs should be regularly updated. Sharing of customer credit information positively affects the loan performance as it helps the SACCOs to decline loaning chronic defaulters, while low default rate would result from lending to borrowers based solely on all credit suppliers (positive information).

5.4 Recommendations

All SACCOs in Kenya should embrace credit information sharing; SASRA should make it mandatory for SACCOs to embrace credit information sharing. Including all credit history from other credit suppliers (positive information) would increase credit approval by SACCOs. SACCOs in Kenya should make more use of the CRB reports so that they control their greatest problem of non-performing loans. Information accessed from CRB should ensure efficiency in loan recovery by SACCOs.

Loan borrowers from SACCOs must ensure that their records are clean and therefore if they have clean history from the CRB, they could bargain to get loans at low interest and better conditions. Information accessed from CRBs should be accurate and up to date. SACCOs should embrace Positive Credit Information in order to increase the borrowers bargaining power. The personality of an individual should also be given priority when evaluating the potential borrowers.

The government should ensure that there is mandatory compliance to the settlement of debts as constitutionally required of the integrity section of the Kenyan law. This will make it easier for the current SACCOs and prospective ones too. The government should

make mandatory for new SACCOs to embrace CRB in the first year of their operation. The information forwarded to CRB should be provided within the regulatory framework to help financial institutions tighten their lending guidelines and control the level of non-performing loans.

5.5 Study Limitations

The current study was guided by four variables, this failed to include other effect of credit information sharing on loan performance among SACCOs in Nairobi County, this denied the study to cover a broad perspective and explore further on more effect of credit information sharing on loan performance among SACCOs in Nairobi County, the study suggested further research to be conducted so as to identify more effect of credit information sharing on loan performance among SACCOs in Nairobi County.

There are some respondents who did not cooperate to provide full information on effect of credit information sharing on loan performance among SACCOs in Nairobi County. Getting the credit reports from the SACCOs was a big challenge. The researcher assured the respondents that the information provided was of strict confidence and was used for the purpose that it was indicated.

5.6 Suggestion for Further Study

The study objective was to identify the effect of credit information sharing on loan performance among SACCOs in Nairobi County. The study findings narrowed into SACCOs in Nairobi County. Further study is necessary to establish the effect of credit information sharing on loan performance among SACCOs in various counties in Kenya. Suggestion for further studies is advisable to contribute towards identification of more

other effect of credit information sharing on loan performance among SACCOs in Nairobi County. The study covered only 42 SACCOs, suggestion for further study is advisable to cover other financial institutions like micro finance institutions which are struggling with loan default. A comparative study should be conducted to analyze the loan performance of Sacco's before and after adoption of credit information sharing. There is need for analysis of CRB activities on credit accessibility from the customer's perspective.

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APPENDIX 1: SACCOS IN NAIROBI

The following are SACCOs in Nairobi that have been licensed by SASRA as at January 2015

1. AFYA SACCO SOCIETY LTD
2. AIRPORT SACCO SOCIETY LTD
3. ARDHI SACCO SOCIETY LTD
4. ASILI SACCO SOCIETY LTD
5. CHAI SACCO SOCIETY LTD
6. CHUNA SACCO SOCIETY LTD
7. COMOCO SACCO SOCIETY LTD
8. ELIMU SACCO SOCIETY LTD
9. FUNDILIMA SACCO SOCIETY LTD
10. HARAMBEE SACCO SOCIETY LTD
11. HAZINA SACCO SOCIETY LTD
12. JAMII SACCO SOCIETY LTD
13. KENPIPE SACCO SOCIETY LTD
14. KENVERSITY SACCO SOCIETY LTD
15. KENYA BANKERS SACCO SOCIETY LTD
16. KENYA POLICE SACCO SOCIETY LTD
17. KINGDOM SACCO SOCIETY LTD
18. MAGEREZA SACCO SOCIETY LTD
19. MAISHA BORA SACCO SOCIETY LTD
20. MILIKI SACCO SOCIETY LTD

21. MWALIMU NATIONAL SACCO SOCIETY LTD
22. MWITO SACCO SOCIETY LTD
23. NACICO SACCO SOCIETY LTD
24. NAFAKA SACCO SOCIETY LTD
25. NAKU SACCO SOCIETY LTD
26. NASSEFU SACCO SOCIETY LTD
27. NATION SACCO SOCIETY LTD
28. NEST SACCO SOCIETY LTD
NEST SACCO SOCIETY LTD
29. SAFARICOM SACCO SOCIETY LTD
30. SHERIA SACCO SOCIETY LTD
31. STIMA SACCO SOCIETY LTD
32. TELEPOST SACCO SOCIETY LTD
33. TRANSCOM SACCO SOCIETY LTD
34. UFANISI SACCO SOCIETY LTD
35. UFUNDI SACCO SOCIETY LTD
36. UKRISTO NA UFANISI WA ANGLICANA SACCO SOCIETY LTD
37. UKULIMA SACCO SOCIETY LTD
38. UNITED NATION SACCO SOCIETY LTD
39. WANA-ANGA SACCO SOCIETY LTD
40. WANANCHI SACCO SOCIETY LTD
41. WANANDEGE SACCO SOCIETY LTD
42. WAUMINI SACCO SOCIETY LTD