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INFLUENCE OF CREDIT MANAGEMENT PRACTICES ON FINANCIAL PERFORMANCE OF SAVINGS AND CREDIT CO-OPERATIVE SOCIETIES IN KAKAMEGA COUNTY, KENYA

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Abstract: **Credit management is a key issue in any organization since most business undertakings are based on timely payment agreed by both parties. This is because without thorough planning of firm's credit components, it is hard for the firm to run its functions smoothly. A wide range of challenges affects SACCOs because most of their clients earn a modest income, resulting to members failing to pay the loans disbursed to them. The study aimed to find out the effect of credit appraisal on financial performance of SACCOs in Kakamega County. The study used descriptive research design. The target population was 556 staff in SACCOs in Kakamega County. Using a simple random sampling, a sample of 227 respondents was selected. Questionnaires were used to collect data. Questionnaires were used to collect data. Empirical data was analysed using simple regression and multiple regressions. The study found out that Credit Appraisal had significant positive effect on financial Performance. SACCO management should automate screening process and credit Appraisal processes to reduce chances of prospective borrowers supplying false information.**

Keywords: **Credit Appraisal, Credit Documentation, Credit Reporting.**

I. INTRODUCTION

Credit Appraisal is a requisition for funds evaluated and examined by a financial institution. It is the process to ensure that individuals will pay for the services rendered and products delivered.it involves, Credit Documentation, Credit Reporting and financial status. Good credit Appraisal techniques are essential for a financial organization continuing profitability and stability, while declining credit quality is the most recurring cause of poor condition and financial performance (Kagoyire&Shukla, 2016).SACCOs with coherent strategies for managing loan defaulters are believed to have high chances of excellent financial performance while SACCOs with ineffective defaulter management strategies are prone to high financial risks (Miriti, 2014). McKillop and Wilson (2011) further assert that it is failing to pay back a loan as per stipulated procedures and policies as a result of lending practices that were insecure. To reduce the chances of unwanted responsibilities that come about from over liquidation and too much-saving credit firms ought to understand the quality of the client's budget, his or her financial history, and lastly the client design of changing instalments (Hyman, 2016).

1.1 Statement of the Problem

According to SASRA, (2019), The SACCO Supervision Annual Report showed that Sukari Sacco Society limited was barred from taking deposits thus ceased to operate front office services because they lacked capital adequacy of 10% of total liabilities, sound management practices and lack of cash to settle its obligation that led to business shrinkage due to membership attrition. Further, the report showed that Wevarsity Sacco was licensed with restrictions since it was at the verge of not meeting the minimum liquid assets and capital requirement. According to KUSCCO, (2018), financial review report showed that out of all SACCOs in Kakamega County, eight of them; Invest and Grow Sacco; Wevarsity Sacco, Mudete Tea Growers Sacco Society Limited; Malava Youth Sacco; Weko Sacco; MwanzaBodaBoda Sacco; Imara Holdings and Kabras News Sacco noted poor performance within the period of the year 2015 to 2018. The report further noted that huge credit owed by customers affected performance of Namulima Sacco, MusemwaMabusi Sacco and Bodeni Star Sacco. This was as a result of no strict policies set by SACCOs in the country that regulate issuing of loans (Hyman, 2016).

1.2 Research Objectives

To determine the effect of credit appraisal on the financial performance of SACCOs in Kakamega County.

1.3 Research Hypothesis

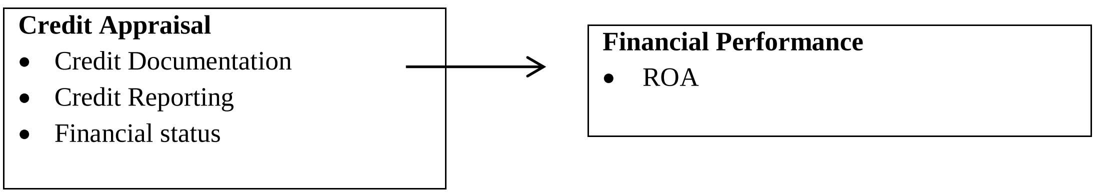
$H0_2$: Credit appraisal does not significantly influence the financial performance of SACCOs in Kakamega County.

II. LITERATURE REVIEW

The loan appraisal is a comprehensive exercise which starts from the time a potential borrower walks into the financial institution and terminates in credit delivery and monitoring with the purpose of guaranteeing and preserving the quality of lending and managing credit risk (Sharma &Kalra, 2015). Customer loan repayments must remain monitored. Hence organizations should avoid issuing loans to risky clients, follow up loan repayment and renegotiate loans when customers get into difficulties (Ameyaw- Amankwah, 2011). Credit appraisal is a requisition for funds, evaluated and examined by a financial institution (Boldizzoni, 2008). The areas of focus in examination include: the purpose of the client, need genuineness, repayment capacity of the borrower, quantum of the loan and collateral security. Credit appraisal plays a vital role to keep the loan losses to a minimum level; hence if those officers appointed for credit evaluation are incompetent, then there would be high chances of lending money to non-deserving customers. Peters and Monroe (2005) stated that credit-related document, including the loan contract, financial statement, business plan, documents of the lender's security interest, and other papers that are used by the lender in evaluating creditworthiness of a prospective borrower. These documents relating the history of a loan are kept in the borrower's credit file for later review by field examiners, from the lender's primary supervisory agency and the loan review committee. Proper documents are essential in lending because the quality of documentation in the loan portfolio is directly related to credit quality ratings.

Mureithi (2010) acknowledges that credit assessment is conducted out for many objects, these are; as an assortment tool, to quantify risk, to aid in decision making, and to ensure good quality business with excellent credit worthiness. Credit appraisal, therefore, remains a vital activity among the lending institutions.Musyoki, (2011) broadly recognizes that proper and adequate examination is the key to controlling or minimizing default. The examination is a crucial stage in the loan process. The stage is the heart of a high-quality portfolio. It includes diagnosing and assessing the business as well as the customer (Korankye, 2014). For a financial institution to establish the creditworthiness, credit analysts typically use a combination of financial or accounting data. And non-financial variables as well as some different models, or analytical tools, where, some of the methods involve a personal approach; others are more systematic in that they use quantitative techniques to evaluate a credit against objective benchmarks (Mohammad &Omni, 2015).

Conceptual Framework



Independent Variable **Dependent Variable**

Fig .1

III. METHODOLOGY

The research applied descriptive research design. The research targeted a population of one hundred and thirty-two (132) Sacco's within Kakamega county(KUSCO,2018).In this study the sample frame included general managers, finance officers, Accounts staff and credit managers.

3.1 Sampling Design

The researcher applied Krejcie and Morgan formular to determine the population

$$S = \frac{X^2 NP(1-P)}{d^2 (N-1) + X^2 P(1-P)}$$

Where

S is the desired sample size

X^2 is the table value of chi-square for one degree of freedom at desired confidence level which is 1.96x 1.96= 3.841

N is the population size

P is the population proportion assumed to be 0.5 since this will provide maximum sample size and d is the degree of accuracy expressed as a proportion 0.05

$$S = \frac{3.8416 \text{ X } 556 \text{ X } 0.5\ (1-0.5)}{0.05^2 (556-1) + 3.8416 \text{ X } 0.5(1-0.5)} = 227 \text{ Respondents.}$$

Collection of data was by use of questionnaires administered by the researcher. The researcher administered 5 point Likert scale questionnaires with closed ended questions to get information from the intended respondents (Saunders, 2009). Primary data was obtained by the employment of self-administered questions using drop and pick method.

IV. RESEARCH FINDINGS

4.1 Credit Appraisal

To measure Credit Appraisal, a set of eight statements were formulated. The results were presented in Table 1.

Table 1: Credit Appraisal

Statement	1	2	3	4	5	Mean	Standard deviation
In my organization we consider Client credit history and character during Credit Appraisal	- -	- -	4% (6)	56.7% (85)	39.3% (59)	3.95	0.515
In my organization Credit related documents detailing the history of a loan are kept in the borrower's credit file.	- -	- -	3.3% (5)	66.7% (100)	30% (45)	4.05	0.628
In my organization we have a credit evaluation committee	- -	- -	6.7% (10)	63.3% (95)	30% (45)	4.13	0.620
In my organization we have competent personnel to carry out Credit appraisal	-	-	3.3% (5)	73.3% (110)	23.4% (35)	4.09	0.638
In my organization we have an internal credit rating system.	- -	- -	3.3 (5)	73.3% (110)	23.4% (35)	4.11	0.661
In my organization customer grading plays an vital role to keep loan losses to minimum level	- -	- -	3.3% (5)	80% (120)	16.7% (25)	4.10	0.599
In my organization data collected from application forms for new or extended credit line are used to assign credit applicants to right or wrong credit risk classes	- -	- -	4% (6)	70% (105)	26% (39)	4.20	0.645
In my organization extension of Credit to borrower is according to customer profile	- -	- -	10% (15)	73.3% (110)	16.7% (25)	4.08	0.681

Key: 1 strongly disagree SD, 2 Disagree, 3 fairly agree, 4 Agree, 5 strongly agree

From table 1 showed that (39.3%) of the respondents strongly agreed and (56.7%) agreed that their SACCO considers client credit history and character during credit appraisal which was a good indicator on credit appraisal techniques although (4.0%) of the respondents fairly agreed. Given that none of the respondents strongly disagreed or disagreed on the same it implied that there are no cases where customers character was underrated hence strongly considered. Further, most of the respondent strongly agreed (66.7%) that they documents showing the history of a client's loan are kept in the borrower's credit file for credit follow up and this was supported by (30%) of the respondents who agreed on the same. Similarly, (63.3%) and (30%) of the respondents agreed and strongly agreed respectively that they had credit evaluation committee that followed up on matters pertaining credit management that gave a positive impact on financial performance of SACCOs. However, (6.7%) of the respondents gave a fare agreement. The results also revealed that (73.3%) and (23.4%) of the respondents agreed and strongly agreed respectively that they had competent personnel to carry out credit appraisal. Further, (73.3%) and (23.4%) of the respondents agreed and strongly agreed respectively that they had an internal credit rating system which monitored and controlled credit appraisal related matters. More, so, (80%) and (16.7%) agreed and strongly agreed respectively that they had a customer grading system that plays an vital role in keeping loan losses to minimum level, implying that at least they had good customers that complied to credit matters. Lastly, 70% of the respondents strongly agreed that data is collected from application forms for new or extended credit line and such information is used to assign credit applicants to right or wrong credit risk classes. However, 26% of the respondents simply agreed on the same implying that before customers credit is appraised data is gathered about credit history of the customer which is important on credit management practices hence yielding positive returns on finance. Furthermore the results also revealed that (73.3%) and (16.7%) of the respondents agreed and strongly agreed respectively that the extension of credit to borrower is according to customer profile .It was also observed that all means ranged between 3.95-4.20 while the standard deviations ranged between 0.515-0.681.there was an indication of smaller variations in responses implying a greater degree of agreement. This is because the lower the standard deviation the higher the degree of-consensus among the respondents.

4.2 Correlation Analysis for Credit Appraisal

Pearson correlation was used to determine the effect of Credit Appraisal on financial performance. The results were as shown below.

Table 2: Correlation Analysis for Credit Appraisal

		Credit Appraisal	PERF
Credit Appraisal	Pearson correlation	1	
	Sig.(2-tailed)		
	N	150	
PERF	Pearson Correlation	.706**	1
	Sig.(2-tailed)	.000	
	N	150	150

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

Credit Appraisal was positively correlated to performance the coefficient was 0.706 (p-value<0.01) and it was significant at 99% confidence level thus increase in Credit Appraisal makes performance to increase in the same direction. The findings showed a strong positive relationship between credit Appraisal and performance.

4.3 Regression Results of Credit Appraisal

Table 3: Regression results for Credit Appraisal

Model Summary

Model	R	R Square	Std. Error of the Estimate
	.706[a]	.498	.31831

ANOVA[a]

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	14.897	1	14.897	147.028	.000[b]
	Residual	14.996	148	.101		
	Total	29.893	149			

Model		Unstandardized Coefficients B	Unstandardized Coefficients Std. Error	Standardized Coefficients Beta	T	Sig.
1	(Constant)	.332	.301		1.103	.0272
	Credit Appraisal	.890	.073	.706	12.125	.000

From the Table 3 above the value of R square is 0.498 shows that credit Appraisal explains 49.8% of variance in performance of Sacco's in Kakamega County. From the anova table significance of the model has a value ($F= 147.028$, $p < 0.05$) this shows that it was significant at 95% confidence level hence the model was feasible. There was a positive relationship between credit monitoring and performance. The regression equation for credit Appraisal becomes; Y Per = 0.332 + 0.890CA. From the regression equation it means that when Credit Appraisal increase by 0.890 % performance would change by 1% in the same direction. Muturi&Thisika (2017) in their research agree with the findings of this research where Credit Appraisal had significant positive effect on performance. This research contradicts research by (Musyoki, 2011) who found out that credit Appraisal had negative effect to performance for profitability firms.

V. CONCLUSION

From primary data results from both correlation and regression showed a positive and significant relationship between Credit Appraisal and performance thus increase in Credit Appraisal makes performance to increase. Further, a unit change in credit Appraisal will lead to a significant change in financial performance in the same direction thus Credit Appraisal has been credited as a tool for sound financial Performance of SACCOs in Kakamega County. It was concluded that clients information and lending methodologies were also found out to influence credit Appraisal as the techniques used ultimately end up affecting financial performance. Credit Policy also influence appraisals as they are the laid down rules and regulations along which credit Appraisal is expected to adhere to.

VI. RECOMMENDATION

Most of the SACCOs confirmed that they relied on client credit history and character during Credit Appraisal .This accounted for more than 50% chance for one to qualify for credit. Most likely borrowers without solid historical records but were less risky were left out. The study recommends that SACCOs should integrate techniques that are more predictive of future performance because historical performance may not predict the ability of the borrower's loan repayment ability. Most of the SACCOs confirmed that data collected from application forms for new or extended credit line were used to assign credit applicants to right or wrong credit class. The study recommends that SACCOs should computerized techniques credit Appraisal techniques like polygraph machine to avoid borrowers who provide false details. Automation of credit Appraisal processes increases the ability of the staff to predict effectively and classify borrowers. Most SACCOs had credit related documents detailing the history of a loan were kept in the borrower's credit file that helped when there is extension of credit to the borrower. The study recommends that SACCOs should automate the Credit Appraisal process and screening process to reduce chances of prospective borrowers supplying false information to qualify for a higher loan.

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