

Influence of Collateral Securitization on loan performance Moi University SACCO, Eldoret, Kenya

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Abstract: *The objective of this study was to find the influence of Collateral Securitization on loan performance. The study was guided by Default Risk Models and Credit Scoring Models. Data collected was analyzed using descriptive statistics such as frequency and percentages. In addition, inferential statistics such as Pearson correlation and chi square were used. Collateral securitization is an important security in loan management of a SACCO. SACCO should protect itself from unforeseen contingencies of loan default due to the fact that the future is uncertain by offering loans secured by immovable assets.*

Key words: *collateral securitization, loan performance, loan management*

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I. INTRODUCTION

Voordeckers and Steijvers (2006) emphasizes on collateral or guarantors as one of the most determinants of demand for credit. They emphasize are on comparisons between business collateral and personal commitments. Collateral is pledged in order to reduce the risks as a result of asymmetric information, adverse selection and moral hazard. However, critics on collateral requirements in connection with credit evaluation argue that banks / microfinance institutions are better placed to evaluate projects of borrowers. The need of collateral weakens the incentives of banks to do so, argue that whether to use business collateral or personal commitment will depend on the classification of credit. These includes whether unsecured, secured with business collateral or secured with personal commitment in order to reduce credit risk.

Asset securitizations give SACCOs the opportunity to increase the quality of their lending portfolios. In this respect asset securitization allows SACCO members to share the risk of lending with investors, and therefore encourage the SACCOs to perform their roles as intermediaries (Robin and Hugh, 2009). If the borrower defaults the lender has a claim against the collateral being offered to secure the loan and if the loan is not repaid the property is sold. The lender is compensated for the money lost through the defaulted loan and collects the money.

Lenders often value the property conservatively and lend only a percentage of its appraised value to further minimize the risk incurred. This is known as the loan to value ratio. To collect reliable information from a prospective borrower, SACCOs often require the loan seeker to fill forms that ask for details about the borrower's financial status, monthly income, previous debts and marital status among others. A similar process is carried when a company applies for a business loan. Information is collected regarding the company's profit losses, debts and financial status (Kose *et al*, 2003).

Collateral and securitization accepted by the SACCO show that collateral securitization is one of the important business activities to consider before a SACCO engages in loan approvals. The kind of collateral securitizations accepted by MUSCO are personal guarantees through shares in SACCO, vehicles, and land which is accepted for some types of loans. Result on undervalued collateral securitization showed that it is a factor for non-performing loan. This implies that the factor is very important, and helps to avoid undervaluation of collateral securitization in lending businesses. According to Juvenalis (2010), a guarantee will not extend to any collateral where guarantors cannot equally share the liability of the defaulting member, and guarantors with more shares and deposits will bear the liability over and above those guarantors with less shares and deposits. This therefore implies that proper assessment of collateral valuation factor helps the SACCO's management to understand the financial condition of all borrowers and they will be able to promptly detect all problem loans for remedial action to be taken.

The success of a firm is measured by its profitability which depends on the efficiency of its management. Employees understand their role in the growth of an organization; hence act to secure the source of the SACCO's livelihood. Michael and Mark, (2008) stated that the SACCO management aimed at benefiting, among others, the management teams who are the people entrusted by the members to take care of their interests in the SACCO. They will strive to understand and improve on the policy setting and implementation for overall sustainability of the sector.

SACCOs should have a clearly established process in place for approving new credits as well as extension of existing credits. All extensions of credit must be made on an arms-length basis. In particular credits to related organizations and individuals must be made, monitored with particular care and other appropriate steps taken to control or mitigate the risks of connected lending as well as maintaining an appropriate credit administration, measurement and monitoring process. SACCOs should have in place a system for the ongoing administration of their various credit risks bearing portfolios (Cole *et al.*, (2005).

1.1 Methodology

The descriptive research design was adopted in this study to describe the data and characteristics of quantitative data that was collected. Further, Chi-square, regression analysis and other statistical tools were applied. The data for this study was mainly Primary data collected from credit department and SACCO members. Secondary data was collected to complement primary data and was obtained through credit manuals like KUSCCO SACCO stars, SACCO magazine and brochures, journals, SACCO and portfolio reports, credit policy, financial statements and loan repayment schedules.

1.2 Model specification

Economists, bankers, SACCOs and analyst have developed many different models to assess the default risk on loans. These models are not mutually exclusive, in that financial institution managers may use more than one model to reach a credit pricing / loan quantity rationing decision (Vorgelegt *et al*, 2002). Consequently, different models have been developed to help economists and others to assess the default risk in SACCOs.

1.3 Results and discussion

1.3.1 Collateral Securitization on Loan Performance

In relation to whether collateral securitization has an effect on loan performance, 64.7% of the respondents agreed with the statement, 27.3% of the respondents disagreed and only 27.3% of the respondents gave no response as tabulated in Table 3.1. The results concur with that of Robin and Hugh (2009).

Table 3.1: Responses on Collateral Securitization on Loan Performance

Response	Frequency	Percent
No Response	12	8.0
YES	97	64.7
NO	41	27.3
Total	150	100.0

1.3.2 Kinds of Collateral Accepted for Loan Securitization in the SACCO

Collateral securitization is one of the important activities that SACCOs engage in the study therefore sought to find out what collateral securitization the SACCO accepts. Results from Table 3.2 indicate that 15% of the respondents accept vehicles as security for some types of loans, while 17% reported that land can be used as a collateral securitization. However, acceptance of animals and household goods secured is not allowed by the SACCO although all the respondents could not agree on this. This implies that animals and household goods like furniture do not appeal as collateral securitization for the SACCO. Hence it was clear that personal guarantees are heavily utilized by the SACCO since 26% of the respondents reported accepting this. Group guarantees are supported by 12% of the respondents who get loans sighted by a pool of members whereas 60% of the respondents did not agree. The key collateral securitization is the use of shares, and 29% of the respondents agreed that shares form a major part of the collateral securitization. The results concur with that of Voordeckers and Steijvers (2006).

Table 3.2: Kinds of Collateral Accepted for Loan Securitization in the SACCO

Kinds of Collateral Securitization	Frequency	Percent
Vehicles	23	15
Land	26	17
Personal guarantees	39	26
Group counted	18	12
Shares	44	30
Total	150	100.0

1.3.3 Savings / Deposits Used by the SACCO for Onward Lending

Another factor accounting for non-performing loan is undervalued collateral securitization. The results in Table 3.3 show 55.4% of the respondents agreed that undervalued collateral securitization is a factor for non-performing loan, 20% (30) did not agree, 8.7% gave no response and 16.0% were undecided. Despite this, it is clear that concerns about the statement shows that the factor is very important. The results concur with that of Juvenalis (2010).

Results on savings /deposit used for onward lending by the SACCO are presented in Table 4.13. These results show that 67% of the respondents agreed that client saving is must before a loan is given by the SACCO. 77.3% of the respondents further agreed that savings / deposits are used by the SACCO for onward lending. Likewise, 56.7% of the respondents agreed that the SACCO has credit risk management techniques on loan performance assessment. The results concur with that of Juvenalis (2010).

Table 3.3: Savings / Deposits Used by the SACCO for Onward Lending

Responses	Yes	No	No response
Client savings before a loan is awarded	67	30	3
Are deposits used for onward lending	77.3	12.7	10
SACCO have credit risk management technologies	56.7	32.7	10.7

1.3.4 Credit Risk Management Techniques used by the SACCO

The study sought to find out if the SACCO engages in any ways to determine the good portfolio credit risk management techniques (CRMT). One of the CRMT portfolios is use of SACCO staff expertise. Results in table 3.4 show that, 64.7% of the respondents' use the SACCO staff expertise, 21.3% disagreed and only 14% did not give any response. 48.8% agreed that information signal from the market environment is applied, though 35.3% reputed and 16.7% gave no response. Also in line is the quick returns impulse as reported by 32.2% of the respondents, 48% disagreed and 19.3% did not give a response. These findings concur with those of Michael and Mark, (2008).

Table 3.4: Responses on Credit Risk Management Techniques used by the SACCO on Loan Performance

Response	No	Yes	No response
Use of SACCO staff expertise	21.3	64.7	14
Informal signal from the market environment	35.3	48	16.7
Where there is quick return impulse	48	32.7	19.3

3.5 H0 There is no relationship between the influence of Collateral Securitization and loan performance

Hypothesis three stated that there is no significant relationship between the influence of Collateral securitization and loan performance of a SACCO. Chi-square results are shown in Table 3.5.

Table 3.5: Chi-Square Test Results on Collateral Securitization and Performance of the SACCO

	Value	df	Asymp sig. (2-sided)	Exact Sig. (2 sided)
Pearson Chi-square	14.021	1	0.324	
Continuity Correction	1.117	1	0.001	
Like hood ratio	1.115	1	0.000	

From table 3.5 the chi-square value of 14.021, df of 1 and p value of 0.000 ($p < 0.05$) shows a relationship between Collateral Securitization and loan performance of the SACCO. This relationship is significant and positively concurred with findings of Voordeckers and Steijvers (2006)

According to the results in table 3.6 in year 2009, out of the Kshs 697 million outstanding loans to customers 9% were non-performing loans, in 2010 out of Kshs 820 million outstanding loan 13% were the non-performing loans. In the year 2011, out of Kshs 639 million outstanding loan, 6% were non performing while in 2012 out of Kshs 565 million of outstanding loans 7% were non-performing loans. These findings concurs with those of Cole et al. (2005) who asserts that the review of portfolio credit risk assessment management can contribute to the success of organizations in three primary arrears namely: how the portfolio credit risk assessment problem has been defined and redefined over time in response to the changing information needs of lenders and regulators, how methodological innovations have improved portfolio credit assessment procedures, and, how the efficiency of financial markets has changed due to the evolution of portfolio credit risk assessment.

Table 3.6: Summary of the SACCO's Loans Performance

Year	Outstanding loans (Kshs)	Performing loans	Nonperforming loans	Outstanding loans to non-performing
2009	696,579,128	631,264,398	65,314,730	9%
2010	819,811,267	715,109,145	104,702,122	13%
2011	638,776,375	601,664,256	37,112,119	6%
2012	564,785,054	526,662,907	38,122,147	7%

Source: SACCO Annual Reports, 2009 – 2012

1.4 Summary

According to Juvenalis (2010), SACCOs lend money without tangible collateral and the security of loans is provided by the check-off system as well as the deductions from wages and salaries by employers for savings and loan repayment. Each loan should be guaranteed by at least one or more members of the SACCO as is regulated in the SACCOs by-laws

1.5 Conclusions and recommendations

Generally collateral securitization is one of the important businesses that SACCOs engage in, before a loan is awarded to the borrower according to Voordeckers and Steijvers (2006). Although more emphasis is put on shares for collateral securitization, it was clear that vehicles are accepted for some type of loans, land can be used as a collateral securitization and personal guarantees are heavily utilized by the SACCO. Weakness in the SACCO system may be where there are special provisions for others to take loans without personal guarantees according to according to (Robin and Hugh, 2009). The key collateral securitization is the use of shares, and clients are required to have a savings before a loan is awarded.

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