
INTERNATIONAL JOURNAL OF SCIENCE ARTS AND COMMERCE

EFFECT OF CREDIT POLICY ON FINANCIAL PERFORMANCE OF DEPOSIT TAKING SAVINGS AND CREDIT COOPERATIVE ORGANIZATIONS IN KENYA

***Michael Oucho**

****Fredrick Ogilo**

*MBA Student University of Nairobi

**Lecturer University of Nairobi Faculty of Business and Management Science

ABSTRACT

This study sought to determine the effect of credit policy on financial performance of deposit taking Savings and Credit Cooperative Organizations in Kenya. Key determinants of SACCO financial performance reviewed in this study were credit collection, loan policy, credit monitoring and insider trading. The study used descriptive research design and a target population of 175 SACCOs registered under SASRA. The study adopted all SACCOs in the study through a census method. Data collected was analyzed using descriptive and inferential statistics through multi-linear regression model. The study established that; Loan policy had a positive significant relationship with financial performance of deposit taking SACCOs in Kenya although its correlation with financial performance was found to be weak. Secondly, credit collection had a positive and significant influence on financial performance of deposit taking Savings and Credit Cooperative organizations in Kenya, however, it had a weak positive correlation with financial performance. Furthermore, credit monitoring had a positive and significant influence on financial performance of deposit taking Savings and Credit Cooperative Organizations in Kenya, it's correlation with financial performance was found to be weak but positive. Finally, insider trading had a positive and significant influence on financial performance of deposit taking Savings and Credit Cooperative organizations in Kenya. However, the study established a weak positive correlation between insider trading and financial performance.

Key words: SACCO; SASRA; Cooperative organizations; Financial performance

1.0 INTRODUCTION

The management of credit risk in financial institutions is a key function to ensure that loan portfolio is well maintained and borrowers at minimum point fail to repay their loans which allows the financial institution to offer more credit to new clients (Mamari, Al- Ghassani & Ahmed, 2022). Poor credit policy can lead to collapse of a financial institution as loaning and interest rates form a large part of income sources for financial institutions. Financial performance is the magnitude at which a firm has achieved or will achieve its financial objectives. Every financial organization has in place a set of rules and regulations on how credit is offered and recovered from clients, however, the application of such rules vary from one organization to the other (Mohamed, Njuguna & Maende, 2022). With time the practices have been reframed to fit in the current business environment. Most financial institutions relax their credit management measures to attract more clients to the portfolio and this has been cited as a major contributor to financial improvement (Orichom & Omeke, 2021).

Credit policy form part of the strategies and decisions adopted by management in ensuring that credit levels in firms are acceptable at all the time. Such strategies include, credit rating assessment, monitoring, invoicing, customer management and risk mitigation (Paul & Musiega, 2020). There are two common methods used in measuring credit risk that, one is based on absolute position in credit risk and the other based on expected rate of default on credit claims (Alfatlah, Othman, Basiruddin & Almagtome, 2022). In the first approach, the financial institution extends a credit facility to a borrower and monitors their pay before and determine whether they are able to pay or not, by end of the financial year the manager assess the exposure of the firm to defaults and adopts strategies to recover unpaid money. In the second approach, a financial institution assesses the ability of a borrower using available tools in order to find their capability to repay and probability that the borrower will default on payment (Saghir & Tabassam, 2020). For this study credit policy was measured through, collaterals, guarantors, policies, compliance, delinquency Management, Portfolio monitoring and compliance assessment.

Organization financial position is determined by two major factors, financial institutions related factors and the macro-economic factors (Mwaniki, 2018). Better financial position of a firm can be realized with increased returns from investments, minimal wastages, tax relief and increased sales over a given financial year (Njenga & Jagongo, 2019). Good financial performance can determine the competitive edge of a firm in a sector such as the financial sector which has many new players coming into the foray every year. Financial performance highly dependent on client monthly deposits, savings, shares traded and interest earned from loan facilities advanced to its clients (Otwoko, Maina, & Kwasira, 2021).

To determine the financial performance of an organization, simply looking at the earnings per share isn't quite enough (Al-Rahahleh, Bhatti & Misman, 2019). It's also important to know how efficiently a firm is using its assets and equity to generate profits. At the end of every financial year, firm accountants and finance officials prepare financial statements that reflect the financial

position of a firm. The most notable measures used in organization to assess financial performance are Return on assets, return on Equity, Return on Investments and Net interest margins. The study used ROA, this measure gave a clear financial position of deposit taking Savings and Credit Cooperative Organizations in relation to how they managed their credit.

1.1 RESEARCH PROBLEM

Adoption and effective management of sound credit risk management has been found to be very crucial in the success of organizations (Nyerere, 2022). Managers in financial institution can use risk management strategies to minimize risk and adjust risk rate of return hence avoid adverse effect of customer's inability to repay interest and the loan. Managers in financial institutions have failed to maximize its benefit as the practice is recurrent and has persistently posed a challenge in managing new risks (Yilmaz, 2022). Managers have also not succeeded in capitalizing their experiences to shape their current risk management practices hence fail to overcome credit risks prevailing in the business environment leading to a huge number of non-performing loans (Aduda & Obondy, 2021). The concepts of credit collection, loan policy, credit monitoring and insider lending still need a better explanation in their application in financial institutions.

Globally, several research works were carried out to look into the practice in various sectors of the economy. Chikama and Mutua (2018) analysed the relationship between credit policies and financial productivity of SACCO in western region of Kenya, the relationship was established to be positive, however, the study scope does not present all SACCOs in Kenya. Samuel (2019) examined the influence of credit policy on productivity of SACCOs in Uganda. The study reported a positive and significant relationship, however, the study was not done in Kenya. Dunyoh, Moses, Ankamah, and Kosipa (2022) examined the influence of credit risk and bank productivity in Ghana. The study reported a negative relationship between credit risk, however, it does not address how credit policy influences financial performance. Gweyi (2018) determined the effect of financial risk on financial productivity of SACCOs in Kenya. A positive relationship was established between the study variables, however, study does not address how credit policy influences financial performance. Studies reviewed have failed to explain how credit policy affects financial performance. Furthermore, key financial performance determinants such as credit collection, monitoring, policy and insider trading are not comprehensively reviewed on their effect to Deposit taking SACCOs in Kenya. This study attempted to fill the research gaps, proving that credit policies in deposit raking SACCOs influence financial performance.

1.2 RESEARCH OBJECTIVE

The study determined the effect of credit policy on financial performance of deposit taking SACCOs in Kenya.

2.0 METHODS

The study adopted a descriptive research design to look into the relationship between credit risk management and financial performance of SACCOs. The research design was considered appropriate as it gave a complete description of the situation hence eliminating biasness in reporting study findings. A total of 175 SACCOs registered under SASRA as at December 2021 and currently in operation in Kenya were targeted for this study. Secondary data sources such as SACCO financial reports for the past ten financial years published in newspapers or the company websites from the year 2017 to 2021 were highly relied in this study. The ten-year period was considered sufficient for determining the relationship between the study variables and data to be captured in this time frame was comprehensive enough to aid in coming up with a reflective conclusion. A multiple linear regression model was used in the inferential analysis of study variables. Through the regression model the study analyzed Correlation, Analysis of Variance, Model summary and Regression co-efficient. The model that the study adopted was illustrated below:

$$Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \varepsilon$$

Where **Y**= Financial Performance.

α = Y intercept / constant of the regression equation

$\beta_1\beta_2\beta_3\beta_4$ = Beta coefficients,

X₁= Loan Policy

X₂= Credit Collection

X₃=Credit monitoring

X₄=Insider lending

X₅ = Financial Management Policy,

ε was the error term assumed to have a zero mean and constant variance with a Gaussian distribution.

3.0 RESULTS

Correlation analysis looked into the relationship between study variables such as credit collection, loan policy, credit monitoring, insider lending and financial performance. The results of the analysis are presented in table 1 below;

Table 1: Correlational Analysis

		ROA	CC	LP	CM	IL	FMP
ROA	Pearson Correlation	1					
	Sig. (2-tailed)						
CC	Pearson Correlation	.211*	1				
	Sig. (2-tailed)	.023					

LP	Pearson Correlation	.400**	.433**	1			
	Sig. (2-tailed)	.000	.000				
CM	Pearson Correlation	.236*	.476**	.362**	1		
	Sig. (2-tailed)	.010	.000	.000			
IL	Pearson Correlation	.183*	.357**	.357**	.566**	1	
	Sig. (2-tailed)	.048	.000	.000	.000		
FMP	Pearson Correlation	.211*	.350**	.329**	.469**	.680**	1
	Sig. (2-tailed)	.022	.000	.000	.000	.000	

*. Correlation is significant at the 0.05 level (2-tailed).

**. Correlation is significant at the 0.01 level (2-tailed).

c. Listwise N=175

Source: Research data (2022)

Key:

CC = Credit Collection

LP = Loan Policy

CM = Credit Monitoring

IL = Insider Lending

FMP =Financial Management Policy

As shown in table 1, The correlation between ROA and credit collection index is a weak positive and significant (r=.211, p=.023); the correlation between loan policy and ROA is a moderate positive and significant (r= .400, p=000); the correlation between credit monitoring and ROA is a weak positive and significant (r=.236, p=.010) and the correlation between Insider lending and ROA is weak positive and significant (.183, p=.048). Independent variables were all found to be all positive with performance as measured by Return on Assets, ROA. The positive correlation observed between the IVs and ROA means that the IVS moves in the same direction as the ROA. This implies that lending policies are one of the true parameters of measuring SACCO’s Return on Assets.

In multiple regression analysis, the regression coefficient results show the contribution of each predictor and its significance in the model to the target variable. The results are presented in the table below;

Table 2: Regression Analysis

Model	Unstandardized Coefficients	Standardized Coefficients	t	Sig.
-------	-----------------------------	---------------------------	---	------

	B	Std. Error	Beta		
	1.080	.321		3.365	.001
Credit Collection	.185	.050	.055	3.68	.000
Loan Policy	.360	.076	.078	.4.755	.000
Credit Monitoring	.125	.056	.037	2.25	.003
Insider Lending	.355	.087	.073	4.095	.000
Financial Management Policy	.565	.081	.587	6.946	.000

a. Dependent Variable: ROA

Source: Research data (2022)

The results in table 2 shows that the loan five predictors of ROA are all positive and significant an indication that the lending policies in SACCOs in Kenya. Based on the magnitude of the unstandardized regression coefficients, financial management policies have strongest contribution to ROA ($\beta=.565$, $p<.000$). This is an indication that financial management activities must be well understood and adhered to. Financial policies clarify the roles, authority, and responsibilities for essential financial management activities and decisions. Key findings is that credit collection has a significant effect on performance ($\beta=.185$, $p<.000$), Loan policy ($\beta=.360$, $p=.000$), Credit monitoring ($\beta=.125$, $p<.003$), Insider lending policies ($\beta=.355$, $p<.000$) are key performance indicators (KPIs) in SAACOs in Kenya. It is important to clarify and prioritize the roles, authority, and responsibilities for essential financial management activities and decisions. The functional form of the performance model as measured by ROA from credit policy dimensions is;

$$\text{ROA} = 1.080 + .185 \text{ Credit Collection} + .360 \text{ Loan policy} + .125 \text{ Credit Monitoring} + .355 \text{ Insider Lending} + .565 \text{ Financial Management}$$

4.0 CONCLUSION AND RECOMMENDATIONS

It was established that loan policy has a positive significant relationship with financial performance of DT-SACCOs in Kenya although its correlation with financial performance is weak. Secondly, it is concluded that credit collection has a positive and significant influence on financial performance of deposit taking Savings and Credit Cooperative organizations in Kenya, however, it has a weak positive correlation with financial performance.

Furthermore, the study established that, credit monitoring has a positive and significant influence on financial performance of deposit taking Savings and Credit Cooperative Organizations in Kenya, it's correlation with financial performance is weak but positive. Finally, the study

concluded that insider trading has a positive and significant influence on financial performance of deposit taking Savings and Credit Cooperative organizations in Kenya. However, the study established a weak positive correlation between insider trading and financial performance. The SACCOs targeted had varied capacities in terms of financial strength, management skills and compliance to financial regulations in the country. There is need for further studies to be done so as to be able to explain how these differences dictate the formulation and implementation of credit policies and their influence on financial performance.

REFERENCES

- Aduda, J., & Obondy, S. (2021). Credit risk management and efficiency of savings and credit cooperative societies: a review of literature. *Journal of Applied Finance and Banking*, 11(1), 99-120.
- Agaba, F., Tamwesigire, C., & Eton, M. (2022). Credit policy and loan performance of commercial banks in Uganda. *Business Perspective Review*, 4(1), 16-28.
- Alfatlah, H., Othman, R., Basiruddin, R., & Almagtome, A. (2022). Taxation as a strategy for circular economy through sustainability reporting: The Agency Theory Perspective. *Webology*, 19(1).
- Bala, S. A., & Ajayi, O. E. (2021). Credit risk management and firm profitability: Empirical evidence from listed deposit money banks in Nigeria. *Nigerian Journal of Accounting and Finance*, 13(2).
- Berko, D., Dankwah, J. B., & Boahene, E. A. (2021). Sale of Loans and Credit Risk Management Practices of Savings and Loans Companies: Evidence from an Emerging Economy. *International Journal of Business and Management Review*, 9(3), 1-15.
- Buro, I. A. (2019). Credit Risk Management and Performance of Loan Portfolios of Deposit Taking Savings and Credit Co-Operative Societies in Garissa County, Kenya. *Journal of Financial Management of Property and Construction*, 15(1), 71-94.
- Chikamai, L. V., & Mutua, M. (2018). Effect of credit policy on financial performance of Savings and Credit Co-operative Societies in Kakamega County, *The Strategic Journal of Business & Change Management*, Vol. 5, Iss. 4, pp 1378 - 1395
- Dunyoh, M., Ankamah, E. T., & Kosipa, S. J. K. (2022). The impact of credit risk on financial performance: Evidence from rural and community banks in Ghana. *Hybrid Journal of Business and Finance*, 3(1).

- Gauchan, A., & Upadhyaya, T. P. (2020). Credit portfolio management and profitability of joint venture commercial Banks of Nepal. *SSRG International Journal of Economics and Management Studies (SSRG-IJEMS)*, 6(3), 125-129.
- Kalu, E. O., Shieler, B., & Amu, C. U. (2018). Credit risk management and financial performance of microfinance institutions in Kampala, Uganda. *Independent journal of management & production*, 9(1), 153-169.
- Lassoued, M. (2018). Comparative study on credit risk in Islamic banking institutions: The case of Malaysia. *The Quarterly Review of Economics and Finance*, 70, 267-278.
- Locurcio, M., Tajani, F., Morano, P., Anelli, D., & Manganelli, B. (2021). Credit risk management of property investments through multi-criteria indicators. *Risks*, 9(6), 106.
- Maina, J., & Jagongo, A. (2022). Effect of capital structure on financial performance of small tiered deposit taking savings and credit cooperatives societies in Nairobi County. *International Journal of Finance and Accounting*, 7(2), 1-15.
- Mamari, S. H. A., Al Ghassani, A. S., & Ahmed, E. R. (2022). Risk management practices and financial performance: the case of Sultanate of Oman. *Journal of Accounting Science*, 6(1), 69-83.
- Morris, R. D. (1987). Signalling, agency theory and accounting policy choice. *Accounting and business Research*, 18(69), 47-56.
- Muriithi, P. K., Nasieku, T., & Memba, F. (2022). Influence of credit management on financial intermediation efficiency of deposit taking SACCOS'S in Kenya. *Journal of Accounting*, 5(1), 1-12.
- Muriuki, K. M., & Ragui, M. (2013). Impact of the SACCO Societies Regulatory Authority (SASRA) legislation on corporate governance in Co-operatives in Kenya. *Public Policy and Administration Research*, 3(6), 65-70.
- Ngugi, B., & Duguma Han, J. (2022). Effect of deposit mobilization on the financial performance of small tiered deposit taking savings and credit cooperatives societies in Nairobi County. *British International Journal of Applied Economics, Finance and Accounting*, 6(2).

Orichom, G., & Omeke, M. (2021). Capital structure, credit risk management and financial performance of microfinance institutions in Uganda. *Journal of Economics and International Finance*, 13(1), 24-31.

Wanjiru, P., & Jagongo, A. (2022). Liquidity risk and financial performance of deposit taking savings and credit cooperative societies in Kenya. *International Journal of Finance and Accounting*, 7(1), 1-14.