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The Influence of Loan Default on Growth of Deposit Taking SACCOs in Nairobi County

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Abstract: *The cooperative sector plays a crucial role in country's socio-economic development significantly contributing to Nation's Gross Domestic Product. SACCOs play an increasingly important role in Kenya's financial sector, serving a growing number of both urban and rural poor households. The objective of this study was to establish the influence of loan default on the growth of deposit taking SACCOs in Nairobi County. Management face the challenge to grow profits and such comes with increased risks. In SACCOs the major activity that grows the income is loan disbursement and recoveries thus the growth of SACCOs is influenced by loan default. The study adopted descriptive research design in which the data was gathered just once over the period 2013 to 2015 to build a strong case on the topic of study. The main characteristic of this method is that the researcher has no control over the variables; he can only report what has happened or what is happening. In this research 41 deposit taking SACCOs in Nairobi County were studied in order to establish the factors that influence their growth. All the deposit taking SACCOs in Nairobi County were covered, no element of chance was left and highest accuracy was obtained. When the universe is a small one, it is no use resorting to a sample survey. The data collection method used is questionnaire however a pilot study was conducted to test its reliability and validity. The data collected was analysed using SPSS to ensure it is accurately evaluated and presented. The researcher concluded that retrenchment, employer delays in submission of deductions are the major causes of crawling growth of income in SACCOs as they contributed to loan default.*

Keywords: *Loan, Loan Default, Growth, Member, SACCOs*

I. INTRODUCTION

In Kenya, the history of cooperatives dates back to 1908 and has continued to grow since then. The first co-operative society was established in Kenya in 1908 that is a dairy Co-operative. The Government's first formal involvement in Cooperatives was in 1931when the first Co-operative ordinance was enacted to regulate the operations of co-operatives. Examples of cooperatives then were Kenya Co-operative Creameries (KCC) in 1925, Kenya Planters Co-operative Union (KPCU) in 1923 and Kenya Farmers Association (KFA) in 1923. These organizations were originally registered as companies and only became registered as co-operatives in 1931 when the first Co-operative ordinance was promulgated (Gatuguta *et al.*, 2014).The co-operative sector has been growing since then especially in the rural areas due to agricultural activities whereas in the urban areas they arise due to people working mainly under same employer or industry. The SACCOs in Kenya are confronted by myriad challenges that include poor record keeping, loan backlogs, high illiteracy level among the SACCO members, audit arrears, managerial deficiency, inadequate capital and heavy taxation. A study by WOCCU (2008) revealed that SACCOs are facing severe liquidity problems and majority are unable to meet the demands of their clients for loans and withdrawal of savings. Ondieki *et al.*, (2011) contend that inadequate managerial skills and knowledge have adversely affected SACCOs in Kenya.

II. HEADINGS

Financial institution's role in the economy of any country is very significant, they play intermediation function in that they collect money from those who have excess and lend it to others for their investment and other needs. Lending is risky in that repayment of the loans is not guaranteed and at times depends on other factors not in the control of the borrower such as economic crisis. The chance that a microfinance institution

(MFI) may not receive its money back from borrowers together with interest is the most common and often the most serious vulnerability in a microfinance institution (Warue, 2012). Therefore, managing loans portfolio in a proper way has a positive effect on the SACCO's performance, to the borrower and a country's economy as a whole. High default rate in SACCOs is a major concern to policy makers in developing countries, because of its unintended negative impacts on their performance. Most loans in SACCOs are unsecured, thus delinquency can quickly spread from a handful of loans to a significant portion of the portfolio. In SACCOs members are exposed to the same external threats such as lack of demand for clients' products, livestock and disease outbreak, bad weather and many others. These factors create volatility in loan portfolio quality, heightening importance of controlling credit risk. SACCOs therefore need a monitoring system that highlights repayment problems clearly and quickly, so that loan officers and their supervisors can focus on delinquency continuously. In lending services, a default is the failure to pay back a loan (Maina *et al.*, 2014). The sustainability of a SACCO depends largely on their ability to collect their loans as efficiently and effectively as possible. Therefore to be financially viable or sustainable, financial institutions must ensure high portfolio quality based on 100% repayment, or at worst low delinquency, cost effective recovery and efficient lending (Maina *et al.*, 2014). The recovery of the loans influences the cash flow in SACCOs either positively or negatively. Profitability is computed as the return on company's total assets. The pecking-order theory suggests that highly profitable companies tend to reduce their external funding, which at the end signals to the creditors that they have low bankruptcy risk (Sheik *et al*., 2011).

III. LITERATURE REVIEW

The researcher used two main theories that are relevant to this study; these are the Bounded rationality theory and Agency theory. In 1940s and 1950s Simon developed a model choice intended as a challenge to the comprehensive rationality assumptions used in economics. The model first appeared in print in Administrative Behavior (1947), which critiqued existing theories of public administration and proposed a new approach for the study of organizational decision making. Bounded rationality is distinguished from rationality as, the perfect human rationality that is assumed in classical and neoclassical economic theory and the reality of human behaviour as it is observed in economic life. The agency relationship can be said to occur whenever one party depends on the actions of another party. An agency relationship is defined as a contract under which one or more persons that is the principal engages another person who is the agent to perform some service on their behalf which involves delegating some decision making authority to the agent. The BODs act on behalf of the SACCO's shareholders, but they may not meet the shareholders expectation due to personal and political interest. They may lack perfect knowledge in areas like finance and credit thus driving the SACCO to the wrong investment and credit decisions. The SACCOs' staff manages member's funds by disbursing loans and ensuring recovery, however sometimes loans disbursed may not be fully recovered.

2.1 Conceptual Framework

Independent Variables		Dependent Variable
Loan Defaulting -Employee income -Job stability	→	**Growth of Deposit Taking Saccos** -Profit -Turnover

Independent Variables **Dependent Variable**

Fig 1 Conceptual Framework

A loan default occurs when the borrower does not make required payments or in some other way does not comply with the terms of a loan (Murray, 2011). A loan is delinquent when a payment is late or the chances of recovery are minimal. Delinquency is measured because it indicates an increased risk of loss, warning of operational problems and helps to predict how much of the loan portfolio will be lost by the lender. The loan default in a SACCO is influenced by the members' ability to pay, as a result of the income earned by the borrower. In addition job stability and the character of the borrower influence the possibility of recovery. If the borrower repays the loan within the check off, recovery is controlled. Once SACCO members leave their job or are retrenched they tend to default. A defaulted loan is a cost to SACCOs in terms of forgone interest, delayed interest, high recovery cost and finance cost associated with external borrowing. It is generally observed that credit which is put to productive use, results in good returns thus the consideration of loan defaultage affecting the growth of SACCOs. Mwaura (2005) insists that lack of credit follow up, credit analysis and hostile lending of money are some of the factors that have contributed to financial gap and poor performance. Most of the

SACCOs' income is from loan disbursement. When loan repayments are delayed and defaults arise, loan disbursement is affected, expenses accrue and in the long term services dwindle.

IV. RESEARCH METHODOLOGY

A research design is a plan, structure and strategy of investigation to obtain answers to research questions and control variance (Ogula, 2005). Therefore research designs are invented to enable answering the research questions as validly, objectively, accurately and as economically as possible. Descriptive research was used in this study as it is concerned with describing the characteristics of a particular individual, or of a group. The research design make enough provision for protection against bias and maximise reliability, with due concern for the economical completion of the research study. Descriptive research includes surveys and fact-finding enquiries of different kinds. The major purpose of descriptive research is description of the state of affairs as it exists at present (Kothari, 2009). This method of investigation allowed the researcher to examine issues that relate to growth of deposit taking SACCOs, collect and analyze data in order to describe the phenomenon in its current status. The number of deposit taking SACCOs with head office in Nairobi were 41, thus census was used to study all units of the population because the universe is small. The questionnaires were used to collect data from managers; considering they have access to all the data in the SACCOs. Pilot survey is the replica and rehearsal of the main survey. The researcher measured the reliability and validity of the questionnaire to determine its consistency in testing what they are intended to measure. The pre-test technique was used to estimate the reliability of the instruments.

1. Research Findings

4.1 Demographic Characteristics of Respondents

The data was then analysed using descriptive and inferential statistical measures as follows. From the data collected the total actual response percentage was 73.2% while the remaining 26.8% had not yet returned their questionnaires due to time factor. The respondents were asked about their position and level of experience in their Sacco. The aim of this question was to determine the distribution of the respondents according to their departments in order to ensure that the information given was from the right respondents. 56.7% of the respondents were Accountants, 16.7% Chief Executive Officers (CEOs), 10% Credit managers, 10% Human resources managers and 6.6% marketing managers. The respondents held practical positions and had adequate information regarding their SACCOs. The position of the respondents is per the Fig. 2 below.

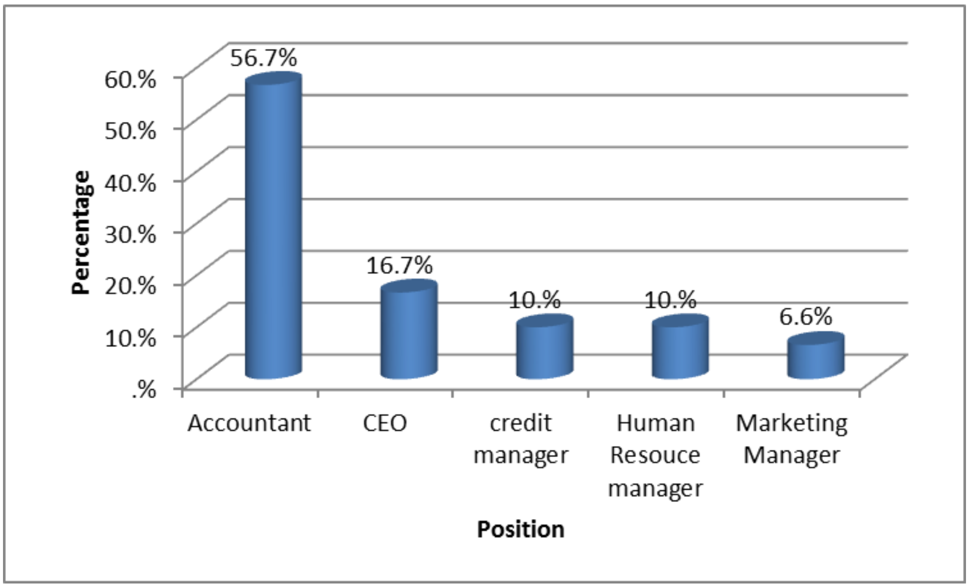

Figure 2: Position of Respondents

The respondents were asked on the number of years they had worked in their respective SACCOs to assess viability of the information given. 63.34% of the respondents had worked in their SACCOs for a at most 5 years while, 20% of the respondents had worked for 6 to 10 years, 13.33% of the respondents had worked for 16 to 20years, while 3.33% of the respondents had worked for at least 21 years. This is presented on Table 1 below.

Table 1: Years worked in the SACCO

Number of Years Worked	Frequency	Percentage
5 and below	19	63.34
6-10	6	20.00
11-15	0	0
16-20	4	13.33
21 and above	1	3.33
Total	**30**	**100**

The deposit taking SACCOs derive members from government, private, Non-governmental organizations and the informal sector, thus data collected was spread across different types of SACCOs. The number of members reflects the SACCOs growth in recruitment in addition to its stability. The findings on the number of members in various SACCOs are as presented on Table 2 below.

Table 2: Membership of SACCOs

Range of Members	Frequency	Percentage
1-20000	23	76.7
20001-40000	3	10
40001-60000	1	3.3
60001-80000	2	6.7
80001 and above	1	3.3
Total	**30**	**100**

4.2 Descriptive Statistics

The respondents were asked on the loan portfolio in their respective SACCOs in order to assess the level of credit they had disbursed to their members. 6.7%, 3.3% and 3.3% of the SACCOs had a loan portfolio below 100M, in years 2013, 2014 and 2015 respectively. 33.3%, 16.7% and 16.7% of the SACCOs had a loan portfolio of 100M to 500M in years 2013, 2014 and 2015 respectively. Adding to that 36.7% of the SACCOs had a loan portfolio of 500M to1B in all the 3years. Finally 23.3%, 43.3% and 43.3% of the SACCOs had a loan portfolio above 1B in years 2013, 2014 and 2015 respectively. The findings are presented on the Fig. 3 below:

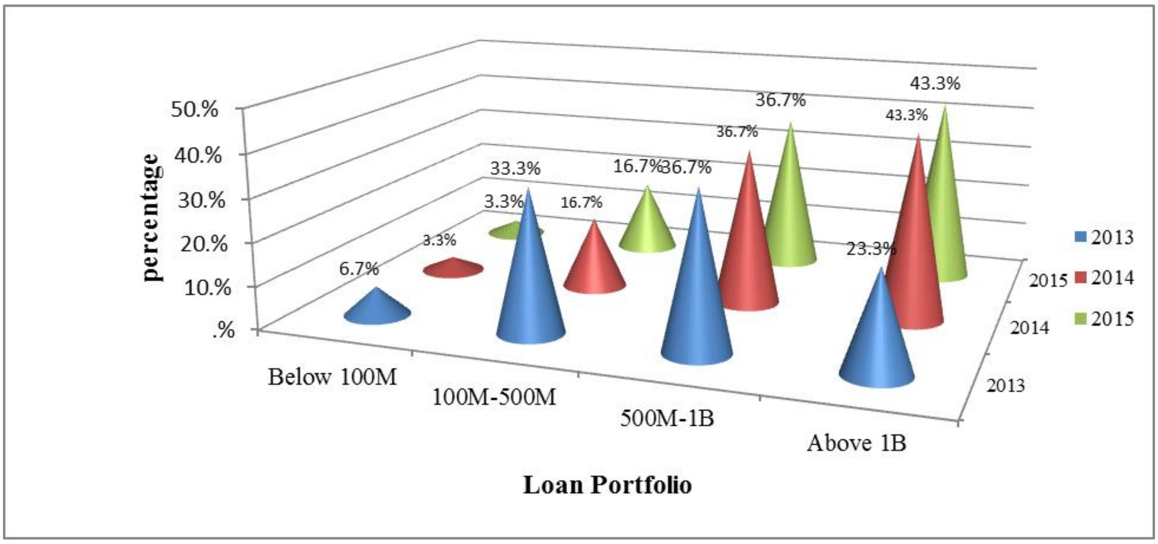

Figure 3: Loan Portfolio

During the 3 years under review 3.3% of the SACCOs had their loans perform at 50%. While SACCOs with 60% performance level were 30%, 13.3% and 10% in years 2013, 2014 and 2015 respectively. In addition to that SACCOs with loans performing at 70 % were 30%, 20% and 6.7% in 2013, 2014 and 2015 respectively. In year 2013, 3.3% of the SACCOs had loans performing at 80%, which increased in 2014 and reduced in 2015 with 26.7% and 16.7% respectively. Finally in 2013, 33.3% of the SACCOs had performing loans at 90%, which improved in year 2014 and 2015 with 36.7% and 63.7% respectively. The findings are presented on Fig. 4 below:

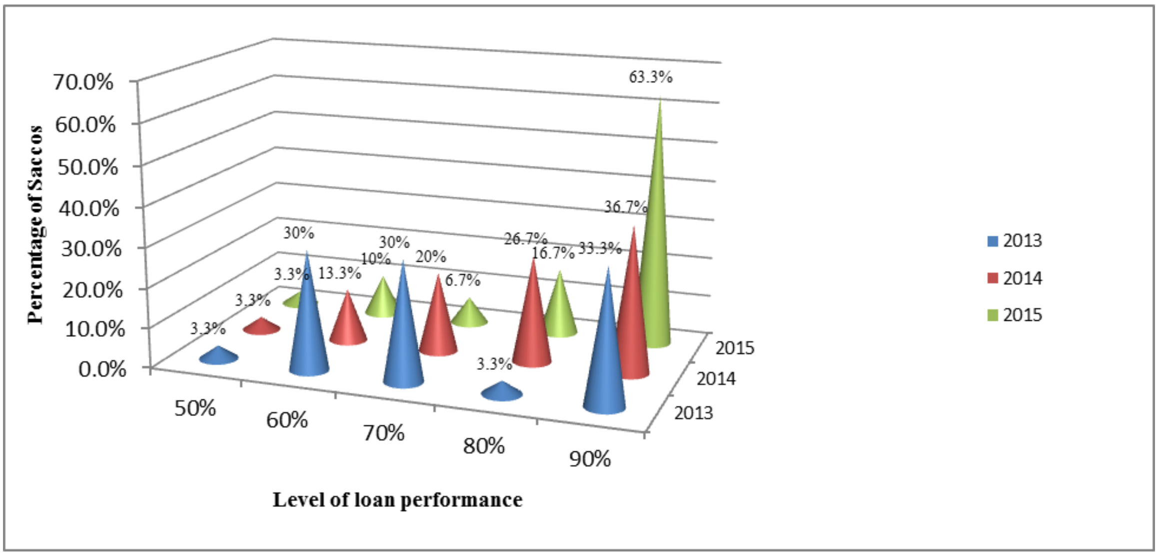

Fig. 4 Loan Performance

According to the findings, the respondents agreed that loan default affect the growth of income in the SACCOs. Moreover the interest rates, number of members and loan portfolio had improved over the years under review. This means that there was a general growth in the deposit taking SACCOs in Nairobi County. The growth in the number of members improved the cash flow and loan portfolio; in the long run the stability of the SACCOs was improved. Increased loan portfolio contributes to growth of income as long as the debts are collected efficiently due to improved cash flows. Improvement in lending rates on the loan products grows the level of income.

Table 3: Loan default and Growth of SACCOs

Statement	Mean	Std. Deviation
Loan default has influenced the growth of income for the SACCO	3.3000	0.70221
The interest rates have increased	3.3333	1.32179
The Loan portfolio has grown for the last three years	4.0000	1.28654
The SACCO has had increase in the Number of members for the last 3 years	4.0667	.94443

4.3 Regression Analysis

The regression analysis for loan default in relation to the Growth of Deposit taking SACCOs in Nairobi County showed a strong relationship between the loan default and the growth of the SACCOs in Nairobi County. The results were computed at 95% confidence level and are summarized and presented in table 4 below.

Table 4: Loan default in relation to the profits of deposit Taking SACCOs in Nairobi County

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.755[a]	0.57	0.502	1.559
a. Predictors: (Constant), Employee income, Job stability				

b. Dependent Variable: Profit

The coefficient of determination was found to be 0.57. This means 57% variability of loan default attributed to growth of profits of the deposit taking SACCOs in Nairobi County. The other variation of 43% is explained by changes in other factors.

The coefficient correlation of 0.755 shows that there is a strong relationship between loan default and growth of the deposit taking SACCOs in relation to the profits of Deposit taking SACCOs in Nairobi County.

Table 5: Loan default in relation to the Turnover of deposit Taking SACCOs in Nairobi County

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.498[a]	0.248	0.128	2.895
a. Predictors: (Constant), Employee income, Job stability				
b. Dependent Variable: Turnover				

The coefficient of determination was found to be 0.248. This indicated 24.8% variability in loan default attributed to the turnover of deposit taking SACCOs in Nairobi County. The other 75.2% is explained by variation of other factors.

The R value of 0.498 shows that there is a moderate relationship between loan default and growth of the deposit taking SACCOs in relation to the turnover of the deposit taking SACCOs in Nairobi County.

4.4 Findings

4.4.1 Loan Default and Growth of SACCOs

The study found that loan default influence the growth of SACCOs in a significant way, as it reduces the income generated in certain period. In addition the loan recovery of the SACCOs had improved hence the growth in income and overall performance. Thus the higher the default rate the lower the income of a SACCO while the lower the default rate the higher the income. The researcher concluded that for SACCOs to grow they should have stringent measures during loan disbursement and debt collection. The researcher established that loss of jobs was the major cause of loan default in the formal sector while in the informal sector loss of businesses was the major cause of loan default. Improvement in performing loans was attributed to quality loan assessment and stringent recovery measures by the deposit taking SACCOs. SACCOs have registered with Credit Reference Bureau (CRB) which enhances members' loan repayment due to the track of their credit records. Quality loan recovery leads to growth of profits and overall growth of the SACCO. The growth in the loan portfolio reflects the increased demand for the loan products by the members in various SACCOs.

V. CONCLUSION

Improvement in performing loans was attributed to quality loan assessment and stringent recovery measures by the deposit taking SACCOs. SACCOs have registered with Credit Reference Bureau (CRB) which enhances members' loan repayment due to the track of their credit records. Quality loan recovery leads to growth of profits and overall growth of the SACCO. The study revealed that loan default has a great influence to the growth of Deposit taking SACCOs. The growth in the loan portfolio contributes to increase of the SACCO's income leading to the general growth of the SACCO sector if the loan recovery measures are stringent. The researcher concluded that retrenchment, employer delays in submission of deductions are the major causes of crawling growth of income in SACCOs as they contributed to loan default. SACCOs need to be more innovative in debt collection measures, maintaining sufficient cash flow and continuous training on investment to both the staff and BODs. Management of loan portfolio has proved to be the cornerstone of financial organisations and SACCOs being one they cannot survive without securing loans disbursed in addition to stringent debt collection measures. The research study will be relevant to the policy makers, SACCOs and researchers to the betterment of the SACCO sector management. The researcher recommends that the SACCOs should manage their loan portfolio to ensure they are performing in order to grow. The employers should make timely remittance to the SACCOs because it affects the loan performance and cash-flow as well.

VI. RECOMMENDATION

SACCOs need to be more innovative in debt collection measures, maintaining sufficient cash flow and continuous training on investment to both the staff and BODs. The researcher recommends that the SACCOs should manage their loan portfolio to ensure they are performing in order to grow. The employers should make timely remittance to the SACCOs because it affects the loan performance and cash-flow as well. Further research can be done to evaluate the influence of SASRA regulation on growth of deposit taking SACCOs. Study on the performance of SACCOs with members from formal and informal can be done so as to evaluate the risks involved in each category especially on loan recovery.

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