

Effects of Debtors' Management on Financial Performance of Savings and Credit Cooperative Organizations in Nandi County, Kenya

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ABSTRACT

Savings and Credit Cooperative Organizations (SACCOs) are key components of the economy and social development. However, it's experiencing both internal and external issues that should be handled. The study attempted to identify the effects of business financial parameters on the performance of SACCOS in Nandi County. Specifically, the study investigated the effects of the management of loan debtors on the financial performance of SACCOs in Nandi County. The study was guided by liquidity preference theory, human capital theory, efficient structure theory, and Pecking order theory. The study used a descriptive research design to examine all the influences on financial performance. The target population was therefore all the ten SACCOs in Nandi County registered and licensed as of January 2023, where eighty-seven employees were randomly sampled to participate. The primary sources of data collection used in data collection were structured questionnaires as the main tool. Content validity was used to determine the validity, while Cronchbach's alpha coefficient was used to determine the reliability of the research instrument. The data was analyzed using both descriptive and inferential statistics. For descriptive statistics, tables and narratives were used, and for inferential statistics, correlations and regression analyses were used. The Statistical Package for Social Sciences software (SPSS) helped with data analysis. The study findings indicated that there was a positive and significant effect of loan debt management on the performance of SACCOs in Nandi County ($t = 9.833, P < 0.05$). The study recommended that Sacco management should maintain a credit policy manual to help in debt recovery and even avail the required resources needed for effective management of loan debtors.

Keywords: Financial Performance, Management of Loan Debtors, SACCOs

I. INTRODUCTION

The earliest cooperative in Kenya was created by white settlers in 1908 at Kipkelion. It was registered in accordance with the firms' regulations and intended to provide dairy and agricultural assistance to white settlers (Kobia, 2011). Subsequently, regulatory reforms have been implemented with the aim of enhancing the efficiency of Savings and Credit Cooperative Organizations (SACCO) operations in order to optimize profits for their members. Despite being faced with numerous obstacles, such as inadequate record keeping, loan backlogs, high illiteracy levels among SACCO members, audit arrears, administrative deficiencies, insufficient capital, and hefty taxation,

SACCOs amass contributions from their members to establish a collective fund, extend loans to their members at a reduced interest rate, distribute dividends on the shares held by each member, and provide interest on deposits. These services exhibit more appeal to individuals compared to obtaining loans through informal moneylenders and financial institutions. The tax rate on dividends derived from SACCOS in Kenya stands at 5%, and this rate is deemed final. In contrast, cooperative societies are subject to a withholding tax of 15%, which is not regarded as a final tax. Consequently, SACCOs appear more appealing than cooperative societies in terms of tax implications within the Kenyan context. Yashwant (2014) conducted a study on the impact of increased default rates in the corporate lending segment on nonperforming assets. The study found that several financial institutions have been identified as experiencing managerial failures due to their inability to effectively address the growing issue of nonperforming assets. Several commercial entities have expressed interest in restructuring their debt as a means to avoid potential consequences from banks due to non-payment of loans. The precise cause of the default remains

unclear; however, it is imperative for financial institutions to conduct a thorough investigation into its origins in order to effectively address and mitigate this issue. Moreover, according to the inspection report compiled by the SACCO Societies Regulatory Authority [SASRA] (2018), it was revealed that the underperformance of SACCOs in Kenya can be attributed to mismanagement, fraudulent activities, corrupt practices, and the utilization of creative accounting strategies to conceal their poor performance. As a result, several measures have been taken to address this issue, such as license revocations, Sacco deregistration, and the placement of certain SACCOs on a watch list.

The SACCO movement in Kenya is made up of 20% of the country's savings (Makori, et al., 2013). This shows that SACCOs are vital components in Kenya's economy and social development. However, inadequate capital has been a challenge facing SACCOs in Kenya (Chahayo, et al, 2013). Other challenges include loan default, assessment and management of risk, negative cash liquidity, poor governance, and poor investment decisions (Olando & Mbewa, 2012).

1.1 Statement of the Problem

According to the SASRA report of 2020, it has been observed that Sacco institutions in Kenya, despite their significant contribution to the socio-economic development of the country, have experienced a decline in financial performance over the past three years. This decline is reflected in an average growth rate of 5.23% in 2020. For instance, SASRA has canceled the licenses of three organizations, prohibiting them from receiving deposits. Three notable institutions in this context include Nandi Hekima, Miliki Sacco, and Sukari Sacco. The Nandi Hekima Savings and Credit Cooperative Organization (SACCO) serves as an indicator of the prevailing financial insufficiency within SACCOs operating in Nandi County. According to SASRA, the deregistration of the Saccos was deemed necessary due to the occurrence of business shrinkage in certain cases. The cause of this can be linked to inefficiencies in management. According to the SASRA report of 2021, the Metropolitan Sacco has garnered attention due to an increasing number of member complaints regarding its operations. The Sacco has faced difficulties in meeting the financial needs of its members, as evidenced by the suspension of dividend payments in 2021, indicating liquidity challenges. Furthermore, Sacco has been criticized for its failure to refund the entire share capital to exiting members as well as for the lengthy process involved in approving loans.

According to Miriti (2014), the majority of SACCOs in Kenya are presently recognized as prominent providers of cooperative credit for the purpose of fostering social and economic development. The extant SACCOs have encountered a diverse array of challenges, partially attributable to their focus on individuals with limited financial resources. An extensive study has been conducted on the challenges encountered by SACCOs in Kenya. This research has examined several aspects that influence the performance of SACCOs, including governance, educational attainment, and market risk. Few studies have been done on how the length of time it takes to process loans, how loan defaulters are handled, and the interest rate charged affect the success of SACCOs. The present study aims to examine the impact of the financial characteristics of firms on the performance of SACCOs in Nandi County, Kenya.

1.2 Objectives of the study

To establish effects of management of loan debtors on performance of SACCOs in Nandi County

1.3 Research Hypothesis

- i. H01: Management of loan debtors has no significant effect on performance of SACCOs in Nandi County.

II. LITERATURE REVIEW

2.1 Theoretical Literature Review

2.1.1 Liquidity preference Theory

In his renowned work, "The General Theory of Employment, Interest, and Money," Keynes (1936) formulated the liquidity preference theory as a response to the economic challenges posed by the Great Depression, characterized by continuous unemployment. This theory emerged as an alternative to the quantity theory of money, which failed to provide adequate solutions to the prevailing economic issues within society. The theory was founded on the premise that money serves as a financial asset within a portfolio, which can comprise either money or bonds. The researcher conducted more investigation into both the transaction and asset theories of money demand. The number 24 is the value being discussed. Keynes identified three distinct incentives for individuals to hold money: the transaction motive, the precautionary motive, and the speculative drive.

Calomiris et al, (2014) assert that the maintenance of cash reserves by banks serves the purpose of mitigating liquidity risk and serves as a prudential regulatory mechanism. Drawing inspiration from the Black-Scholes model, the theoretical framework posits that cash, in contrast to capital, is devoid of risk and can be readily observed and verified. Financial institutions employ the strategy of retaining cash as a means to both manage default risk and liquidity risk.

There exist multiple theories pertaining to liquidity, one of which is the liquid asset theory. This theory primarily emphasizes the asset aspect of the financial position and posits that financial institutions should maintain substantial quantities of liquid assets. The purpose of holding such assets is to provide a buffer against potential demands or payments, as well as to ensure the availability of readily marketable short-term liquid assets in the face of unforeseen circumstances. The aforementioned strategy is deemed to be financially burdensome within the contemporary context of a fluctuating money market (Ngwu, 2006).

The concept of shift ability states that in order to keep a bank solvent, it is necessary to have assets that can be easily traded for cash from other lenders or investors. The concept expands the definition of liquidity to include marketable securities. Based on the maturity structure of its loan and investment portfolios, Sacco's liquidity can be evaluated and managed according to the theory of anticipated income. Loans secured by real estate are predicted to have lower liquidity levels than short-term company and customer installment loans (Taye, 2014). The commercial loan theory posits that the liquidity of SACCOs can be ensured by holding assets in the form of short-term loans that can be easily liquidated as part of regular business operations. Additionally, by extending working capital loans, liquidity can be guaranteed since the inventory held by SACCOs will eventually be sold for cash.

Saunders and Cornette (2011) propose the implementation of prudent cash flow planning through the alignment of asset durations with the maturities of liabilities. In order for a company to maintain a positive cash flow, it is imperative that the maturity of its assets precede the maturity of its liabilities. According to the SASRA (2008), the SACCO Societies Act stipulates a requirement of 15%. The liquidity ratio is calculated by dividing the entire amount of cash and cash equivalents by the sum of short-term deposits and short-term liabilities. The ratio incentivizes SACCOs to maintain a high level of liquidity in order to effectively fulfill the daily financial needs of their members (Ruth, 2001).

According to Allen and Gale (2004), in situations when there are no financial shocks and the markets for aggregate risk are complete, they argue that there is no need for regulation as it cannot enhance the efficiency of the market equilibrium. In contrast to the findings presented in the literature by Farhi et al. (2009), the authors recommend the implementation of a liquidity requirement that pertains to the minimum or maximum level of liquidity holdings for a short asset held by an intermediary. The authors suggest a causal factor for market failure and externality, wherein intermediaries fail to internalize the extent of liquidity they offer to other intermediaries through the potential for private market transactions. Significantly, this externality persists even in the absence of collective shocks. This finding contradicts the findings of Holmstrom and Tirole (1998) as well as Allen and Gale (2004), who argue that government intervention in controlling liquidity is significant only in the presence of aggregate shocks.

According to Saunders and Cornet (2011), it is advisable to engage in sensible cash flow planning by aligning the maturities of assets and liabilities. In order to mitigate risk, it is imperative for organizations to maintain a positive cash flow and ensure that the maturity of their assets precedes the maturity of their liabilities. The SASRA Act promotes the implementation of a liquidity ratio of 15%. Divide the total amount of cash and cash equivalents by the sum of short-term deposits and short-term obligations to arrive at this ratio. The SASRA (2008) recommends that SACCOs keep a lot of cash on hand so that they can meet their financial commitments to their customers. This study examines the relevance of a certain theory for guiding SACCOs. The theory under consideration provides insights into the level of indebtedness experienced by SACCOs, distinguishing between heavy and light debt burdens. Additionally, it sheds light on the financial trajectory of these organizations, determining if their financial status is improving or not.

Baumol and Tobin (1958) elaborated on the liquidity preference. According to Saunders and Cornette (2011), the hypothesis was bolstered by advocating for the judicious management of cash flows through the alignment of asset and liability maturities. In order to mitigate risk, it is imperative for organizations to maintain a positive cash flow and ensure that the maturity of their assets precedes the maturity of their liabilities. The SASRA Act promotes the implementation of a liquidity ratio of 15%. This ratio is calculated by dividing the total cash and cash equivalents by the sum of short-term deposits and short-term liabilities. According to the Government of Kenya (2008), SACCOs are encouraged to maintain a high level of liquidity in order to fulfill their obligations to their members. This study examines the relevance of the theory in guiding SACCOs by assessing their level of indebtedness, determining the severity of the debt burden, and evaluating the progress of their financial status. Hence, this theory pertains to the

relationship between capital interest rates and the management of loan debtors’ variables, which will be employed by the researcher in the course of the study.

2.2 Conceptual Framework

2.2.1 Management of Loan Debtors

A loan defaulter refers to an individual or entity that fails to fulfill their loan repayment obligations to a financial institution. Loan default incurs costs for the lender, irrespective of whether the loan was insured against default or not. In the event that the loan is insured, the insurance premium represents a financial burden for the Savings and Credit Cooperative (SACCO). Conversely, if the loan is not protected, the organization faces the risk of losing the defaulted amount. Debt collection is a costly endeavor that necessitates the engagement of a professional debt collector. If a financial institution is capable of effectively mitigating or significantly reducing default rates, it can ensure the long-term viability of its financial services. SACCOS has chosen to conduct periodic training sessions and counseling sessions for their borrowers in order to ensure their continued adherence to repayment obligations.

The implementation of comprehensive training for loan applicants is important prior to loan disbursement and thus should be regarded as a prerequisite for loan eligibility. Loan default is not a common occurrence in developed nations such as Germany, primarily due to the effective mechanisms employed to regulate and oversee loan default. The organization provides debt management advice to their clientele, who possess many loans from various service suppliers. The organization provides borrowers with training, guidance, and counseling services to support their continued adherence to the repayment process (Hartarska, 2005).

When assessing a member's loan application, the SACCOS management seeks to determine the likelihood of loan repayment and the potential for earning profit from the member's borrowed funds. Prior to granting a loan application, financial institutions must assess the business's ability to repay the loan, along with the accrued interest, within the specified time frame in order to mitigate the risk of loan default. The process of debt collection incurs significant costs, hence constituting an expenditure for the financial institution. Banks engage in a comprehensive evaluation of a client's financial capacity, encompassing an assessment of their ability to repay loans. Additionally, banks seek to ascertain the level of risk associated with a client's business, as this information informs the bank's potential exposure to financial losses.

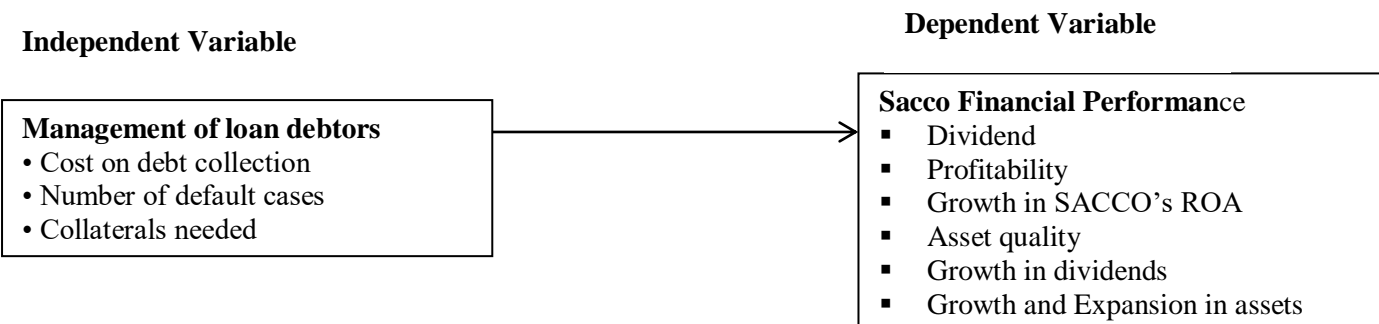


Figure 1

Conceptual Framework for the Effects of debtors’ management on Financial Performance of SACCOS in Nandi County, Kenya

2.3 Empirical Review

The act of failing to fulfill financial obligations is a significant issue that should be diligently avoided. In many instances, the act of defaulting on payments can be attributed to temporary circumstances, such as the debtor experiencing a loss of employment, encountering an unforeseen and temporary increase in expenditures that deplete their available funds, or enduring an extended period of illness that leads to financial difficulties or an extended hospital stay. In a limited number of instances, customers may default on their obligations due to the occurrence of permanent failure or the sudden demise of an uninsured individual who lacked sufficient financial means to support their family. Temporary reasons can be effectively addressed by the implementation of rigorous oversight and the systematic assessment of projects funded by the loan (Hartarska, 2005).

Defaulting on payment is a legitimate transgression that should be diligently avoided at all costs. Defaulting on installments is typically a temporary occurrence that can be attributed to various factors, such as the loss of

employment by customers, a temporary increase in expenses that leaves them with insufficient funds to make the repayment, or a prolonged illness that may result in financial distress or hospitalization for a few months. In exceedingly rare instances, individuals may experience default due to the permanent failure or unexpected demise of an individual who lacked sufficient protection or assets to provide for their family. Transitory causes can be effectively monitored through diligent supervision and meticulous observation and evaluation of the actions funded by the credit. Thorough preparation by a credit applicant is crucial prior to making a loan payment. In developed countries such as Germany, credit defaults are not solely attributable to the mechanisms employed for managing and supervising loan defaults. The company provides credit management advice to its customers, who have diverse loans from various financial institutions. They provide assistance, coaching, and counseling to debtors in order to ensure their adherence to the repayment plan. Effective management of defaults requires a well-designed plan (Hayes, 2022).

III. METHODOLOGY

The present study employed a descriptive research design to address the research questions (Kothari, 2009). This descriptive design primarily adopted a quantitative approach. In this study, the population referred to the entirety of individuals meeting specific criteria (Mugenda & Mugenda, 2003). Consequently, the population consisted of 112 employees selected from all ten SACCOs within Nandi County.

To establish a representative sample, a simple random sampling method was employed, guided by the formulas developed by Krejcie and Morgan in 1970. The sample comprised all CEOs, accountants, credit managers, and executive board members of the ten SACCOs located in Nandi County that were operational as of January 1, 2023.

Primary data was collected from randomly selected respondents, with the main data collection tool being questionnaires employing a 5-point Likert scale. The data collected were descriptively and inferentially analyzed. The questionnaire responses were instrumental in providing insights into the influence of debtors' management on the performance of SACCOs in Nandi County, Kenya.

IV. FINDINGS

4.1 Normality Test

Ghasemi and Zahedias (2012), in their paper on normality tests for statistical analysis, recommend that normality be assessed visually. With large samples (<30 or 40), the violation of the normality assumption should not cause major problems (Oztuna et al., 2006). Thus, we can use parametric procedures, as in large samples (<30 or 40), the sampling distribution tends to be normal regardless of the shape of the data.

Table 1 Normality Test

	Kolmogorov-Smirnov ^a			Shapiro-Wilk		
	Statistic	df	Sig.	Statistic	Df	Sig.
Management of loan debtors	.213	82	.000	.755	82	.000
Performance of the SACCOs	.284	82	.000	.666	82	.000

a. Lilliefors Significance Correction

Based on the figure below the normal Q-Q plot of the management of loan debtors, the departure from normality was not as much as the approximation to the line of fit. Thus, the data had a near-normal distribution and could hence be used in a regression analysis. Based on the Q-Q plot depicted in Figure 1 shown below, it can be observed that the deviation from normality was rather minimal in comparison to the proximity to the line of best fit. Therefore, the data had a distribution that closely approximated a normal distribution, making it suitable for utilization in a regression analysis.

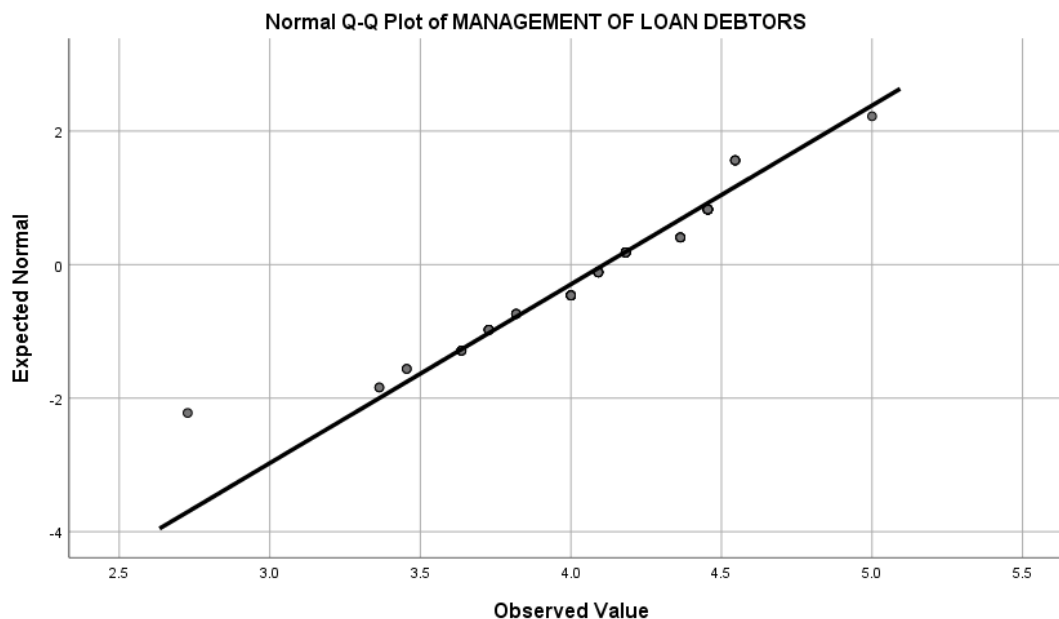


Figure 1
Normal Q-Q plot of Management of Loan Debtors

4.2 Pearson Correlation Analysis

The correlation coefficient (r) results are presented as shown in Table 2 below using Pearson correlation analysis, which computes the direction (positive or negative) and the strength (ranging from -1 to +1) of the relationship between two continuous or ratio/scale variables.

Table 2
Multiple Correlation Matrix

		MLD	FP
MLD: Management of Loan Debtors	Pearson Correlation	1	
	Sig. (2-tailed)		
	N	82	
	Sig. (2-tailed)	.000	
FP: Performance	Pearson Correlation	.740**	1
	Sig. (2-tailed)	.000	
	N	82	82

From the correlation Table 2, management of loan debtors is positively correlated to performance; the coefficient is 0.740 (p value < 0.05), which is significant at the 95% confidence level. Thus, an increase in the management of loan debtors would also cause the performance of SACCOs in Nandi County to increase. This is consistent with Mulema et al. (2017), who studied the relationship between debtors’ management and financial performance in microfinance institutions and concluded that there is a positive relationship but that there are other factors affecting the performance levels of the microfinance institutions.

4.3 Regression analysis

A regression analysis was done to establish the effects of the management of loan debtors on the performance of SACCOs in Nandi County. Results are presented in Table 3.

Table 3*Model Summary and ANOVA for Management of loan debtors*

Model	R	R ²	Adj R ²	Std. Error of the Estimate
1	.740 ^a	.547	.542	.606704

a. Predictors: (Constant), Management of loan debtors

From Table 3, the R square, which is the coefficient of determination, shows that up to 54.7% of the variation in performance is significantly accounted for by the management of loan debtors ($R^2 = 0.547$, $P = 0.000$). This indicates that the management of loan debtors has a significant effect on performance. Thus, more favorable credit terms had a significant relationship with the performance of SACCOs.

Table 4*ANOVA*

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	35.587	1	35.587	96.679	.000 ^b
	Residual	29.447	80	.368		
	Total	65.034	81			

a. Dependent Variable: Performance of the SACCOs

b. Predictors: (Constant), Management of Loan Debtors

The F test gave a value of $(1, 81) = 96.679$, $P < 0.05$, which supports the goodness of fit of the model in explaining the variation in the dependent variable as indicated in Table 4. It also means that the management of loan debtors is a useful predictor of performance.

Table 5*Regression Coefficient for Management of Loan Debtors*

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.241	.395		.609	.544
	Management of loan debtors	.960	.098	.740	9.833	.000

a. Dependent Variable: Performance

From Table 5, the unstandardized regression coefficient (β) value of management of loan debtors was 0.960 and the significance level was $p < .05$. This indicated that a unit change in the management of loan debtors would result in a change in performance of 0.960 in the same direction. The regression equation to estimate the performance of SACCOs in Nandi County because of the management of loan debtors is hence stated as:

$$\text{Performance} = 0.241 + 0.960 * \text{Management of Loan Debtors} + 0.395$$

From the results, it is evident that the management of loan debtors has a significant positive influence on the performance of SACCOs in Nandi County. The inferential results revealed that there is a direct relationship between the management of loan debtors and performance ($R = 0.740$, $P = 0.000$). This implies that an increase in the management of loan debtors would result in an increase in their performance. The coefficient of determination through the R square indicated that up to 54.7% of the change in performance is significantly accounted for by the management of loan debtors ($R^2 = 0.547$, $P = 0.000$). This implies that the management of loan debtors is a significant predictor of SACCOs performance in Nandi County. When interest rate charges and capital adequacy are controlled, a unit increase in the management of loan debtors will result in a significant increase in performance by 0.566 units ($\beta_1 = 0.566$, $P = 0.000$). Therefore, the study failed to accept the first null hypothesis, which is: H_{01} : Management of loan debtors has no significant effect on the performance of SACCOs in Nandi County.

V. CONCLUSIONS & RECOMMENDATIONS

4.1 Conclusion

It is evident that SACCOs in Nandi County maintained a credit policy manual to help in debt recovery and they have established internal guidelines to approve and review counterparty credit limits. Besides, they considered client credit history and character during the credit appraisal. These have resulted in a significant improvement in the performance of SACCOs in Nandi County. Therefore, the study concluded that the management of loan debtors has a significant effect on the performance of SACCOs in Nandi County.

4.2 Recommendations

The study recommended that Sacco management maintain a credit policy manual to help in debt recovery. Further, management should avail itself of the required resources needed for effective management of loan debtors. This includes competent and motivated staff and efficient information systems to make data processing quicker and more accurate, which will also improve the process of debt collection and ensure that their objectives and goals are met without constraints.

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