

Factors Influencing Non-Performing Loans in Registered Savings and Credit Co-Operative Societies in Kenya: A Case of Trans Elite County Sacco in Nandi County

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Abstract: The purpose of the study was to investigate the factors influencing non-performing loans in registered savings and credit co-operative societies in Kenya: A case study of Trans Elite County SACCO in Nandi County. The study sought to achieve the following research objective to determine the influence of members' personal characteristics on non-performing loans. The study was guided by asymmetry theory. Research study employed descriptive research design. The target population was 5214 members. The study utilised stratified random sampling design. The researcher randomly sampled 10% of the target population for the study from the SACCO members. The research instrument for this study were structured questionnaires developed by the researcher which included close ended questions giving scales that refer to questions that ask respondents to rank their answers at a particular point on a scale. The questionnaires were piloted in similar SACCO outside the county of study before the actual research to determine their reliability. The validity was determined by giving the questionnaires to the supervisors and research experts to vet the items used in the questionnaires. Data collected for this study was analysed by use of descriptive analysis techniques for which Statistical Package for Social Sciences (SPSS Version 22) was used to analyse data to generate reports in form of frequencies and percentages. The researcher utilized multiple linear regression model to establish the relationship between the dependent variable and the independent variables and Pearson's Product Moment Correlation Coefficient was used to establish the strengths between the variables. The findings is presented using tables and percentages arising from the analysis. The findings of the research study is of use to the SACCOs in efforts to deal with non-performing loans. The study also provide insights to policy makers in SASRA and in Central Bank of Kenya. The study further contributed to the existing body of knowledge regarding non-performing loans and motivate further research in other areas which were not covered under this study.

Keywords: Credit, Credit rating, Default, Loan, Non-Performing Loans, Savings and Credit Co-operative Society (SACCOs)

INTRODUCTION

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 [1]. The displeased individuals seek financial credit services from other sectors including Savings and Credit Cooperative Societies (SACCOs). According to the Kenya's SACCO Societies Act, [2] the aim of SACCOs is to stimulate the economic empowerment of their members and promote thrift among its members by giving them a chance for gathering savings and earning reasonable yields on these savings as well as access to other financial services such as loans. Information asymmetry, agency problem and poor contract enforcement mechanism are some of the characteristics of credit markets.

SACCOs play a considerable role in the mobilization and allocation of economic resources [1]. Nishimura, Naruhito, & Yukiko, [3] observed that one of the underlying causes of continued economic stagnation in Japan was the non-performing loans or bad loans. They were of the view that some of the loans awarded to individuals, companies and industries by financial institutions during the bubble period became non-performing when the bubble burst.

Bayang, [4] observed that, at the time the loan is disbursed, the poor borrowers are thoughtful with pressing economic challenges ranging from shortage of food, absence of seeds for planting and paying medical bills among others, and this practice makes repayment of the loan a difficulty. Krueger & Aaron, [5] attributed the credit crunch in Mexico after the 1995 crisis partly

to the NPLs. Moreover, the non-performing loans are closely associated with financial crises all over the world [6]. The co-operative movement is evident in all the main sectors of any economy including agriculture, finance, housing, manufacturing, transport, industry, education, health among others [7].

The co-operative movement in Kenya continues to contribute enormously towards the social economic welfare of Kenyans (SASRA, 2013). The movement has grown impressively in the recent years and is now embraced by many Kenyans as the alternative way of doing business and a way of life. To date the department of co-operative development has registered more than 15,000 co-operative societies with membership in excess of 12 million (SASRA, 2013). Kenya has the most vibrant and dynamic SACCO sectors in Africa (SASRA, 2013). According to SASRA, (2013; 2015), about 90% of Kenyans directly or indirectly benefit from the co-operative movement and therefore, emphasis is made on co-operative sector as an investment vehicle towards mobilization of resources, wealth creation and industrialization.

The significance of the SACCO sub-sector in Kenya's economy made the government to have the SACCO Act [2] and the SACCO Societies Regulations Act (2010) enacted. The Acts brought into existence the SACCO Societies Regulatory Authority (SASRA) whose main mandate includes licensing, regulating and supervising deposit taking SACCOs. One of its vital areas of attention is the credit function by the SACCOs operating in the country. SACCOs have made a significant push into the provision of credit in order to take advantage of the prevailing high levels of profitability in the past few years (SASRA, 2013). Although cooperative societies have mechanisms in place to safeguard against loans like taking mortgage on landed properties, stock, bonds and other securities to fall on in time of default, loan default has become an inevitable part of lending business [8].

Loans whose repayments have not come forth for three or more months are considered as non-performing notwithstanding the fact that explicit contract terms may be dissimilar at times [9]. The study by Mpogole *et al.*, [10] in Tanzania found that the prevalence of failure to repay loan on time were high with majority of respondents admitting to often face problems in repayment. Non-performing loans are closely linked to financial crises all over the world [6]. However, there is no evidence of studies carried out to establish the causes of NPLs in registered SACCOs in Kenya. Globally, the cooperative societies serve over 3 billion persons with the US having the biggest number of members followed by India and China. The SACCO under this study was formally known as Nandi teachers SACCO until April, 2014 when the members agreed together with the management that as part of rebranding and to comply with prevailing regulations of SASRA,

the society be renamed to Trans Elite County SACCO. The SACCO draws its membership majorly from the teaching fraternity with few exceptional cases. This study is therefore established the factors influencing NPLs by members of Trans Elite County SACCO in Nandi County.

ASYMMETRY THEORY

The theory says that it may be difficult to distinguish good borrowers from the bad ones [11, 12], which may result into adverse selection and moral hazards problems. In a financial market, the party that possesses more information on a specific item to be transacted is in a position to negotiate optimal term for the transaction than the other party [11]. 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 non-performing loans [13]. This theory was relevant to the study because at the time of loan application by a member and even thereafter, both parties in a loan agreement will not always understand the other explicitly. SACCOs may grant a loan to undeserving member because of false information provided or due to leniency in loan appraisal. Any hidden or classified information held by either the SACCO or the borrower may have effects on the performance of a loan if granted. The loan appraisal process should be diligently done by the credit officers or loan officers.

NON-PERFORMING LOANS (NPLS)

Non-performing loans are accounts whose principal or interest remains unpaid 90 days or more after due date and are also referred to as defaulted loans [14]. Similarly, Berger & De Young [15] describes these types of loans as problem loans. This high level of NPLs continues to be an issue of major supervisory concern in Kenya. International Monetary Fund [16], observed that, a non-performing loan is any loan in which interest and principal payments are more than 90 days overdue; or more than 90 days' worth of interest has been refinanced.

A default is the failure to pay back a loan or occurs when a borrower has not met his or her legal obligations according to the debt contract [17]. Default may occur if the debtor is either unwilling or unable to pay their debt. The above definition does not mean that the borrower had entirely stopped paying the loan and therefore been referred to collection or legal processes; or from an accounting perspective that the loan had been classified as bad or doubtful, or actually written-off. Non-performing loan is also the inability of a borrower to fulfil his or her loan obligation as at when due [18]. The non-performing loans are likely to cause challenges in the SACCO such as low profitability, low liquidity, low growth rate, poor competitiveness of the SACCO as well as rise of disputes with stakeholders.

INFLUENCE OF MEMBERS' PERSONAL CHARACTERISTICS

The characteristics that define a borrower's ability to repay the loan include character, capacity and capital [19]. The character of a member is important to analyze his willingness to pay within schedule and the obligation to adhere to the agreed loan conditions is of considerable importance in credit evaluation in practice [20]. The financial officer or credit manager should judge whether the member will make lowest effort to honour their credit obligations [19]. Pandey, [20] also posits that the main factors from the borrower side include socio-economic characteristics such as, gender, educational level, marital status and household income level and peer pressure in group based schemes. The question is whether these socio-economic factors of the SACCO members may determine the non-performing loans in the SACCO.

The borrower's ability to repay is adversely effected under these conditions due to a reduction in disposable income of households [21]. Thus lenders such as SACCOs should avoid loans to risky members, monitor loan repayments and renegotiate loans when members get into difficulties [17]. The personal characteristics of the borrower such as age, their gross pay, sex, marital status among others may have effects on the performance of loans granted by SACCOs. The process of collecting information on the client for the purpose of determining credit worthiness as well as credit limits is very crucial and the loan officer should have specific information available which will guarantee that the data and figures provided by the client will have a pro-margin error [22].

STATEMENT OF THE PROBLEM

Lending institutions consider certain characteristics of potential borrowers before a loan is granted [23]. The SACCOs play important roles in economic development through resource mobilization by giving members loans on affordable terms, low interest rates, members guarantee, different types of loans, encouraging savings and members' welfare such as benevolent funds [12, 20, 24]. Issues of non-performing loans (NPLs) has faired prominence in the past decade and it is a critical issue for every financial institution to manage bad loans [25].

In Kenya, the SACCO sector contribute greatly to the financial industry and economy with over 45% to the country's GDP [7] and the SACCO deposits consists more than 78% of total deposits and assets of the industry [16]. Despite all the concerted efforts by SACCO's management to control lending, they still suffer from non-performing loans. The concern has been whether personal characteristics of members is responsible for these NPLs. Studies such as the one conducted by [26] focused on macroeconomic and bank specific factors influencing NPLs and at the same time several studies have been carried on the

cooperative movement and SACCOs so far; leadership [27], members' attitudes [28], financial challenges [29], financial mismanagement, [30], the relationship between risk management and the level of NPLs in Kenya [31], among others. This study varied considerably from the others studies already undertaken in Kenya in terms of area of study. In Kenya, no study has been done to establish factors influencing NPLs in SACCOs. Therefore, this study, sought to investigate factors influencing non-performing loans in Trans Elite County SACCO in Nandi County.

RESEARCH METHODOLOGY

The study employed descriptive research design. Descriptive research design was chosen because it enabled the researcher to generalise the findings to a larger population. The major purpose of descriptive research is to provide information on characteristics of a population or phenomenon [32]. The researcher made use of a case study. Robson as cited by Saunders *et al*, [33]; defines case study as a study for doing research which involves an empirical investigation of a particular contemporary phenomenon within its real life context using multiple sources of evidence. Descriptive design was used to obtain information concerning the current status of the phenomena and to describe what exists with respect to variables in a situation. The methods involved range from the survey, which describes the status quo, the correlation study that investigates the relationship between variables, [34]. Target population in statistics is the population from which information desired may be obtained from [34]. The study targeted a population of 5232. The researcher randomly sampled respondents represented 10% of the target population for the study for the case of members and 18 staff members giving 539 participants as observed by [35].

The research instrument for this study was self-administered structured questionnaire that were developed by the researcher. One advantage for using the questionnaire is that the questions for each category of respondents are framed the same way thus ensuring uniformity [36]. The questionnaires were represented by items of the Likert Scale and was piloted in one SACCO outside the county before the actual research and the data from the piloting was analysed to determine the reliability of the items in the questionnaire. This helped to avoid the spill over effect of the instruments to the proposed study area. The researcher took the questionnaires personally to the respondents and later collected them after they were duly filled.

RESULTS AND DISCUSSIONS

This study focused on the factors influencing non-performing loans in SACCOs in Kenya: A case of Trans Elite County SACCO. The SACCO operates at Kapsabet town in Nandi County. The study sought to establish the influence of member's personal

characteristics on non-performing loans in SACCOs. This was deduced from the reviewed literature that suggested that borrowers' personal characteristics affects loans making them to non-perform. Pandey, [20] was of the opinion that the main factors from the borrower's side which influence NPLs include socio-economic characteristics such as, gender, educational level, marital status and household income level and peer pressure in group based schemes. Some of these characteristics were used to measure the first variable of this study. Moreover, empirical work done by Arene [37] revealed that income, farm size, age of farmers, farming experience and level of education contributed positively to the credit worthiness of borrowers.

From the study, 22.13 percent and 37.74 percent of the respondents strongly agreed and agreed respectively that the age of borrowers in SACCOs has an effect on non-performing loans, while 10.09 percent and 17.59 percent strongly disagreed and disagreed respectively. 12.45 percent were of neutral opinion about the same statement. From the data on age of respondents, age is a critical aspect to be taken into account given the fact that 68 % (348) of respondents are below the age of 45 years and are presumed to borrow loans several times in future. Roslan & Abdikarim, [38] argued that older borrowers are wiser and more responsible than younger borrowers and therefore, age of a person can influence positively or negatively the repayment of loan depending on life cycle or the behaviors associated with certain age group.

The study respondents indicated that 22.53 percent and 63.24 percent agreed and strongly agreed respectively that personal monthly gross income levels of the borrower affects the non-performing loans in SACCOs, while 4.15 percent and 2.96 percent disagreed and strongly disagreed on the same question. Those of neutral opinion represented 7.12 percent. Koch & MacDonald [21] observed that the borrower's ability to repay is adversely effected under these conditions due to a reduction in disposable income of the households and further supported by Merritt, [39] who opined that most frequently cited causes of defaults were curtailment of income.

From the study, 12.65 percent and 42.69 percent strongly agreed and agreed respectively that employment issues such as interdiction influences the non-performance of loans advanced to members of a SACCO. 21.34 percent were of neutral opinion in relation to employment issues of members. However, 9.49 percent do strongly disagreed while 13.83 disagreed that employment issues affects NPLs in the SACCO. The borrower's ability to repay is adversely effected under these conditions due to a reduction in disposable income of the household [21]. Moreover, most causes of defaults were curtailment of income, excessive obligations, unemployment, illness of

principal mortgagor or family member, and marital difficulties [39].

Data analysis also indicated that, 28.46 percent and 10.68 percent of the respondents agreed and strongly agreed respectively that there are other socio-economic factors which influences the borrower's ability to repay loans in the SACCO leading to NPLs, while 13.04 percent and 18.18 percent strongly disagreed and disagreed respectively. A significant proportion of 29.64 percent were of the neutral response. The finding also concur with AMFI [19], that observed that the main characteristics that define a borrower's ability to repay the loan include character, capacity and capital commonly known as 3 C's and many financial institutions besides using other models of evaluating borrowers do make use of the 3 C's model. Moreover, Waweru & Kalani [40], opined that some of the causes of NPLs is reduced people's ability to purchase goods and services which is much related to employment issues of the borrowers and this was also echoed by Merritt [39].

To determine the relationship between personal characteristics of member and non-performing loans, the member's characteristics items were correlated with respondents' items pertaining to non-performing loans. A correlation test was performed and the null hypothesis tested at 0.05 level of significance. Hypothesis one tested the relationship between member's personal characteristics and non-performing loans to determine if there is any influence of the independent variable on the dependent variable. Pearson's Product Moment Correlation Coefficient test was used to test this relationship. The member's personal characteristics was correlated with the non-performing loans in SACCOs.

The hypothesis of the study tested was:

Ho: There is no statistically significant relationship between member's personal characteristics and non-performing loans in savings and credit cooperative societies in Kenya

The results indicated a moderately positive and significant correlation between member's personal characteristics and non-performing loans ($r = 0.567$, $p = 0.000$). This was tested at 95% confidence level. The null hypothesis that there is no relationship between members' personal characteristics and non-performing loans was therefore not supported and the alternative hypothesis supported. This meant that member's personal characteristics positively and significantly affected non-performing loans in SACCO. This indicates that member's personal characteristics were mostly likely to influence non-performing loans.

CONCLUSION

The aim of the study was to investigate the influence of members' personal characteristics on non-

performing loans in Savings and Credit Cooperative Societies in Kenya. Several items were used to test it and come out with findings. Age of the member is an important characteristic in understanding non-performing loans in SACCOs. From the study, 22.13 percent and 37.74 percent of the respondents strongly agreed and agreed respectively that the age of borrowers in SACCOs has an effect on non-performing loans. Also, the study found out that the gross salary of borrower affected the non-performing loans with 22.53 percent and 63.24 percent of respondents agreeing and strongly agreeing respectively. Moreover, 12.65 percent and 42.69 percent strongly agreed and agreed respectively that employment issues such as interdiction influences the non-performance of loans advanced to members of a SACCO. Concerning other socio-economic factors, 28.46 percent and 10.68 percent of the respondents agreed and strongly agreed respectively that it affects the borrower's ability to repay loans in the SACCO which may result to non-performing loans. It is evident therefore that personal characteristics of members who request for loans in a SACCO play a role in influencing the non-performance of the loan or otherwise.

RECOMMENDATIONS OF THE STUDY

1. The SACCOs should be diligent and strict during loan appraisal to ensure that only deserving applicants are given the loans with some high degree of assurance of not becoming non-performing loans.
2. Training of successful loan applicants should be considered by SACCOs to ensure that the funds will be utilized according to plans so as to generate some returns.

SUGGESTION FOR FURTHER STUDY

A study be done to investigate non-performing loans in other SACCOs not similar to the one studied such as Farmers' SACCOs.

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