Influence of Loan Portfolio Management on Performance of Saving and Credits Organizations in Kenya, a Case Study of Saccos in Kakamega County

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Abstract: The Kenyan SACCO business plays a key role in contributing to the country's savings that has boosted social development and the economy. Co-operative societies in Kenya may be traced to the pre-independence times with initiation of development in the time immediately after the country gained independence. Most SACCOs in Kakamega begin and fail to reach the breakeven point and thus end up closing down. It is against this backdrop, that this study sought to interrogate the effects of internal factors as far as growth of SACCOs in Kenya is concerned, particularly those within Kakamega County. The aim of the study was to establish the effect of loan portfolio management on Sacco performance. Descriptive research design was applied in the study whereby census was used for the whole chosen population. The 52 active SACCOs found in Kakamega County formed the target population; focusing on 156 respondents. Stratified random sampling was applied to select 111 respondents comprising of CEOs/Top managers, finance officers and Sacco accountants. Questionnaires having closed ended questions relating to the objective were used to collect primary data. Both descriptive and inferential statistics were applied in the study to analyze data from the questionnaires. SPSS version 23 software was used to code and analyze data. Tables were used in data presentation. The study established that loan portfolio management positively affected the on performance of Sacco in Kakamega County. The study recommends that SACCOs need to develop strict and strategic policy guidelines on loan portfolio management (Credit Policy) that would positively determine performance of the institutions (SACCOs) in their day to day operations.

Keywords: Performance, Saccos, Loan Portfolio Management, Kakamega County.

I. INTRODUCTION

Effective loan portfolio management function is vital for maintaining a financial institution safety and soundness as stated by IACPM (2005). Qualified and competent staff who can identify risks associated with individual borrowers and all borrowers (the loan portfolio), should be employed by SACCOs. Fundamental credit handling experience, quantitative analytical / marketing skills and experiences should be possessed by the portfolio management staff to perform their tasks well. Moreover, the bank should design the stress testing measures to examine the vulnerability of portfolios loss due to unanticipated events

Savings and credit cooperative societies, which are known by acronym "SACCOs", were first introduced in Kenya in 1964. However, due to operational problems, high loan delinquencies, and lack of workable systems, the precursors of the present day SACCOs were not economically tenable. In 1969, the government made a radical policy departure to register SACCOs strictly based on employment relationship or secure crop which has seen the rapid growth of SACCOs in Kenya. (The national development plan 2002-200, paragraph 3.6.4, page 38). SACCOs in Kenya provide opportunities for more to access savings, cheap affordable credit, and a chance for a secure tomorrow. The impact of these SACCO societies on the poor rural and urban populations, particularly the un-banked segment, has been felt and is evident. Opportunities for accessing credit through mainstream financial institutions are out of reach for most people. This has

posed a great challenge to the SACCO movement to provide high quality and diversified financial services, which members can easily access.

The introduction of Front Office Savings Accounts (FOSA'S) and other SACCO products have gone a long way in meeting this challenge. Currently, there are more than 122 SACCOs offering those quasi-banking services. These FOSA have filled the void left by banks during the restructuring process. FOSA sections in SACCOs therefore provide a majority of the rural and urban poor access to financial and quasi-banking services usually obtained only in formal financial institutions. Kenya Union of Savings Credit and Cooperatives (KUSCCO) as the umbrella organization for SACCOs in Kenya have been mandated by its own constitution to provide specialized services to SACCOs in Kenya.

 As a member owned and member –managed financial institution, KUSCCO plays the role of a mouth-piece, advocate, spokesman and representative all SACCOs in Kenya. (IFAD rural finance thematic workshop 29th July 2005- Nairobi Serena Hotel institutional development and the provision of rural finance experience and challenges of rural out-reach a case for savings and credit co-operatives (SACCOs). Savings and credit cooperative organizations (SACCOs) are currently undergoing a turbulent period trying to adjust to the liberalization of the economy. This sector is faced with weak marketing structures, regulatory frame work, financial constraint, leadership and governance and ways of developing a competitive business model. Studies have found that the poor not only need a complete range of financial services (Robinson, 2002). Majority of the middle and low income workers continue to join saving and credit cooperative societies, consequently the proper governance of these cooperatives should be an issue of priority concerns for the government, the private sector generally, the entire Kenya society and indeed every Kenyan in general. This is because good governance will enhance the ability of cooperative to create wealth for their members, create increased employment opportunities improve and expand the range of service and opportunities available to all.

The diminishing role of the government in the management of SACCOs means that these societies have to survive with minimum government control. SACCOs must thus upgrade their internal governance to survive. There has also been a serious need for SACCOs to upgrade their management capacity especially in areas of information technology, marketing and customer services. The ongoing retrenchment of staff in many business organizations, parastatals and government department has resulted in an unexpected decrease in both members of SACCOs and the capacity of these SACCOs to raise or even retain member shares. Many SACCOs do not have the management capacity to address such challenges adequately and KUSCCO as the umbrella union has been called upon to guide SACCOs in this difficult time of adjustment. One particular challenge that KUSCCO had had to deal with is that of assisting non-employee based SACCOs to be integrated into the SACCO movement. These SACCOs are particularly vulnerable to management problems because, unlike the employee based, SACCOs that enjoy a common bond they comprise of members from various small business back grounds. And yet as the established formal SACCOs continue losing members due to the on-going retrenchment, these formal SACCOs have continued increasing both in numbers and in size. (Ministry of co-operative development & Marketing Strategic plan journal 2004 – 2008 (Revised).

Statement of the Problem

Credit financial institutions play a key role in every nation's growth and development. SACCOs being among the financial institutions have played a noteworthy role in mobilization and utilization of unexploited resources. However, global evidence has shown that many SACCOs are struggling with non-performing loans due to failure by borrowers to honor their loan obligations (Siems, 2016). Kenya's Non Performing Loans Ratio for DTSs stood at 6.14 % in 2018, compared with the ratio of 6.13 % in the previous year. The immediate consequence of large amount of non-performing loans in the SACCO sector is SACCO failure.

While the issuance of loans increased over the year, their risk level as measured by level of non- performing loans deteriorated from 5.73 percent in 2014 to 6.62 percent in 2019. This indicates an elevated credit risk due to deterioration in performance of loans. However, some of the loans given out become non-performing and adversely affect the profitability and overall financial performance of the lending institutions. Many lending institutions in Kenya are confronted with the challenge of rising non-performing loan portfolios despite efforts at stemming the tide (Auronen, 2016). NPLs create problems for the banking sectors balance sheet on the asset side, and have a negative impact on the income statement as a result of provisioning for loan losses (Kumar & Tripathi, 2012).

A study conducted by Anderson (2016) found that there is a positive relation between collection efforts and interest rate with non-performing loans. However, the same study insisted that there is no clear relationship between the credit policy, interest rate and non-performing loans in SACCOs. In a similar study by Hann (2018) found that there is a negative

relationship between credit policy and interest rate with non-performing loans in SACCOs. This study contradicts that of Anderson (2016) as it negates the relationship of credit policy and interest rate and non-performing loans in SACCOs. This two contradicting viewpoint arises a question of doubt over the validity of the findings in the above studies and thus necessitates further investigation. Hence, the current study tends to find influence of loan management on performance of Saccos in Kakamega County.

Research Objective

The study sought to find out the influence of loan portfolio management on performance of Saccos in Kakamega County

Research hypothesis

H_0: There is no significant influence of loan portfolio management on performance of Saccos in Kakamega County.

II. LITERATURE REVIEW

Theoretical Review

Modern portfolio theory was proposed by Markowitz (1952). It tries to exemplify the returns expected from a specific investment and guides in the selection of proportions of assets in a given institution (Esfahani et al., 2016). This theory is commonly used in financial institutions as an advanced mathematical modelling of finance. It encourages hedge diversification of assets against market risk which is unique to a specific company. On the other hand, MPT is a sophisticated investment decision approach which assists investors to easily classify, approximate and control both the type and amount of expected and return. It is also referred to as portfolio management theory. The cornerstone of the theory is the ability to quantify the association that exists risk and return. The theory assumes that investors should be compensated for assuming risk. On the concept of investment diversification, the theory aims at selecting a collection of investment assets that has collectively lower risk than any individual asset. Through this combination, there is positive correlation even some assets in the combination may have negative returns hence MPT makes an assumption that investors are rational and markets are efficient (Fabozzi, Gupta & Markowitz, 2002)

MPT looks at return as a motivating factor to investors and it classifies returns as realized returns and expected return. Expected return is just a prediction which may or may not happen but realized returns is what has been achieved and can be used to plan for the future cash flows in terms of dividends, interest, bonus, capital gains available to the investor. This theory assumes that there is usage of normal distributions to model returns and there is also neglecting of taxes and transaction fees (Omisore et al., 2012). This is related to the study in such way that, it explains more about returns on investment where by DTSs equally invests by loan portfolios as assets with aim of getting returns from the investment. In such kind of investment, there are risks involved which in turn affect the Saccos performance. This theory is relevant to the study since it focuses on the financial performance of financial institutions while the study equally aims at determining the effect of loan management techniques on financial performance.

Conceptual Framework

The study was guided by the relationship of dependent variable and the independent variables. The study aimed at established the relationship between the dependent variable and the independent variables. The conceptual framework shows that there is a relationship between the two variables. The dependent variable was Sacco performance as indicated through SACCOs" membership, savings and profit levels. It was assumed that among other factors, the independent variables influenced performance of SACCOs in Kakamega County. Independent variable was loan portfolio management which was conceptualized in to credit policies, loan recovery and loan monitoring. The variables are presented on Figure 1.
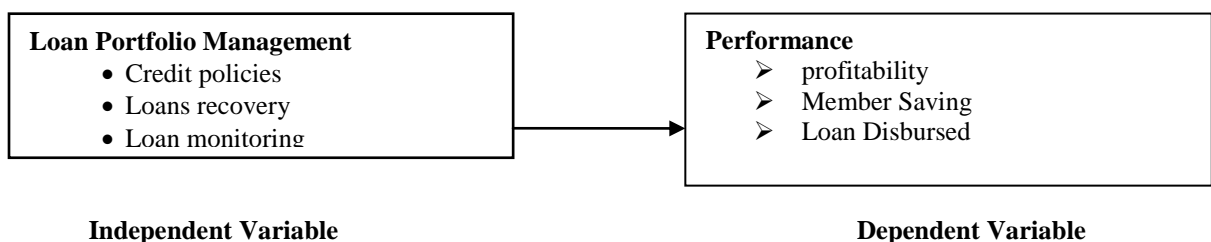
Loan Portfolio Management	Performance
• Credit policies	➢ profitability
• Loans recovery	➢ Member Saving
• Loan monitoring	➢ Loan Disbursed

Independent Variable   Dependent Variable

Figure 1: Conceptual Framework

Empirical Studies

Magali and Oiong (2014) conducted a study on Assessment of Microfinance Institution Performance: The Importance of Institutional Environment and found out that the nine elements which comprise the effective loan portfolio management include formulation of sound portfolio objectives and risk tolerance limits, assessment of the credit culture, effective management information systems, portfolio segmentation and risk diversification objectives, analysis of loans originated by other lenders, aggregate policy and underwriting exception systems, portfolios stress testing, independent and effective control functions and analysis of portfolio risk/reward tradeoffs. Most of these techniques however, are applied in banks than in rural MFIs such as rural SACCOs.

Gunga (2008) found that a direct influence on the profitability of a financial institution in Kenya was because of effective loan portfolio management, since banks and other MFIs depend on interest income as their revenue. Effective loan portfolio management will thus, make borrowers to repay their loans on time which will lead to increase in banks" or MFIs" revenue of which in turn will lead to increased profitability.

Devinaga, (2007) conducted a study on a management development model for SACCOs in Zambia and found out that, the higher the volume of loans extended, the higher the interest income and hence the profit potentials for the commercial banks. At this point, it is also worth noting that financial institutions with a high volume of loans will also be faced with higher liquidity risk. Thus, the SACCOs need to strike a balance between liquidity and profitability.

On assessment of the history of the Cooperative Movement in Kenya Bryan (2010) found out that, loans are among the highest yielding assets of an organization which adds to its balance sheet, and they provide the largest portion of operating revenue. In this respect, the financial organizations are faced with liquidity risk since loans are advanced from funds deposited by customers. Hamisu, (2011) notes that credit creation involves huge risks to both the lender and the borrower. The risk of a trading partner not fulfilling his or her obligation as per the contract on due date or anytime thereafter can greatly jeopardize the smooth functioning of a financial institution business. On the other hand, a financial institution with high credit risk has high bankruptcy risk that puts the depositors in jeopardy.

The largest share of a MFI"s operating income is generated from the loan portfolio as argued by Brandt et al., (2013). They asserted that income generated by the loan portfolio is affected by number of loans disbursed, the effective term for repaying the loan and the number of active clients. As per their argument, higher default rate occurs because of setting inappropriate loan terms. Moreover, they argued that if the MFI has ability to retain clients, the size of loan portfolio increases. The reviewed literature did not present any study on internal factors affecting SACCOs conducted in Kakamega County. The study aimed at filling this gap by finding out how loan portfolio management influence performance of Sacco in Kakamega County.

III. METHODOLOGY

This research employed the descriptive survey design. According to Kombo and Tromp (2006) the major purpose of descriptive research is to describe the state of affairs as it exists. The target population for this study was 156 respondents from 52 SACCOs affiliated to KUSCCO and in operation as at 31st December 2017. The sampling frame will consist of Top Managers/CEOs, Finance officers and Sacco Accountants. The study sample involved a total of 111 respondents from 52 SACCOs in Kakamega County. Stratified random sampling was done across the stratified levels of employees cutting across the CEOs/Top managers, finance officers and Sacco accountants. The study used primary data which was collected directly from the respondents using the research instruments. The data was analyzed using both descriptive and inferential statistical methods. The descriptive statistics which involves the use of means and standard deviation was used in the analysis to provide the basic characteristics of the data. Inferential statistics involved the use of linear regression analysis to determine the nature of the relationship between the variables. Data analysis was done using SPSS version 23.

IV. FINDINGS AND DISCUSSIONS

Descriptive Statistics

The study sought to describe the extent of agreement/disagreement with the statement about loan portfolio management in their respective SACCO. The responses are rated in the Table 1 below.

Table 1: Descriptive Statistics for Interest Risk Management Practices

Interest Risk Management Practices	Mean	Std. Deviation
Loan repayment schedules are issued to borrowers on loan application	3.84	1.041
The SACCO conducts frequent loan evaluations /appraisals	3.86	1.944
The SACCO has defined loan recovery procedures /policy	3.64	0.243
The SACCO issues insured loans to borrowers	3.51	0.451
The SACCO issues loans on provision of security	3.66	0.194
The SACCO penalizes borrowers on failure to pay loan on time	3.73	0.205

As indicated on Table 1, all the above statements were agreed as the SACCO issues insured loans to borrowers by a mean of 3.51; The SACCO conducts frequent loan evaluations / appraisals (mean=3.861), The SACCO issues loans on provision of security (mean= 3.66), The SACCO penalizes borrowers on failure to pay loan on time (mean= 3.73), Loan repayment schedules are issued to borrowers on loan application (mean= 3.84) and the SACCO has defined loan recovery procedures /policy by a mean of 3.64. Financial performance of SACCOs can be said to be significantly determined by how credit facilities (Loans) are managed.

Sacco Performance	Mean	Std. Deviation
There is increased membership	4.01	0.884
There is increased saving	3.91	0.124
Loans applications/disbursements increased	3.71	0.413
Borrowers have improved on loan repayment obligations	3.34	1.212
SACCOs profit levels have increased	3.75	0.568

From the Table 2, membership and SACCO savings have greatly increased as supported by a strong mean of 4.01 and 3.91 respectfully. SACCOs have also greatly increased the loans applications and disbursements as shown by a mean of 3.71 as well as their profit levels. There has however been a slow but steady loan repayment obligation from borrowers as supported by a mean of 3.34 with significant standard deviation. The standard deviation of the variable aspects was ranging between as the highest and 1.212 and 0,123 as the lowest indicating that the data collected was widely spread on the Likert scale.

Inferential Statistics

Inferential Analysis consisted of linear regression which yield R, R Square, F statistics and regression coefficients. The purpose of linear regression was to the linear influence of loan portfolio management and Sacco Performance. The R value indicated correlation between loan portfolio management and Sacco Performance while R square indicated changes in Sacco Performance that is been accounted for loan portfolio management. F statistic revealed whether the model is useful in predicting Sacco Performance and regression coefficients predicted changes in Sacco Performance as a result of loan portfolio management.

Table 3: Regression Results; Loan Portfolio Management and Sacco Performance

Model Summary									
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.618[a]	.381	.374	.5532911	.381	49.327	1	80	.000
a. Predictors: (Constant), Loan Portfolio Management									

ANOVA[a]						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	15.101	1	15.101	49.327	.000[b]
	Residual	24.490	80	.306		
	Total	39.591	81			
a. Dependent Variable: Sacco Performance						
b. Predictors: (Constant), Loan Portfolio Management						

Coefficients[a]						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
	(Constant)	1.144	.328		3.487	.001
	Loan Portfolio Management	.624	.089	.618	7.023	.000
a. Dependent Variable: Sacco Performance						

Linear regression results in table 3 shows that loan portfolio management significantly influences performance of Saccos; R^2 =0.381, significant at p<0.001. This implies that loan portfolio management accounts for 38.1% variations in performance in Saccos in Kakamega County. The F value was more than zero, F=49.327, P=.000, hence, loan portfolio management is a significant predicator of performance in Saccos in Kakamega County. Further, regression coefficient is; β= 0.624 with a standard error, 0.089. This indicate that a unit increase in Loan Portfolio Management will lead to 0.624 unit increase in performance of Saccos in Kakamega County with a standard error of 0.089. The relationship can presented as shown in the model below

Y=1.144+0.624 X1

Where;

Y= Performance of Saccos

X2= Loan Portfolio Management

Regarding loan portfolio management on performance of Sacco in Kakamega County, the study established that loan portfolio management positively affected the on performance of Sacco in Kakamega County. It was strongly found out that SACCOs issue loans on provision of security, penalizes borrowers on failure to pay loan on time, issue loan repayment schedules to borrowers on loan application, conduct frequent loan evaluations / appraisals, has defined loan recovery procedures /policy and finally issues insured loans to borrowers. This is justified as indicated by the positive means and standard deviations. The fact that nearly all SACCOs must have strong loan portfolio management system for credit control, growth doesn't necessarily have to be determined by this predictor variable. These findings agree with that of Omino (2014), who analysed the loan management measures and performance of SACCOs in Kisumu County. The study found out that liquidity risk mitigation approaches adopted by different SACCOs had a significant effect on their financial performances. The study revealed that SACCOs adopted a more cautious position in their current liabilities to ensure that operating cash flows were sufficient to cover the short terms obligations entered by the firms. Further, the study revealed that debtor collection periods were longer to encourage voluntary membership and consequently the SACCOs were either unjustifiably constraining their creditor payment periods or were conditioned to do so. Similar results were also obtained by Muithya (2019) who indicated that loan management significantly influence growth of Saccos in Machakos County. Murage (2018) revealed that loan management techniques positively affected financial performance of DTSs in Kisii County. It was also revealed that the effect was generally weak.

V.   CONCLUSION AND RECOMMENDATION

The study concluded that loan portfolio management is a key aspect on the growth of SACCOs. Building a strong capital base of a SACCO is determined by the systems that the SACCO puts in place to manage its loan portfolio. The study concluded that the SACCOs survival also depends on the kind of products they offer and how differently they offer them to the members compared to other similar providers of that product. Society introduces new products as members need change. They often introduce new methods of service delivery as members demands change to ensure growth. It was also found that products offered by SACCOs are similar given that the respondents were neutral on this aspect. The study recommends that SACCOs need to develop strict and strategic policy guidelines on loan portfolio management (Credit Policy) that would positively determine performance of the institutions (SACCOs) in their day to day operations

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