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THE MANAGEMENT PRACTICES AND NON-PERFORMING LOANS IN DEPOSIT TAKING SAVINGS AND CREDIT COOPERATIVES IN KENYA

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Abstract

The problem of non-performing loans has been escalating in the recent years with the situation worsening as it has been fronted as one of the leading causes of collapse of SACCOs. The research sought to establish the effectiveness of existing loan management practices which include loan restructuring, guarantee practices, monitoring practices and loan recovery strategies on non-performing loans in deposit taking savings and credit cooperatives in Kenya. The stakeholder theory, the shareholder theory and acceleration theory forms the theories the study is anchored on. The study collected primary data through structured questionnaires which were distributed to 166 senior credit managers from all registered deposit taking SACCOs in Kenya. Correlation and regression analysis were used to study the relationships amongst the study variables and answer the research questions and hypotheses. Multiple liner regression was used to model the relationship between NPLs as the response variable and management practices variables as the predictor variables. The study found a positive significant effect of loan restructuring, guarantee practices, monitoring practices and loan recovery strategies on performance of NPLs in DTSs in Kenya. In conclusion the study noted that all the predictor variables are critical determinants of the performance of SACCOs. Since loan restructuring, guarantee practices, credit monitoring practices and loan recovery practices are significant in the performance of non-performing loans, SACCOs should align their loan facilities in line with these management practices so as to reduce the level of NPLs.

Key word: *Loan Restructuring Practices, Loan guarantee practices and Deposit Taking SACCOs*

Introduction

The survival of a SACCO is anchored on its loan performance and the general institutional performance is always the ultimate managerial goal. The core business of a SACCOs is to collect funds from customers and later investing the funds into a meaningful investment, which include lending it in ways that the loaned amount is efficiently recouped plus interest at a stipulated time period as per the outlined agreement. In the last decade, the numbers of customers seeking loans are on constant rise. This is partly due to the fact that the wants are more than available resources for an individual. Also on constant rise is the number of Nonperforming loans which has necessitated the need for SACCOs to relook into ways that maximize the value of the loaning while minimizing the possibility of each individual defaulting.

Financial institutions like SACCOs are licensed with the sole objective of uplifting the members' social economic wellbeing are most relevant in the economy world over. They operate by borrowing funds by accepting deposits or by borrowing in the money markets. They borrow from individuals or financial institutions. They then use those deposits and borrowed funds to advance loans or to purchase securities. Banks make these loans to businesses, other financial institutions, individuals, and governments that need the funds for investment at cost; that is, interest rates. When these banks do well by having low Non performing loans, they have usually do well and sustain economic development and uplift the citizen welfare.

Credit risk is as the possibility of losing the outstanding loan partially or totally, due to credit events (default risk) and this is an internal determinant of bank performance, and it is the measure of efficiency of loaning management practices an institution has in place. The non-performing loans are problems world over, they indicate the both the state of economy performance and the lending conditions of the institutions. After the financial crisis of the late 2000s, non-performing loans (NPLs) have become an increasing matter of concern for financial institutions like banks in many European countries (Lindblad & Riley, 2015). The negative effect of credit risk and non-performing loans on banks performance and the economy in general has made the issue of NPLs a global one and of great importance in the last decades (Ahmad & Ariff, 2013).

The problem of non-performing loans is not a preserve of developed economies but also for developing countries thereof. African banking crisis is at the hearth of the same situation. The steady rise in credit risks in sub-Saharan Africa (SSA), which began in 2015, is now threatening to slow down loans availability in the region. Data shows that at the close of the year 2015, eight per cent of commercial banks' outstanding loans in SSA were classified as non-performing, on average terms. The situation worsened as the figure rose to 10 per cent in 2016 and in 2017 it was a huge 13 per cent (Meyer, 2015). The steep upward glide has been driven by three of the region's banking sector heavyweights, namely Nigeria, Angola and Ghana. The economy of the East African region has

recorded record increase in the NPLs. In Uganda, though NPLs declined to 6.2 per cent in June 2017, a surge in default rates seems to reflect big shocks experienced by borrowers and lenders since last year, in spite of bullish growth forecasts pegged to certain sectors. Uganda has recorded a success story brought by the regulatory seizure of Crane Bank back in October 2016, which accounted for half of the sector's non-performing loans (Otchere, Senbet, & Simbanegavi, 2017).

In Tanzania, the ratio of non-performing loans rose to 10.8 per cent at the end of April from 8.2 per cent a year ago (Abbas & Li. (2017). In August last year (2016), audit firm KPMG raised the alarm noting that Tanzania's NPLs were way above the country benchmark of 5 per cent (Amin, Sanusi, Kusairi, & Abdallah, (2018). Out of the nine Kenyan banks that have released their 2017 half-year results, eight have recorded a rise in non-performing loans, a key indication that businesses are struggling not only to stay afloat but also to meet their financing needs (Ndungo, J. M., Tobias, O., & Florence, M. (2017).). The rise in non-performing loans (NPLs) in the financial sector has been blamed to delays by the national and county governments in paying businesses that trade with them. Most of the borrowers are new entrepreneurs who get loan finances from SACCOs because of their (SACCOs) flexibility and less stringent lending policies than banks (Schaner (2017). This has not only damaged the confidence of investors and act as a contagious for financial malaise but it has driven away deserving loan borrowers out of the financial system (Kibet, K., & Sile, I. (2017), Dinçer, H., Yuksel, S., & Adalı, Z. (2018). The foregoing as highlighted the background of the situation regarding the NPLs from the global, regional and local perspective in the financial sector.

In Kenya SACCOs have fast grown, this growth has been attributed to the fact that the majority seek financial services with ease due to majorly due to cheap credit and flexible terms offered by the SACCOs. However due to poor loan recovery strategies employed by the SACCOs, it has led to some SACCOs experiencing liquidity problems and others have faced imminent closer by the regulatory agency (SASRA, 2013). SACCOs in Kenya are guided by core principles and values; voluntary and open membership, democratic member control, economic participation by members, autonomy and independence, education, training and information, cooperation among co-operatives and concern for the community (Wambui, 2012). All these principles are meant to focus on member core needs since co-operatives work for the sustainable development of communities through member friendly development initiatives.

The major activities of SACCOs is instilling saving culture, investing activities and offering lending services, which is the major source of raising revenue for SACCOs. Large proportion of SACCOs asset comprise issued loans to members (Okundi, 2011). Some these loans given out by the SACCOs unfortunately become non-performing hence eventually declared bad debts with adverse consequences for the overall loan recovery performance of the institutions SACCOs play a significant role in the provision of financial services to the target both rural and urban groups (Turyahebwa, 2013).

While Kenya has over 14 million co-operators, it is estimated that three quarters of the Kenyan population nearing 30 million depend on the activities of SACCOs either directly or indirectly for a living (Kilonzi, 2012). In fighting unemployment especially among the youths in Kenya, SACCOs have played a key role in employing over 500,000 people directly.

According to chege 2010, the author notes that SACCOs account for 80% of the total accumulated savings while Kenya's sub-sector is the largest in Africa, accounting for 62, 65 and 63% of the continent's savings, loan and assets respectively (Chege, 2010).

The survival of any organization will depend on how quickly the revenue is collected and the retention of the customers for continuity (Omara, 2007). While financial institutions have faced difficulties over the years for a multitude of reasons, the major challenges faced by financial institutions continue to be directly related to lax credit standards for borrowers and counterparties, poor portfolio risk management and lack of attention to changes in economic or other circumstances that lead to deterioration in the credit standing of financial institutions counterparties (Basel, 2002).

The foregoing literature underscores that the presence of NPL in the books of an institution is a problem. Non-performing loan is a risk management issue in any financial lending institution. Poor credit risk management practices leads to rising non-performing loans which compresses profit margins, of commercial banks hence bringing about more challenging environment for banks. In this regard, banks and SACCOs have put in place management practices, among other duties, to control the rise in the NPLs in their financial books. Indeed after the financial crisis of the late 2000, the central bank put up stringent regulations in place to ensure that the financial institutions, like deposit taking SACCOs have sound financial risk management in place.

Whilst there is this progress, the reality on the ground is that the NPL are on a constant increase in the recent years as depicted by central Bank of Kenya results in figure1. According to the Ministry of Trade and Industry, the overall ratio of non-performing loans in Sacco's is currently high well above the industry regulatory requirement of five per cent. The presence of non-performing loans in Sacco's financial books causes challenges in the SACCOs. The challenges include low profitability, low liquidity, low growth rate, poor competitiveness of the SACCO as well as rise of disputes with stakeholders. (Zhan, Cai Dickinson & Kutan, 2016, .Munyiri 2006). The below figure represents the rate at which non-performing loans are on the rise as the Y- axis represents the percentile and X-axis represents the period of concern .

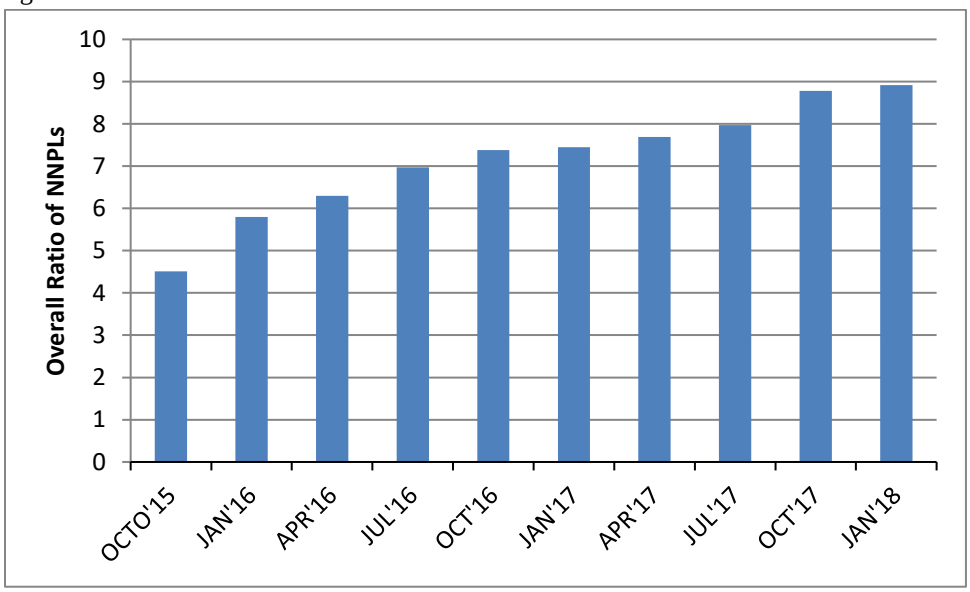


Figure 1: Kenya's Non-Performing Loans Ratio from OCTOBER 2015 to January 2018

Source: www celdata.com, central bank

The aim of this paper was to establish the management Practices on the Non-Performing Loan in Deposit Taking SACCOs in Kenya. In this paper an attempt was made to evaluate the extent of loan restructuring practices among deposit taking SACCOs in Kenya, and then then go further to evaluate the effect it has on the performance of NPLs deposit taking SACCOs. It is anticipated that the findings contributed valuable knowledge in the financial literature regarding the concept of restructuring.

Methodology

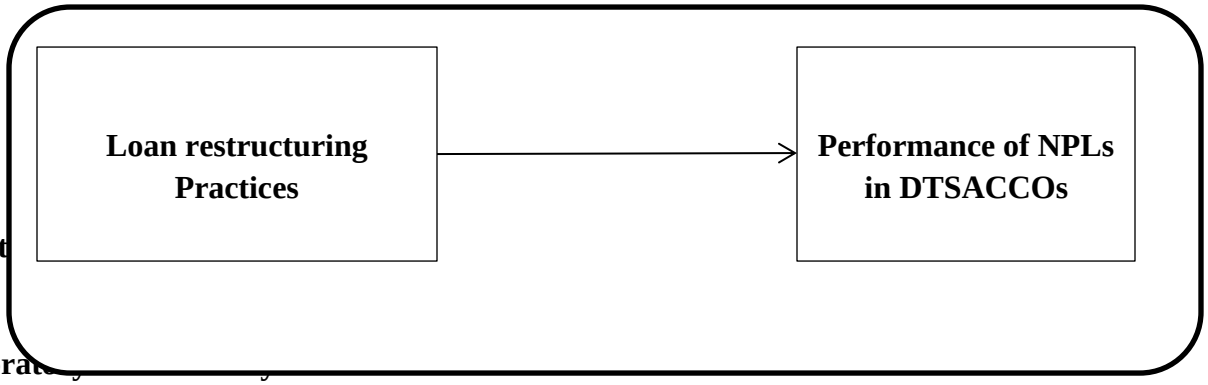
The study used a descriptive design. Data was collected from all the 166 managers of the deposit taking SACCOs in Kenya as 2018. A questionnaire was the main tool of data collection. The researcher got approval of the university to collect data by getting a written permission from the department of Jomo Kenyatta university of Agriculture Technology. Moreover, a written permission from National Council for Research, Science and Technology (NACOSTI) authorizing to collect data in the field was obtained. A questionnaire was given to the respondents and picked on the agreed time for each respondent.

In line with credible research practices, this study assessed the reliability of the instrument in order to evaluate the consistence of the research instrument. Also validity was assessed in order to demonstrate that the questionnaire items actually measured the restructuring constructs and performance constructs as intended. For this purpose, Exploratory Factor Analysis (EFA) was used to judge the reliability and validity. Moreover the famous Cronbach's alpha was additionally used to assess internal reliability of the instrument. The primary purpose of Exploratory Factor Analysis (EFA) is the assessment of the factor structure in the

dataset by identifying redundancy and indiscriminate items (Cooper, 2011).

Also to ensure credible results, data was assessed for multivariate assumption since the parameters of the model were estimated using the Maximum likelihood Estimate, MLE, method. The method requires that the regression residuals are normally distributed. The independent variables are jointly linearly related and the independent variables are not highly correlated (multicolinearity). Also the MLE requires that the error variance is constant across the levels of the dependent variable. In other words the errors are uncorrelated.

This study proposed that Loan restructuring Practices has an effect management practices on non-performing loans as conceptualized in if figure 1 above. To evaluate this effect, restructuring practices on performance data were regressed using maximum likelihood method to compute the regression coefficient. In obtaining a significant regression coefficient (P<.05) study concluded that restructuring has a significant effect. On the other hand, a non-significant regression coefficient was evident that restructuring has no significant effect on performance of NPLs



Result

Explorat

Figure 1 the conceptual framework of restructuring and performance of NPLs in DTSACCOs in Kenya

Eleven items were subjected to factor analysis in order to establish the actual structure in the dataset. Eigne value extraction criterion was used to extract factors as opposed to extracting a predetermined number of factors. We examined the KMO and Bartlett's statistics to assess the suitability of the EFA procedure on the data set. The EFA results showed a KMO value 0.897 and Bartlett's Test of Sphericity Chi square 1007.918, is significant, p=0.000, df = 55. Collectively, the results showed that the Factor analysis was appropriate procedure to discern the actual factor structure of the dataset.

Table 1: KMO Measure of Sampling Adequacy Bartlett's Test of Sphericity

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		.877
Bartlett's Test of Sphericity	Approx. Chi-Square	1007.918
	df	55
	Sig.	.000

Table 2 Total Variance Explained Results

Component	Initial Eigenvalues			Extraction Sums of Squared Loadings			Rotation Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	5.302	48.203	48.203	5.302	48.203	48.203	4.675	42.504	42.504
2	1.965	17.860	66.063	1.965	17.860	66.063	2.591	23.559	66.063
3	.670	6.090	72.153						
4	.639	5.806	77.958						
5	.556	5.054	83.012						
6	.478	4.348	87.360						
7	.375	3.411	90.771						
8	.316	2.876	93.646						
9	.293	2.667	96.314						
10	.252	2.291	98.605						
11	.153	1.395	100.000						

As it can be seen from table 2 results, the first factor (restructuring) was the most robust with total variance explained of 42.5% while factor two; Non Performing was the second with total variance explained of 23.6% In total the two factors accounted for 66.1% which is above the minimum value of sixty percent threshold recommended in social sciences (Hair J. F 2014)

Table 3 shows the rotated component matrix results from which it is observed that the elven items converged to a two factor structure as expected. So the dataset consisted of two distinct structure or factors. The first factor comprised of seven items all

representing extent of restructuring. It is observed that the loading for restructuring ranges from 0.706 to 0.859 which is well within the threshold of greater than 0.7

The second component comprised four items that represent performance of NPLs indicators. They indicators loads strongly to their respective construct meaning that the questionnaire demonstrates adequate Construct Reliability. The minimum is 0.731 which is within the threshold value of greater than 0.7. The Cronbach's alpha coefficient of performance appended is 0.816

Table 3 rotated component matrix of the EFA

		Restructuring Cronbach's=0.913	Performance Cronbach's= 0.816
Rest1	Loan repurchase is popular	.734	
Rest2	We regularly restructure repayment periods	.839	
Rest3	We have robust restructuring process	.798	
Test4	Encourage members to restructure	.836	
Rest5	Repurchase commission is affordable	.859	
Rest6	Favorable restructuring terms	.855	
Rest7	Restructure has helped reduce defaults	.706	
Perf1	Loan default on the decrease		.764
Perf2	Loan default is a major problem here		.847
Perf3	Number of defaults are constant		.754
Perf4	NPLs amount on the decrease		.731

Descriptive results

Seven items measured the extent of restructuring practices among the DTSACCOs in Kenya. The descriptive results of the loan recovery practices are presented in table 4. below. It is seen from the results that a majority of the management respondents agreed to most of the loan recovery items. In particular, they agreed (60%) that loan purchase is popular, loan is regularly restructured (72% agreed,), there is robust restructuring process (57%), encouraging members to restructure loans (69%.). it was however observed that the respondent managers were not out-and-out sure that indeed restructuring generally reduces default cases. This view is based on the results in which it is seen that a majority identified with the neutral option at 55% with only 21% agreeing and almost equal number (23%) disagreeing.

In-depth look at these restructuring practices items used in table4.1, the first six items were designed to measure the extent of restructuring among the SACCOs. In this regard it is evident from these descriptive results that restructuring is extensively a popular strategy among the SACCOs. Yet, the last item was intended to evaluate the opinion of respondents regarding their opinion on its Non-performing loans on DTSACCOs; the opinions are mixed as we have seen in the previous paragraph.

Table 4: Descriptive Results of Loan Restructuring Practices in DTS in Kenya

Restructuring indicator	SD	D	N	A	SA
Loan repurchase is popular	-	12%	22%	60%	7%
We regularly restructure repayment periods	2%	-	20%	72%	7%
We have robust restructuring process	-	3%	23%	57%	17%
Encourage members to restructure	-	-	20%	69%	12%
Repurchase commission is affordable	3%	3%	43%	44%	7%
Favorable restructuring terms	-	26%	22%	41%	10%
Restructure has helped reduce defaults	-	23%	55%	21%	-

Table 5: Descriptive Results of NPLs

NPLs indicators	SD	D	N	A	SA
Loan default on the decrease	23%	45%	17%	11%	5%
Loan default is a major problem here	7%	12%	17%	21%	43%
Number of defaults are constant	25%	32%	19%	19%	5%
NPLs amount on the decrease	13%	47%	13%	14%	13%

The state of none performing loans among DTSs in Kenya formed the dependent variable and was assessed using four unique items in which the fundamental concern was whether the NPLs are increasing or decreasing as performance indicator. The descriptive results of NPLs are shown Table 4. Regarding whether loan default are on the decrease, the results shows that only 16 %(11%agree+5%strongly agree) of credit managers agreed but a majority, that is 68 %-(23+45) of disagreed meaning that default cases are not on the decrease in majority of SACCOs implying that NPLs are on the decrease and therefore the problem of NPLs is not on the decrease as default is not decreasing.

From the results, it is concluded that loan default is a major problem as 21% of the managers agreed and other 43% of them even strongly agreed implying that it ia actually a problem. Therefore a total of 64% of

managers indicated that default is a major problem in their SACCO. Yet, regarding if the number of defaults are constant, it was observed that a total of 24% (19+5%) of the respondents agreed while a total of 57% (25+32) were of the contrary opinion.

he results are in line with the Moody's report, a global rating agency which predicted the rise of non-performing loans. When the default are on the rise, the non-performing loans on its books also rise proportionately which means that the SACCOs have no money and no longer collect interest on them, which is how they make money.

All together, these results reveal little success by SACCOs in taming the rising percentage of NPLs which does not only affect a SACCO negatively, but also affect potential borrowers because of the less money now available for new loans, thus curtailing growth of SACCOs with huge NPLs.

Prior to running a regression analysis, we first checked for the regression assumptions in which no significant violation of the regression assumptions were observed. The Skewness and Kurtosis was within threshold (less than 1). The histogram of the residuals suggested that the regression residuals are normally distributed. The VIF are much less than the 5 threshold value. Then a simple regression was run to study the effect of restructuring on the performance of NPLs in DTSs in Kenya. The regression analysis resulted into three outputs; the model summary, ANOVA and regression coefficients. The model summary output provides the R and R square statistics of the model which provides the correlation and coefficient of determination respectively. From the model summary results in table 5 the R value is 0.674 which is the correlation between restructuring and performance. The adjusted R square, coefficient of determination, is 0.450 means that the considering restructuring practices has the only predictor of growth, it accounts for 45% of variance in performance of NPL and the remaining 55% is accounted for by other factors. The standard error of the estimate is .45108 measures the accuracy of the estimates

On the other hand, ANOVA output in a regression analysis assess the fitness of the model and tests the null hypothesis that the slope of a regression line is not significantly different from zero. The ANOVA results shown in table 6 shows that the model is significant ($F_{(1,119)}$ =99.111), p<.001 implying that the regression slope is significantly different from zero, thus, rejecting the hypothesis that the regression slope is zero. The results means restructuring has significant effect on the performance of NPLs and therefore improving restructuring practices results in improved performance.

Table 5: model Summary of Relation between Restructuring and performance of NPLs

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.674[a]	.454	.450	.45108

Table 6 ANOVA results of the model predicting performance of NPLs from Restructuring

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	20.167	1	20.167	99.111	.000[b]
	Residual	24.213	119	.203		
	Total	44.380	120			

Table 7: Coefficients results of the model to predict performance of NPLs from Restructuring

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	2.282	.189		12.098	.000
	Restructuring	.458	.046	.674	9.955	.000

The regression coefficient output provides the estimated standardized and unstandardized regression coefficients that are fitted tin the regression model. Table 7 provides the estimated regression coefficient for this study which shows that the regression coefficient of restructuring is 0.674 which is significant ($p < 0.001$). The results mean that performance of NPLs is significantly influenced by restructuring practices and therefore renegotiating for flexible payments of loans as a means of loan restructuring, reduces probability of default and therefore enhances performance of NPLs in DTSs. The final restructuring-performance model fig3

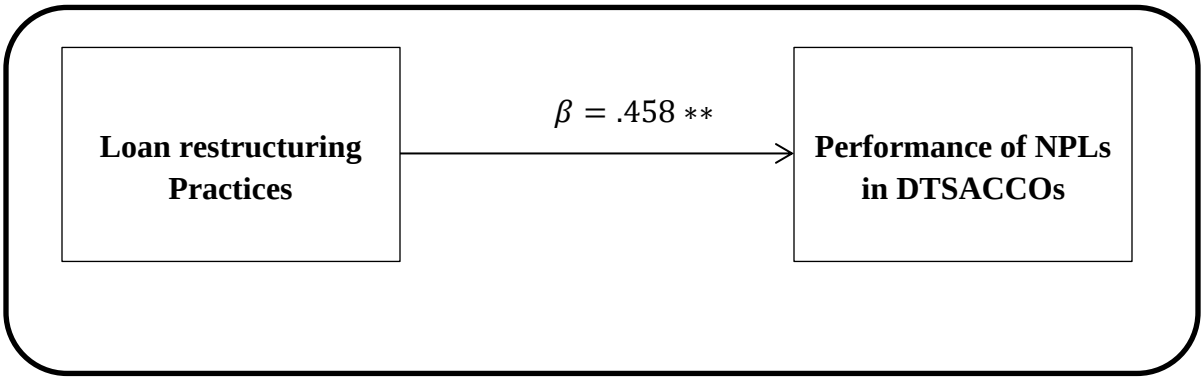


Figure 2 The conceptual framework of restructuring and performance of NPLs in DTSACCOs in Kenya

The results revealed important viewpoint that shed a renewed perspective regarding Loan restructuring practices. Deposit taking SACCOs surveyed have embraced loan restructuring practices as mitigation to the problem of loan servicing by customers. Good and effective restructuring strategies that relook at the terms of the loan and coming up with flexible ways to service loans are essential in recovery efforts so as to reduce the bad loans. This view is supported by Kithuz (2010) who said that restructuring enables an institution to relook at the terms of the loan or renegotiate its debts to improve or restore liquidity so that it can continue its operations.

The regression results established that restructuring practices has significant positive effect on performance of NPLs in DTSs in Kenya. The results has significant implications; for the managers, the SACCOs need to brace for extended repayment period by renegotiating with potential defaulters to come up with a flexible payment plan that should enable the customer continue to service his or her loan. For the distressed customers, the significant link between restructuring and loan performance means that they need to master the available restructuring services available to them right from loan application stage and the sacrifice of restructuring.

The core findings underscore the critical relationship of restructuring and performance of Non-performing loans. It means that as the loan repurchase is popularized, the repayment periods are constantly reviewed and the restructuring terms are favourable the balance sheet of DTSACCOs improves in terms of Non-performing loans. Thus the efforts in renegotiating the terms of payments by SACCOs helps the potential defaulters to continue servicing their loans which will otherwise been difficult to service. SACCO management acting as an agency can play a critical role in embracing effective restructuring policies to ensure mutual benefit of the SACCO stakeholders by reducing agency costs that affects the overall loan performance in the SACCOs. By addressing the problem of NPLs lies in effective exploration of innovative and enhanced restructuring products that encourage more uptakes of the restructured

products by customers. Moreover, Restructuring is central to addressing the runaway NPL ratio in most financial institutions due to the economic difficulties most borrowers go through and borrowers are likely to avoid repayment of their loans thus necessitating proactive management of SACCOs to put in place mechanisms such as loan restructuring practices to encourage flexible plans, to come up with innovative products so as to reduce the non-performing loans in SACCOs.

When the economy is bad, it affects business but more so the SACCOs whose core function is providing cheap loans to low income earners in society. In this bad economy, the customers find it difficult to continue servicing their loans as early agreed. These calls for the need to change the terms of existing loans in order to make it easier for the borrower to continue servicing the loan. The boards must prepared to cope with the situation that could push the SACCO into incapacitation by reading the warning signs. This will be the important asset SACCOs can rely on to navigate them through the hard times. It is then not surprising that even the big multinational banks are seriously restructuring their loans to stay afloat. It is becoming apparent that restructuring will continue to occupy a significant strategic position among the management and perhaps restructuring will not only be the most important factor in creating competitive advantage for the organizations but also will be the unique asset in determining the standard of living for nations, Kenya included.

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Appendix : Research Instrument

Nonperforming loans						
	The number of loan defaults is on the increase in this SACCO	SD	D	N	A	SA
	The number of loan defaults is on the decrease in this SACCO	SD	D	N	A	SA
	The number of loan defaults is on the constant in this SACCO	SD	D	N	A	SA
	The NPLs portfolio is on the increase in this SACCO	SD	D	N	A	SA
	The NPLs have significantly hindered our operations and profits	SD	D	N	A	SA
	NPLs i not among the topmost problem in this SACCO	SD	D	N	A	SA

Code	**Question**	**SD**	**D**	**N**	**A**	**SA**
LR5	Loan repurchase is popular	SD	D	N	A	SA
LR6	We regularly restructure repayment periods	SD	D	N	A	SA
LR7	We have robust restructuring process	SD	D	N	A	SA
LR8	We restructure in the interest of the borrower	SD	D	N	A	SA
LR9	Repurchase commission is affordable	SD	D	N	A	SA
LR10	Favorable restructuring terms	SD	D	N	A	SA
LR11	Restructure has helped reduce defaults	SD	D	N	A	SA