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Analysis of Credit Terms and Loans Performance Among Deposit-Taking SACCOS in Nairobi City County, Kenya

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Abstract

Deposit-taking SACCOs in Kenya have consistently recorded an increasing rate of loans that are not honored as and when they become payable throughout the years. According to SASRA 2021 Sacco supervision report, the NPL in the DT-SACCOs was 5.23% in 2016, 6.14% in 2017, 6.30% in 2018, 6.15% in 2019, 8.39% in 2020, and 8.86% in the years 2021. This persistent increase in NPL among the DT-SACCOs is worrying, and the cause has not been established conclusively. This study sought to analyze how credit terms aspect of CMP affects loan performance in DT-SACCOs within the City County of Nairobi. A descriptive research approach was adopted in this research and the target population included 47 DT-SACCOS. A census approach was used and the 47 credit managers were the targeted responders. Descriptive and inferential statistics were employed to analyze the data collected. The findings revealed that credit terms had a negative and significant effect on loan performance. The study concluded that credit terms reduce loan performance among deposit-taking SACCOs. The research recommends that SACCO's management should have well-stipulated credit terms that are understandable to the borrowers. The management should have flexible loan repayment periods to help them reduce the NPLs.

Keywords: *Credit Terms, Loans Performance, Deposit-Taking SACCOs*

1.0 Introduction

Savings and Credit Co-operatives (SACCOs) execute a significant global function in enhancing financial inclusion (Ndegwa & Koori, 2019). According to Ntoiti and Jagongo (2021), the SACCOs' primary role is to enhance the financial position of their members through mustering savings and issuing credits/loans to the members. SACCOs in Kenya gained importance and relevance in the late 1990s as the banking sector faced a crisis and banks closed their branches in rural areas (Johnston, 2006). The SACCOs, therefore, took advantage and rose to give financial services that the majority were missing, particularly in the rural areas. The primary target market for SACCOs was the informal sector, for example, farmers with limited access to banking services (Johnston, 2006).

The lending terms and conditions of commercial banks restrict individuals within the informal quarter's access to credits (Atieno, 2001). SACCOs offer easily accessible and customized financial services with lenient terms and conditions, hence accommodating most persons who are not able to easily access conventional banking services (Johnston, 2006). Unlike in the past,

SACCOs have been developed to serve both formal and informal sectors in rural and urban areas.

According to SASRA (2021), SACCOs generate their income mainly from loans issued to its members. Lending pauses financial risks to lenders stemming from the possibility of nonpayment of the loans as they fall due (Ibrahim, 2010). Timely repayment of loans advanced to SACCO members is crucial since it dictates the profitability of SACCOs and their growth rate (Benson et al., 2016). Performing loans are the ones that are paid back as per the terms and conditions. According to Kroszner (2018), loans that are not paid per the stated terms and conditions are termed non-performing, and they affect SACCOs' financial performance. Non-performing loans are expensed in the profit and loss account, reducing the profit SACCOs record.

According to Demary (2018), poor loan performance is a global issue that puts all financial institutions globally at risk. According to the report by the WOCCU in 2019, the average non-performing loans among SACCOs globally stood at 4.15%. The report further stated that SACCOs in developing countries, such as African countries, have poor loan performance which stood at 9.7%. According to Ozili (2015), Africa has the highest rate of non-performing loans compared to other continents, this is majorly attributed to the poor financial regulatory frameworks. According to Ozili (2019), non-performing loans in Africa have remained a challenge to SACCOs and are rising. Poor loan performance has affected the economic growth of these countries, just like SACCOs.

Tunisia, Nigeria, and Kenya have been identified as African countries struggling with high percentages of defaulted loans (Mpofu & Nikolaidou, 2018). Kenya has one of the globe's largest SACCO industries; therefore, the increasing rates of Non-Performing Loans (NPL) are of great concern. The non-performing loans among Kenyan SACCOs are also on a rising trend. As of 2021, the Kenya DT-SACCOs recorded 8.86% NPL, while the Non-Withdrawable Deposit Taking (NWDT) recorded 9.78% NPL (SASRA, 2021).

Credit management is critical in any organization, particularly those that offer financial services. CMPs are implemented in financial organizations to reduce or avoid the issue of non-performing loans. Failure to enhance good credit management practices directly affects the organization's performance since the organization will lose revenues and its financial resources/capital to its debtors (Uzoh, 2012). SACCOs are among the lending financial institutions that need elaborate credit management practices to ensure they reduce credit risks and costs associated with non-performing loans or bad debts. Credit risk is the hazard that the loan repayment agreement is not going to be honored (Brown & Moles 2014). The performance of loans issued by SACCOs greatly affects their financial performance in terms of profits and stability and threatens their survival (Benson et al., 2016). The credit terms will safeguard the lender's interests to reduce credit risk (Susan, 2012).

DT-SACCOs in Kenya have shown an increase in non-performing loans despite the improvement in all other financial performance indicators (SASRA, 2020). This increase in the number of loans that are not performing among DT-SACCOs raises questions about the effectiveness of their credit management practices. Deposit-taking SACCOs lend its members against their deposits/savings and collaterals. If the borrowers fail to honor the repayment obligation, the collateral or the deposits/savings will be taken to pay the loan. The rise in non-performing loans is a subject of great concern that bothers all partners and even the regulator, SASRA.

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1.1 Problem Statement

Credits fulfill a cardinal financial assignment in government, business entities, and individuals. Through credits, various entities can meet their financial needs in advancing their economic agendas. SACCOs were initiated to encourage members to save and get loans based on their savings. The interest charged on loans issued to SACCO members is the prime source of income for SACCOs (SASRA, 2021). Credit management is, therefore, very critical not only to SACCOs but also to any other lending institution. Any flaw in credit management increases the default cost, which is transferred to successful borrowers making the cost of credit expensive (Wang & Wafula, 2016). Proper credit management assists lenders in increasing loan recovery hence improving financial performance.

DT-SACCOs have recorded an increasing and positive performance in all financial performance indicators from 2017 to 2021, except for Non-performing Loans (NPL) (SASRA, 2021). The DT-SOCCOs' NPL consistently increased from 5.23% in 2016, 6.14% in 2017, 6.30% in 2018, 6.15% in 2019, 8.39% in 2020, and 8.86% in the year 2021, according to the SASRA 2021 Sacco supervision reports. The NPL has therefore remained a challenge to the DT-SACCOS in the recent past. The NPL not only causes financial losses to SACCO but also reduces SACCO's lending appetite, reducing the financial accessibility to its members (Ntoiti & Jagongo, 2021).

The study conducted by Silikhe (2008) about credit supervision and microcredit organizations in Kenya, found that in defiance of the stern measures implemented to guide loan management, the default rate goes high and becomes a major problem in these financial institutions. Kamau (2015) researched CMP on the financial achievements of SACCOs in the hotel industry in Nairobi. This study considered SACCOs in one sector, that is, the hospitality industry. The study established that the capability to repay the loan is not considered a requirement to borrow since it cannot be established with certainty. A study by Muturi (2016) about the results of CMP on the economic prosperity of deposit-taking microfinance within the Nairobi central district, concluded that proper credit management practices positively influence the financial prosperity of these institutions. This research focused on the effects brought on financial performance by credit management failing to acknowledge the difference between financial performance and loan performance.

So far, the studies conducted in Kenya have not extensively and conclusively studied the DT-SACCOs within the City County of Nairobi despite being the County with the majority of the DT-SACCOS. Most of these studies also try to demonstrate the link between CMP and financial performance failing to recognize the difference between financial performance and the performance of loans. This study focused on filling the study gap and adding information on how the credit terms aspect of CMP affects loan performance in DT-SACCOs within the City County of Nairobi.

1.2 Research Hypothesis

HO: Credit terms have no significant effect on loan performance among deposit-taking SACCO, Nairobi City County, Kenya

2.0 Literature Review

2.1 Theoretical Review

Information Asymmetry Theory was proposed by George A. Akerlof in the 1970s. Akerlof conducted his study regarding information asymmetry in the automobile markets. In his study, Akerlof found that information asymmetry enabled sellers to sell goods whose quality was

below the market average. In the financial market, information asymmetry is where one facet of the marketplace/transaction possesses more relevant information details than the other party of the marketplace/transaction. Information asymmetry is, therefore, a problem in the financial markets where lending and borrowing happen. The borrowers have more information about their financial health and state than the lender. The borrowers do not share this information fully with the lenders leading to market failure and adverse selection of clients. Despite the client appraisal mechanism, the borrowers will hide some important information about their financial status to qualify for a loan or higher amount at the risk of the lender.

According to Auronen (2003), distinguishing bad borrowers from good borrowers is a difficult task that, in most cases, results from adverse selection and, consequently, moral hazards. Adverse selection happens when bad customers qualify for a loan that they could not have qualified for in a perfect market where there is no problem with information asymmetry. A moral hazard occurs when the borrowers divert borrowed funds to other projects contrary to the agreement by the lender, subjecting the lender to default/credit risk. Negative choice and moral hazards affect the performance of loans in the SACCOs (Buro, 2019).

Information asymmetry in the financial markets brings about credit rationing that disadvantage credit-worthy customers. In Kenya, the government has instituted the Credit Reference Bureau (CRB) to assist in solving the information asymmetry challenges for lending institutions. Financial institutions share information about their customers through the CRB. The CRB receives information about customers and their loan performance from all licensed institutions and shares this information with other lending institutions on request. The information will guide the lender in understanding the credit history and creditworthiness of the customer before making a lending decision.

2.2 Empirical Review

The study by Osendo (2019) revealed that when the payment terms are flexible, the loan repayment is enhanced. The study also found that changing interest rates to the disadvantage of customers results in delays in loan repayments since most of the customers are not comfortable with the interest changes. The research further revealed that imposing penalties on customers who default in paying loans improves loan performance. The research investigated the effect of loan payback conditions and the performance of the YEDF (Youth Enterprise Development Fund) in Kisumu Central Sub-County, Kenya. The study embraced the census method to gather data from members in the entire 45 committees using questionnaires.

A study done by Wilberforce et al. (2021) to determine how credit terms impact loan performance in SACCOs within Mbarara City in Uganda embraced a cross-sectional research design. The study covered 18 SACCOs within Mbarara city. Data was collected from all 18 SACCOs and 209 directors, 18 managers, and 202 employees through interviews and questionnaire surveys. The study found that lenient credit terms, for example, extended credit period, enhance loan performance by a great margin. The study further confirmed that loan rescheduling improves the performance of loans. Finally, the research revealed an inverse relationship between selling collateral and loan performance. According to Ono and Uesugi (2009), attaching collateral to a loan improves the customer's commitment to pay the loan, but selling the attached collateral kills the customer's commitment, morale, and mutual understanding between the customer and the lender.

Chege (2021) studied CMP and loan delinquency in AFC, Kenya. The targeted population was 485 staff employees across the 47 AFC branches across Kenya. The study looked at how credit terms impact loan repayment. The study found that high interest rates affect loan repayment

negatively as they discourage borrowers from paying the loan. The repayments are affected more if the interest charged is higher compared to the returns from the venture where the funds were invested. In the case where the venture records losses, the loan repayment is even affected more.

Muthama and Warui (2021), found that the credit period influences loan performance and it ought to be clearly stated to enhance loan repayment. The study used the Kisii (KWFT) branch as the case study in demonstrating the impact of advancing terms on loan performance. A total of 181 responders were targeted and this comprised 14 bank employees and 167 customers of KWFT. A census design was adopted in employee/responder selection and a semi-structured questionnaire was used as an information collection instrument.

3.0 Methodology

A descriptive research approach was adopted in this research. Nairobi City County is the county with the most DT-SACCOs, with 47 DT-SACCOS out of 176 SASRA-regulated DT-SACCOs. A census approach was used and the 47 credit managers at the head offices of the DT-SACCOs within City County of Nairobi were the targeted responders. The researcher gathered both primary and secondary information. Every head office was dropped with one questionnaire and out of the total 47 dropped questionnaires, 44 were collected fully filed. Secondary data was acquired from the published economic records of the DT-SACCOs to ascertain loan performance trends during 5 years starting in 2017 and ending in 2021. The statistical package for social sciences (SPSS) was employed to examine and study data. Descriptive and inferential statistics were employed to analyze the data collected. Hypothesis testing was done at a 0.05 significance level.

4.0 Results and Discussion

4.1 Credit Terms and Loan Performance

Responders were implored to select the level of concurrence with various assertions on how credit terms relate to loan performance in their SACCOs. Below is the summary of their responses on a Likert scale: SA appeared for Strongly Agree, A stood for Agree, MA stood for Moderately Agree, D stood for Disagree, SD stood for Strongly Disagree, M denotes the Mean, and SE DEV indicated the Standard Deviation.

Table 1: Credit Terms and Loan Performance

Statement	SA	A	MA	D	SD	M	SD DEV.
Credit terms help curb Non-performing Loans	10	11	13	9	1	3.45	1.12
Flexible loan repayment period reduces loan default rate	14	10	9	9	2	3.57	1.25
Loan penalty enhances loan repayment compliance	8	11	18	6	1	3.43	1.01
Credit period influences loan repayment	12	8	12	12	0	3.45	1.16

Source: Researcher 2023

With a mean of 3.45 and std Dev. 1.12, the research established that credit terms help in curbing non-performance loans. This meant that the credit terms moderately helped in enhancing loan performance in DT-SACCOs within the City County of Nairobi.

The findings further confirmed that flexible repayment periods (Mean 3.57 and SD DEV 1.25) as a powerful tool for reducing rates of loan non-repayments. This was followed by a credit period (Mean of 3.45 and SD DEV 1.16) and then followed by a loan penalty (Mean of 3.43 and SD DEV 1.01). Among the examined credit terms variables, the Loan penalty had the least influence in compelling customers to pay the loan while flexible loan repayment had a great influence.

4.2 Loan Performance Among DT-SACCOs within Nairobi City County

Figure 1 shows loan performance results as measured using NPL.

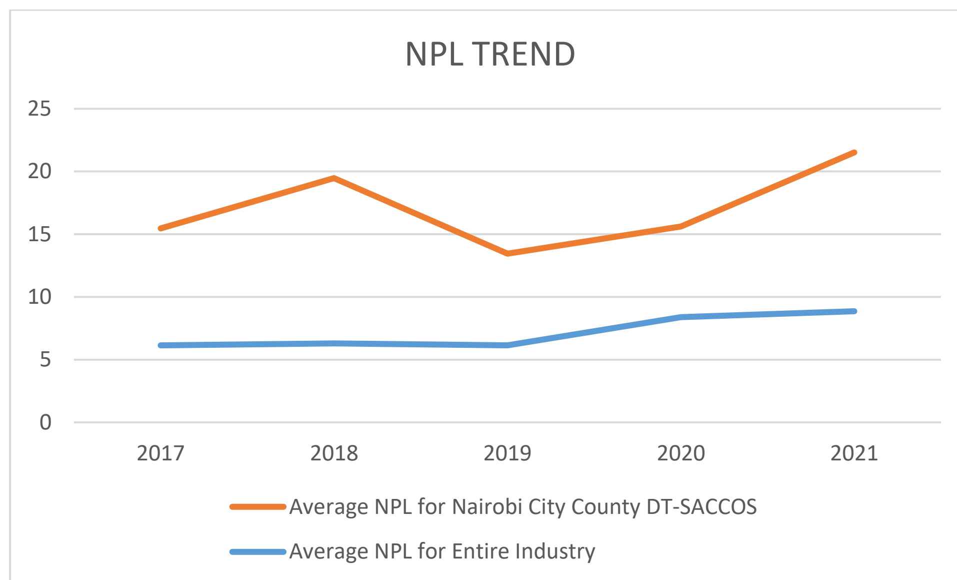

Figure 1:NPL TREND

Source: Published Financial Reports 2017-2021

Data collected from secondary sources for loan performance indicated an upward trend in average NPL for the entire industry and DT-SACCOs within the City County of Nairobi. The DT-SACCOs within the City County of Nairobi had higher rates of NPL than the industry average.

4.3 Effect of Credit Terms on Loan Performance among Deposit-taking SACCO

Table 2 shows regression results on the effect of credit terms on loan performance among deposit-taking SACCOs.

Table 2: Regression Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	0.043	0.472		0.092	0.928
	Credit Terms	-0.333	0.117	-0.769	-2.861	0.007

a Dependent Variable: Loan performance

Source: Researcher 2023

Equation:

Loan Performance =0.043-0.333 Credit Terms

From the above model, loan performance will be 0.043 holding credit terms constant.

Credit terms have an unstandardized coefficient of - 0.333, and this means that for every unit increase in credit terms, the dependent variable (loan Performance) decreases by 0.333 units. Moreover, credit terms are a statistically significant predictor of loan performance as indicated by a p-value of 0.007 <.05. Based on the findings, the null hypothesis (HO) that credit terms have no significant effect on loan performance among deposit-taking SACCO, Nairobi City County, Kenya was rejected.

The findings corroborate those of Osendo (2019) who found that changing interest rates results in delays in loan repayments since most of the customers are not comfortable with the interest changes. Similarly, Wilberforce et al. (2021) found an inverse relationship between selling collateral and loan performance. Additionally, Chege (2021) found that high interest rates affect loan repayment negatively as they discourage borrowers from paying the loan.

5.0 Conclusion

The study established that credit terms have a negative but significant impact on loan repayment among Nairobi City County deposit-taking SACCOs. The study concluded that credit terms significantly reduce loan performance among DT-SACCOs. The implication is that credit terms contribute to a decrease in loan performance to a great extent.

6.0 Recommendations

The research recommends that SACCO's management should have well-stipulated credit terms that are understandable to the borrowers. The management should have flexible loan repayment periods to help them reduce the NPLs. As economic circumstances change, the financial ability of customers to repay their loans also changes hence the need to embrace a flexible loan repayment period strategy. The management should adjust the installment amount and repayment frequency to accommodate customers who are affected by changes in economic times. Further, the management should set punitive measures to deter customers from trying to default willingly or unwillingly.

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