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Effect of repayment period on loan performance in Moi University SACCO, Eldoret, Kenya

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Abstract: *The objective of this study was to find out the effect of repayment period on loan performance of a SACCO and was guided by Default Risk Models and Credit Scoring Models. Data collected was analyzed using descriptive statistics such as frequency and percentages. Further, inferential statistics applied include Pearson correlation and chi square. It was found out that that there is positive relationship between loan repayment and a long repayment period and this depict that repayment period of a loan affects loan performance of a SACCO. SACCO should adopt lean ways of loan recovery.*

Key words: *loan repayment, loan performance, period*

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I. INTRODUCTION

According to Mwaisekwa (2004), several studies have been conducted regarding credit risk, and have insisted that credit is a two-sided problem. One side of the problem is extending too much credit on excessively generous terms to unreliable and unproductive borrowers. The alternative danger of too little credit provided on too conservative terms is only infrequently recognized. Too much and too risk a credit can lead to serious losses; too little and too safe a credit can lead to a level of production, employment and income significantly below that would otherwise be achieved. Economic consequences can be serious when credit is too safe, as well as when is to risk. However when his study analyzed, it is realized that, the problem of credit risk is that of balancing risks and benefits of balancing the cost involved in reducing credit risk against the benefit derived from the increase.

Rashid (2005) asserts that the essential element of the desired commercial infrastructure is a legal and judicial framework that provides for an efficient and prompt debt recovery process. Unsatisfactory debt recovery is one of the main reasons for financial distress to many lenders across the world (Malimba and Ganesan, 2009). In most developing countries, a significant proportion of loans made by savings and credits organizations and other financial institutions are in default. Consequently many such lending institutions may be technically insolvent. The effect of non-performing loans goes beyond its impact on lending institutions and the repayment period. Severe financial distress of lenders has a widespread negative impact on economic growth and development. It is particularly costly to developing countries. The record of recoveries of loans, mounting overdue and bad debts cause a lot of concern to SACCO management as well as the political leadership. This left doubts as to whether the lending officials themselves in general were well and adequately equipped analytically to detect in advance such weaknesses. The most appropriate and timely action is not to lend or extend credit to any borrower or business or project if it would most likely be unable to pay its way (Malimba and Ganesan, 2009).

Ndazi (2001) suggests that supplying liquidity to constrained firms is very risky as it reduces the probability of payments and increases moral hazards problems due to repayment period on loan performance. This implies that the supplying firm would also experience liquidity problems and high costs resulting from late payments that would further affect profitability of the firm. Good loans are loans that are repaid according to the terms and condition agreed when they were issued. In most cases loans are known to be a good source of financial institution profitability if not defaulted (Shango, 2000).

A study by Chijoriga (2011) on credit risk modeling and valuation found out that firms share a common dependence on the economic environment, which results in cyclical correlation between defaulters. This also observed jumps in spread that suggested that a large variation in the credit risk of one issuer, which causes a spread jump, could propagate to other issuers as well. This study also indicated that the future of borrowing customers businesses can be predicted and possible defaulters identified during the appraisal stage (onset) and pried accordingly, or decision to reject the request made.

According to Pearce and Robinson (2007), operational risk controls provide post action risk evaluation and risk controls over short periods from one month to one year. To be effective, operational credit risk controls must take four steps common to all post action credit risk controls; set standards of credits risks performance,

measure actual credit risk performance, identify deviations from standards and initiate credit risks corrective actions (Samules, 2011). According to Mwaura (2005), lack of credit risk analysis, credit follow-ups as well as lending without proper procedures are the key factors that contribute to poor performance in loan lending by SACCOs in Kenya. Mudibo (2005), reports that with the Credit administration desired, loan analysis based on repayment capacity, loan size limited by capital amount requirements available and loan write-downs on quarterly eliminations is necessary.

Many Savings, Credit and other financial institutions in market economies have routine internal procedures for evaluating their clients. These are built around credit files that contain complete information on the relationship between a SACCOs and client. Credit files contain a summary of business relationship between SACCOs and clients information on senior officers and directors, financial data including audited financial statements, spreadsheets constructed by savings and credit society that contains ratios and other analytical indicators calculated from financial data. Information about this relationship forms the basis for financial institutions strategy in managing its exposure and obtaining more business from the client. Appropriate analysis that provides a window on risk and consistency in evaluation are important for good decisions and for maintaining good relationship with borrower (Vorgelegt *et al*, 2002).

Rashid, (2005) asserts that savings and credit institutions rarely lose money solely because the decision to lend was wrong, even where there are greater risks than the financial institution recognized; they only cause a loss after giving warning signs. More savings and credit institutions lose money because they do not monitor their borrowers properly, and fail to recognize the warnings early enough, than for almost any other reason of default. Early recognition of problem signs always gives some chance of helping in several ways. It gives the chance to the savings and credit institutions to study the problem, decide on its main causes, prospects of dealing with them and how likely they are to prove fatal. Early identification of credit problems allows considered action alone jointly with management of the savings and credit organizations or with other lending institutions, to rescuer the situation before the borrowers, financial problem reaches unsalvageable state.

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 Loan Repayment

Results on respondents' loan repayment period on Table 3.1 show that 49.3% of the respondents agree that a short loan repayment period is a cause of non-performing loans, 28.6% did not agree, 11.3% were undecided while 10.7% did not respond. These results imply that although a short loan repayment period can easily lead to a non-performing loan, the same situation is displayed by those with long loan repayments. Only 34% disagreed, 8.7% gave no response and another 8.7% were undecided. The results concur with that of Malimba and Ganesan, (2009).

Table 3.1: Respondent Views on Loan Repayment

	Frequency	Percent
No response	16	10.7
Agree	74	49.3
Undecided	17	11.3
Disagree	43	28.6
Total	**150**	**100.0**

1.3.2 Causes of Loan Default

The cause of loan default was sought from the respondents and results shown in Table 4.17 indicate that overcommitted pay slips account for 22% of the loan defaulters, suspended or sacked employees accounted for 29.3%, interference with SACCO loan recovery were 13.3 % and poor tracking hence taking long to recover loans was 15.3% of the sample as depicted on Table 3.2. The results concur with that of Chijoriga (2011).

Table 3.2: Respondent Views on the Causes of Loan Default in SACCO

	Frequency	Percent
No response	30	20.0
Overcommitted pay slips	33	22.0
Employer suspending or sacking employee	44	29.3
Interference with SACCO recoveries	20	13.3
Poor tracking hence taking long to recover loans	23	15.3
Total	**150**	**100.0**

1.3.3 Overall Loan Default Percentage

Results in Table 3.3 further show that the loan default percentage is low (2%) as reported by 66.7% of the respondents while 33.3% of the respondents. This could be an indicator that they are not informed or do not work in the department dealing with loan defaults. The results concur with that of Mwaisekwa (2004).

Table 3.3: Overall Loan Default Percentage

Responses	Frequency	Percent
No Response	50	33.3
Less than 2%	100	66.7
Total	**150**	**100.0**

1.3.4 Credit Follow Up Contributes to Poor Performance

Results in Table 3.4 show that non-credit follow-ups contribute to poor performance in loan lending by the SACCO. From the results 46% of the respondents agreed it contributes to poor performance while 39.3% disagreed. However, poor lending procedures contribute to poor performance as indicated by 138 (85.3%) of the respondents who agreed while only 9 (6%) of the respondents disagreed. Generally, the percentage of respondents who gave no response or were undecided is low (14.7%). The results concur with that of Mwaura (2005).

Table 3.4: Responses on Credit Follow Up Contributes to Poor Performance in the SACCO

Response	Frequency	Percent
Undecided	22	14.7
Disagree	59	39.3
Agree	69	46.0
Total	**150**	**100.0**

1.3.5 Liquidity and Credit Risks

Results in Table 3.5 on the liquidity and credit risks indicate that majority of the respondents, (79.4%) of the respondents agreed with the statement, 10% disagreed and 6.0% gave no response while 4.7% were undecided. From the results shown in the table, it can be concluded that supplying liquidity to a constrained firm is very risky since it reduces the probability of payment. The results concur with that of Ndazi (2001).

Table 3.5: Responses on Liquidity and Credit Risks on Loan Performance in the SACCO

Response	Frequency	Percent
No Response	9	6.0
YES	119	79.4
NO	15	10
Undecided	7	4.7
Total	**150**	**100.0**

1.3.6 Waiting Period and Repayment

Results in table 3.6 further show that there is a waiting period between repayment and the disbursement of a subsequent loan. 64.7% of the respondents responded yes to this and 27.3% stated no and only 8% gave no response. The results concur with that of (Mudibo, 2005).

Table 3.6: Views of Respondent on Waiting Period and Repayment on Loan Performance in the SACCO

Response	Frequency	Percent
No Response	12	8
YES	97	64.7
NO	41	27.3
Total	**150**	**100.0**

1.3.7 $H0_2$There is no significant relationship between loan repayment period and loan performance of a SACCO

Hypothesis two stated that there is no significant relationship between repayment period and loan performance of the SACCO. The Chi-square results are presented in Table 3.7. The results concur with that of Vorgelegt et al, 2002.

Table 3.7: Chi-Square Results on Repayment Period and Performance of the SACCO

	Value	Df	Asymp sig. (2-sided)	Exact Sig. (2 sided)
Pearson Chi-square	11.321	1	0.324	
Continuity Correction	1.326	1	0.002	
Like hood ratio (P value)	1.237	1	0.000	

From the Table 4.17, the chi-square statistics of 11.321, df of 1 and p value of 0.000 ($p<0.05$)

1.4 Summary

Results on loan repayment period showed that short loan repayment period is a cause of non-performing loans. These imply that a short loan repayment period can easily lead to a non-performing loan. Despite this, findings revealed that there is positive relationship between good loan repayment and a long repayment period. This finding is consistent with researchers' expectation. According to Malimba and Ganesan, (2009), an understanding of socio-economic factors affecting loan repayment behavior of clients is essential for outreach and sustainability of mushrooming cooperative societies in Kenya. Consequently, it can be argued although the foregoing relationship is significant, as the low repayment period increases, it will reduce the cash flow burden. Ultimately if the repayment period increases, it will reduce the possibility of losses in SACCOs. This is contract with where the SACCO's long repayment is considered to be more at risk due to the fact that the future is uncertain.

1.5 Conclusions and recommendations

A strategy to increase a loan repayment period should be adopted to expand and maintain the existing market niche. A longer period of loan repayment provides better terms to borrowers who are required to pay lesser amount per installment while collecting substantial amount as principal loans.

The SACCO's management should ensure that there are timely and adequate actions taken on problem events or risks which may give rise to loan default to prevent accumulation of portfolio losses and bad loan performance.

The SACCO has to educate its borrowers on the necessity of paying their debts and train its staff and management on effective debt follow up. In doing this, the SACCO should have a program to conduct seminars and workshops to their borrowers so that borrowers are educated and know the meaning of a loan and the importance of paying it back within the specified repayment period. This will instill discipline in the SACCO's membership and inculcate the sense of saving promptly and using wisely.

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