

COLLECTIONS POLICY AND FINANCIAL PERFORMANCE OF SAVINGS AND CREDIT COOPERATIVE SOCIETIES IN NYERI CENTRAL SUB COUNTY, KENYA

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ABSTRACT

The World Council of Credit Unions recently highlighted the Kenyan Savings and Credit Cooperative Societies' sub sector as the fastest growing in the world. The growing popularity and landmark growth of the sub sector is driven by the ability of the entities to meet clients credit needs on better and easier terms than other players in the financial sector. Scholars are in consensus that credit management is the foundation for stability and growth of modern-day enterprises. The research therefore sought to establish the influence of collections policy on the financial performance of the Savings and Credit Cooperative Societies in Nyeri Central Sub County of Kenya. The study was particularly interested with the financial aspects of firm performance and specifically exploited profitability ratio aspects measured through Return on Investment. The study also considered Credit Risk Exposure measures namely Portfolio at Risk and Write off Ratio. The study was anchored on the Information Asymmetry Theory, Agency theory as well as the Transaction Cost Theory as the key guiding theoretical models. The study adopted a census study of all the 15 active Savings and Credit Cooperative Societies in Nyeri Central Sub County. The study used both primary and secondary data pieces. Questionnaires were the choice

tools for collecting primary data. The questionnaire was dropped in person and then picked at a later date. The questionnaire was tested for validity and reliability using a pilot study, seeking expert opinion and Cronbach's Alpha Reliability Analysis. Financial performance was considered for 5 financial years 2012-2016 for better understanding of performance over time. Secondary resources from the SACCO societies Regulatory Authority publications and reports were also useful. The study used the Statistical Package for Social Sciences to generate both descriptive and inferential statistics. The results of the multiple regression analysis established that collections policy ($\beta=1.425$, $p=0.05$) was a statistically significant predictor of financial performance. Pearson correlation analysis results indicated that collections policy ($r=0.721$, $p=0.030$) has a very strong and statistically significant relationship with financial performance. A recommendation was made on need to tighten the collections policy and embrace a stringent as opposed to lenient collections framework in the tune of the agency theorists.

Key Words: Credit Management, Collections Policy, Financial Performance, Savings and Credit Cooperative Societies.

INTRODUCTION

Background of the study

Scholars and Researchers worldwide are in consensus that loan management also referred to as Credit management has momentous value to offer for individual and corporate entities engaged in lending business in their pursuit of wealth maximisation goal. Van Deventer, Imai, and Mesler (2013) observe that prudent practise of credit management guarantees that clients pay for the products supplied or the services rendered. The instrumental role of credit management is pinned on the importance of cash flow. Regardless of business viability, lack the cash to continue with the enterprise may mean the road to bankruptcy or take-over by other entities that understand how to prudently deal with cash. The biggest risk for Savings and Credit Cooperative Societies is lending money and not getting it back (Altman, 2002). This is made serious that SACCOs cover a clientele of people who have previously been under financial exclusion, lacking the required collateral or tough requirements to obtain credit from traditional sources like banks. In the noble role of driving financial inclusion therefore, it is prudent for SACCOs to ensure that Credit Administration is guided by policies and regulations that tend to minimise the credit risks involved. Only by so doing will the SACCOs survive in an environment marked with stiff competition and unpredictable economic variables.

Gatuhu (2013) argues that timely identification of potential credit default is an area that needs to be emphasized by financial institutions that aim to cover the financial excluded clientele. This is particularly because high default rates lead to decreased cash flows, poor liquidity status and ultimately financial distress. SACCOs have for instance, introduced the group lending framework as a way of striking a balance on the need to give lending services to the financially excluded and the need to safeguard shareholder wealth through risk distribution. In the group lending system, the borrowers get funding as a group rather than as individuals. The members of the group effectively become co-guarantors and are expected to hold themselves, collectively and individually responsible in case of any default. The group lending system or strategy has been proved as an effective way of reducing default, especially for SACCOs and MFIs whose credit terms and conditions are oversimplified.

Saunders, Cornett, and McGraw (2006) describe Credit management as a function that is implemented in a business entity to improve as well as control credit policies. The key outputs sought are increased revenues, lowered risks, increased level of collections, credit costs reduction, and development of competitive credit terms. Brealey, Myers, Allen, and Mohanty (2012) posit that Credit Management involves strategies, methods, policies and structures adopted by a firm to ensure optimal and effective administration of credit. (Altman, 2002) observes that in today's environment of intense competitive pressures, volatile economic conditions, rising bankruptcies and defaults, not forgetting the increasing levels of consumer and commercial debt, an organization's ability to effectively monitor and manage its credit risk could mean the difference between its success and collapse. As a financial management function, credit management involves credit analysis, credit rating, credit classification and credit reporting. The processes ensure that credit risks are effectively minimized through an informed and well-structured administration of credit.

According to Allen and Saunders (2002), Credit risk essentially covers risks due to promotion or demotion or rather, the variance of a borrower's credit worthiness. SACCOs are devoting a considerable amount of time and thought to defining and managing credit risk that apparently hold the make or break point for modern day enterprises. Cossin and Pirotte (2001) asserts that credit risk management is a continuous cycle that forms the very heart of an organization's ability to stay competitive. The concept ideally involves identifying and correctly pricing risk in the customer acquisition process, measuring risk throughout the customer lifecycle, determining capital allocations and regulatory requirements and finally a timely and effective collection framework. According to Fight (2004) When the risk has been identified, investment decisions can be made and the risk versus return trade off considered from a better position. Credit risk can be reduced by monitoring the behavior of clients who intend to apply for credit in the business (Bagchi, 2004).

According to De Servigny and Renault (2004), Credit management is essentially the means by which an entity manages its credit sales and always starts with the sale and does not stop until the full and final payment has been received. The principles applied in the administration of credit in a business organization should therefore be concerned with ensuring that the client will be able to make scheduled payments with interest in full and within the required time span. Altman, Resti, and Sironi (2004) add that awarding credit is a journey whose success depends on the methodology applied in the evaluation and award of credit to clients. The Credit Management Journey starts from the application for credit by clients, through acquisition of credit sales and only ends once the debt is fully paid. Credit management as a corporate function therefore aims to improve and control credit policies in an attempt to raise revenues levels while controlling for the risks involved. Altman (2002) asserts that credit management is a function performed within a company to improve and control credit policies that will lead to increased revenues and lower risk including increasing collections, reducing credit costs, extending more credit to creditworthy customers, and developing competitive credit terms.

Mukherjee (2008) describes Credit Appraisal as the process of subjecting potential borrowers to thorough screening to ensure their willingness, commitment and ability to repay the loan advanced to them promptly. The objective of credit appraisal is to ascertain the repayment capacity of the borrower that then guides the decisions whether to accept or reject loan applications. The 5 Cs model as advanced by Bhattacharya (2011) has found wide application in SACCOs in their quest to determine the credit worthiness of potential borrowers. The method evaluates the SACCOs loan clients using both qualitative and quantitative parameters. The 5 Cs Model evaluates five characteristics of the borrower as it endeavors to measure the chance of default. The five Cs of credit are Character, Capacity, Capital, Collateral and Conditions.

Abeyratne (2001) asserts that Character is used in this context to refer to a borrower's reputation as driven by his or her integrity and trustworthiness. The variable is instrumental in ascertaining the willingness to repay as well as the self-drive to run a successful enterprise through prudent management of the loan advanced. Capacity evaluates a client's ability to repay a loan by comparing income against recurring debts. As such, the lender is interested in ascertaining whether the business and household cash flows are adequate enough to cover loan repayments as scheduled. According to Chen, Guo, and Huang (2009), Capital is used to refer business and household assets and

liabilities. The lender will consider the borrower's injection of resources in financing a potential investment. It is worth noting that a large contribution by the borrower will lessen the chance of default. Collateral refers to access to an asset that the applicant is willing to cede in case of non-payment, or a guarantee by a respected person to repay a loan in default. Collateral may take various forms such as property, assets, or personal guarantees and is a useful tool to secure the loan. Lastly, conditions are used in reference to terms agreed upon based on careful analysis of environmental conditions such as regulations, level of competition, demand for products and the economic situation. Conditions include terms such as the interest rate and amount of principal which will significantly guide the lender's desire to finance the borrower (Mukherjee, 2008).

Credit Risk Controls, according to Hu (2009) involves activities that guarantee loan administration to as many worthy clients as possible and minimising advances to less credit worthy in equal measure. The concept involves a number of elements namely; Loan product design, Credit committees, Client orientation, Staff incentives and Loan rescheduling. SACCOs can mitigate a significant portion of default risk through loan products designed to meet the diverse needs of clients. The loan attributes of significance here include loan size, interest rate and fees, repayment schedule, collateral requirements. The constitution of Credit Committees mandated to make decisions concerning loans is an essential control mechanism in reducing credit risk. Gordy (2000) observes that if power to decide who receives loans, which loans will be written off or rescheduled, and under what conditions is concentrated on one individual, this power can easily be abused and covered up. This condition would potentially expose the organisation to credit risks emanating from power abuses. As such, credit committees ensure distribution of decision-making power to avoid unnecessary exposure to abuse that would lead a firm to detriment.

The credit committee is mandated to not only approve loans, but also to monitor the loan progress and to be participate in delinquency management should borrowers have repayment problems. Delinquency is ideally the failure to settle loan obligations as they fall due or as agreed. In most SACCOs, missing two successive payments will normally make the account to be rendered delinquent. Delinquency management methods applied by SACCOs involve cultivating an institutional culture that embraces zero tolerance of arrears and immediate follow up on all late payments. SACCOs can also remind clients who have had recent delinquency problems that their repayment day is approaching to ensure timely settlement (Gatuhu, 2013). Client Orientation involves instilling and communicating the concept of zero tolerance to delinquency or delayed payments to new loan clients. Staff incentives also play a central role in discouraging delinquency. The loan should be designed in a manner that discourages default, for instance imposing penalties based on the duration the dues remain unsettled.

According to Gisemba (2010), delinquency occurs when a client fails to repay a loan instalment according to the agreed repayment schedule. A repayment schedule should be worked out and agreed upon by both the lender and the borrower upon loan advance to clients. Once a situation arises where payments become past due, the loan is said to be turning delinquent. The borrowers who have not been able to fulfil the repayment terms are called delinquent borrowers. Kibui and Moronge (2014) observes that failure to control loan delinquency, which often leads to default, is probably the largest single down fall of SACCOs. There are their major types of delinquents, willing

but unable to pay, Unwilling but able to pay and willing and able to pay but lacking self-discipline. Staff should also be equipped with good working lending frameworks to ensure effective management of loan portfolio e.g., Credit Reference Bureau (CRB) information sharing. Staff should also be well motivated to carry out their credit management duties diligently to ensure superior loan portfolio quality. A good collection policy is an instrument for organisations to achieve quality loan portfolio.

Due to diverse character of clients, loan will not always be repaid at the same time. Some clients are fast payers, others slow payers while others are non-payers. As such, a prudent collections policy ensures that loan agreements are adhered to. The collection effort should, therefore aim at fast-tracking collections from slow payers and reducing losses associated with bad debts. Training and development programmes are at the core of the organisation's credit management performance. The staff need to have the relevant understanding of credit management as a profession and also need to be developed regularly to keep pace with dynamics in the business world. There needs to be regular training needs assessment programmes by SACCOs to evaluate the knowledge gaps to be filled through training and development programmes (Mays, 2001).

Penman and Penman (2007) describes the concept of financial performance as the level of a firm's or project's performance over a specified period of time which is conveyed in terms of overall returns or losses during that particular period. The assessment of the financial performance of a business is critical to business organisations in that it allows decision-makers to critic the results of the enterprise or corporate strategies and activities in objective monetary terms. Marr (2005) presents that the financial systems approach emphasizes the importance of financially sustainable SACCO and other financial institutions programs. Application of the financial systems approach ensures a SACCOs success in the quest to provide financial inclusion services to the financially excluded. The process of comparing the performance of SACCOs is made complex due to lack of publicly available financial information and differences in reporting in a mostly little regulated industry. Most past researchers have used financial ratios such as Profitability Ratios; Return on Investment also known as Return on Assets, Return on Equity, Efficiency Ratios, leverage ratios and other risk ratios as a way of assessing the financial performance of Savings and Credit Cooperative Societies (Gatuhu, 2013).

Other scholars have recommended the use of CAMELS rating to assess the financial performance of financial institutions which includes SACCOs. The CAMELS rating as gathered from Nimalathan (2008) is an international bank-rating system where bank supervisory authorities rate institutions according to six factors represented by the acronym "CAMELS." The acronyms represent the following variables: C - Capital adequacy, A - Asset quality, M - Management quality, E - Earnings, L - Liquidity, and S - Sensitivity to Market Risk. SACCOs supervisory authorities assign each bank a score on a scale of one (best) to five (worst) for each factor. If an institution has an average score less than two it is considered to be a high-quality institution, while those with scores greater than three are considered to be less-than-satisfactory establishments (Nimalathan, 2008).

The study at hand exploited profitability as well as credit risk ratios. Profitability indicators included the Return on Assets (ROA) which assesses the ability of SACCOs to generate income based on its assets. It is important to note that the ratio excludes non-operating income and donations (Marr, 2005). Another method that was used to assess SACCOs financial performance was the assessment of credit risk exposure (CR) which is measured by the total number loans past due 30 days or more and still accruing interest also called Portfolio at Risk (PAR-30). Also exploited was the write-off ratio (WOR) which is essentially the value of loans written off during the year as uncollectible and is expressed as a percentage of average gross loan or total disbursements. It is important to note that only WOR is applicable as a measure of default for SACCOs, while Portfolio at Risk (PAR) is a measure of the risk of default.

Statement of the Problem

In spite of the high ranking of the Kenyan SACCO sub sector in global ratings such as the World Council of Credit Unions (WOCCU), enormous challenges continue to be encountered in the sector with a few SACCOs forced to shut doors (Gamba and Komo, 2014). The role of prudent credit management practices on the financial stability and ultimate survival of SACCO Societies cannot be under estimated. Wanyama (2009) observes that credit management is at the core of the SACCOs mandate and therefore SACCOs that wish to survive must create structures and policies that balance the need to ensure financial inclusion of current and potential members on matters credit against the risks involved.

Mugwe (2011) in a review of a joint report by the Central Bank of Kenya, the SACCOs Societies Regulatory Authority (SASRA), Capital Markets Authority (CMA), Insurance Regulatory Authority (IRA) and the Retirements Benefits Authority (RBA) identifies Credit Risk as one of the most serious drawbacks facing the Kenyan SACCO sector. It is ironical that of the 15 SACCO Societies identified within the Sub County, only 4 of them are licensed to operate by the SACCOs Societies Regulatory Authority. The licensed SACCOs are 2NK SACCO, Biashara SACCO, New Forties SACCO, and Taifa SACCO. This condition leaves 10 SACCOs which represents 67 % of the SACCOs not SASRA Regulated. It was critical for the study at hand to establish the credit management standards of the unregulated SACCOs compared to the regulated SACCOs and report if Credit Management standards used significantly relate to the SACCOs financial Performance.

Poudel (2012) examined the impact of credit risk management on financial performance of commercial banks in Nepal. The study established that all these parameters had an inverse impact on banks' financial performance with default rate being the most significant predictor of bank financial performance. Kolapo, Ayeni, and Oke (2012) conducted a study on Credit risk and commercial banks' performance in Nigeria using a panel model approach. The study established that the effect of credit risk on bank performance measured by the Return on Assets of banks is cross-sectional invariant. This implies that the impact is similar across banks in Nigeria.

Njeru (2012) considered the factors affecting loan delinquency in microfinance institutions in Kenya. The results indicated that microfinance institutions and self-help groups' specific factors and external factors significantly affect loan delinquency performance among microfinance

institutions in Kenya. From the above review, the study has unveiled methodological gaps, contextual gaps as well as empirical gaps that would be filled by the study. The current study therefore considered the effect of collections policy on performance of SACCOs in Nyeri central sub county, Kenya.

Objective of the Study

To determine the effect of collection policy on financial performance of Savings and Credit Cooperative Societies.

Research Hypothesis

H₀₁: Collection Policy does not significantly affect the financial performance of Savings and Credit Cooperative Societies.

LITERATURE REVIEW

Theoretical Review

The study was anchored upon the agency theory, information asymmetry theory, credit risk (structural) theory and transaction cost theory.

Agency Theory

This theory was particularly useful in the assessment of the effect of Credit Risk Control and Credit Appraisal objectives of the study. The model ideally illuminates the relationships that exist between the principal(s) and agent(s) in a given entrepreneurial undertaking or investment. There are many challenges and conflicts that emerge from the agency relationships and as such the agency theory is about offering working solutions to these principal-agent problems. With regard to SACCOs, relationships do exist between shareholders as the Principals (owners) and company executives and managers as the agents (Miller and Sardais, 2011). The shareholders delegate management of their SACCOs to their authority and responsibility to managers.

It was therefore clear that in the context of SACCOS, agency relationships do exist between boards, management and owners and agency problems must be addressed. The agency problems arise where employees or managers fail on their obligation to act responsibly in safeguarding shareholders' wealth. Sometimes the agents may act selfishly without minding owners best interest (Ballwieser (2012). The agency theory presents the management as self-interested, individualistic, opportunistic and bounded in rationality. The agency theorists therefore recommend a system of strict corporate policy where rewards and punishments are used to check the excesses of agents. This, according to Hillier, Grinblatt, and Titman (2011) helps in preventing situations where the agents abuse their power to settle their own selfish ends. The agency theory therefore prescribes strict sanctions in reconciling the often-divergent goals of management and owners.

Information Asymmetry Theory

According to Eppy (2005), Information asymmetry is used to describe a condition where the business owners or managers are more knowledgeable about the projections for, and risk hazards facing their enterprise, than do lenders. The concept ideally represents a condition in which all parties involved in a business enterprise do not know all information that would be considered relevant. With regard to SACCOs where lending is a primary object, information asymmetry would arise if the borrower has better information about the potential risks and returns that would be attached to an investment project of which the loan borrowed is aimed to finance. On the other hand, the lender lacks sufficient information concerning the borrower (Lin and Sun, 2006).

According to Frieden and Hawkins (2010) perceived information asymmetry would occasion two drawbacks for the lenders, in this case SACCOs: Moral Hazard which involves monitoring entrepreneurial behavior and Adverse Selection which would be used in content and context to mean making errors in lending decisions. SACCOs would logically find it challenging to solve these problems under all possible circumstances. This is especially so if the amounts being loaned are relatively low where then it would not be economically feasible to devote heavy corporate resources to appraisal and monitoring. It is needful to note that the data needed to screen credit applications and to monitor the character, history and behavior of borrowers are not freely available to SACCOs.

Information sharing entities such as Credit Reference Bureaus (CRB) will always charge a fee for pieces of information shared. Information asymmetry condition will be faced by SACCOs especially when assessing lending applications (Korir, 2014). In conclusion, the information needed in the appraisal and assessment of borrowers, their competence, and the prospects of their businesses is either not available, uneconomic to obtain or is difficult to interpret. The information asymmetry condition therefore exposes the SACCOs to two types of risks, the risk of adverse selection resulting when SACCOs lend to enterprises which subsequently fail (type II error), or wrongful failure to lend to businesses with high potential for success (type I error) (Altman, 2004).

Credit Risk Theory or Structural Theory

Merton (1974) presented structural theory of credit management often called the credit risk theory. The theorists describe credit risk as the chance of facing a financial detriment due to the drop in the creditworthiness of a counterparty in a financial operation. The theorists posit that the foremost basis of credit risk is the default risk which is in essence the risk that a counterparty will fail to honour their contractual obligations. According to Lando (2009), the Merton's Model presents two main approaches of modelling credit risk. These methods are the Structural approach and intensity-based approach which is also referred to as reduced form approach.

The former method of risk modelling tries to model explicitly the event or experience triggering default or in other words the process behind the value of the assets. On the other hand, the intensity-based approach does not attempt to model default. As such, the proponents of intensity-based

approach take a credit risk event as an unpredictable and volatile event. This implies that the date of its manifestation is a totally distant stopping time with respect to an underlying filtration. In conclusion therefore, the proponents of the latter approach argue that in some situations the intensity-based approach is equivalent to the modelling of a default time in terms of its intensity process (Bielecki and Rutkowski, 2013). The theory is particularly key with regard to measures taken by SACCOs and understand what triggers default and measures taken to lessen the effect of default including delinquency management safeguards.

Transaction Cost theory

The transaction Cost theory was first developed by Schwartz (1974) and later the concept was developed by Tadelis and Williamson (2010), Tadelis & Williamson (2012). The basic premise upon which the transaction cost model is built is the proposition that suppliers may in most circumstances have an advantage over traditional lenders, and in this case SACCOs, in scrutinising the real financial condition or the credit worthiness of borrowers. Suppliers are also in a better position to monitor and force repayment of the credit than lenders. The dominances highlighted may give suppliers a cost advantage when compared with SACCOs as lenders of finance. Saussier (2000) classifies the sources of cost advantage as follows: information acquisition, controlling the buyer and salvaging value from existing assets.

Information acquisition as a source of competitive advantage can be explained by the fact that sellers have more, less costly and faster access to information about buyer since the information is obtained in the normal course of business. To be precise the frequency and amount of goods or products bought per purchase order gives suppliers an idea of the customer's financial situation (Tadelis and Williamson, 2010). The suppliers may also encounter situations like the buyer rejecting discounts for early payment which may serve to alert the supplier of weakening credit-worthiness of the buyer. Lastly, in normal circumstances, sellers usually visit customers more often than financial institutions and in this case SACCOs do and as such may get more developments concerning the borrowers than the lending institutions (Williamson, 2005).

Empirical Literature Review

The empirical review presents past studies reviewed. The review presents the methodologies or approaches, concepts, theoretical foundations used as well as the findings established through the studies. This process is essential as it plays a key role in the identification of research gaps and guides a framework of filling those gaps. Fredrick (2012) assessed the Impact of Credit Risk Management on Financial Performance of Commercial Banks in Kenya. The study sought to establish if there exists any relationship between the credit risk management and financial performance of commercial banks in Kenya and used the CAMEL rating system as the choice approach of influencing financial performance. Financial performance was indicated by ROE. The study established a strong impact between the CAMEL components on the financial performance of commercial banks indicated by ROE.

Kolapo, Ayeni, and Oke (2012) conducted a study on Credit risk and commercial banks' performance in Nigeria using a panel model approach. The study exploited the traditional profit theory to formulate profit and used Return on Asset (ROA) to measure performance. Credit risk measures used included as a ratio of non-performing loan to loan & Advances (NPL/LA), ratio of Total loan & Advances to Total deposit (LA/TD) and the ratio of loan loss provision to classified loans (LLP/CL) as measures of credit risk. The established that the effect of credit risk on bank performance measured by the Return on Assets of banks is cross-sectional invariant. This implies that the impact is similar across banks in Nigeria.

Gatuhu (2013) assessed the effect of credit management on the financial performance of microfinance institutions in Kenya and through a census study of all the 59 MFIs in Kenya that are members of AMFI. The study established that Collection policy had the highest implication on financial performance indicated by Return on Equity. A stringent policy was found to be more effective in debt recovery than a lenient policy. The study recommends that MFIs should enhance their collection policy by adapting a more stringent policy to a lenient policy for effective debt recovery.

Wachira (2015) undertook a study on the effect of credit policy on the financial performance of deposit taking SACCOs in Kenya. The study used a census sampling approach for the six deposit taking Sacco in Kenya to get the data required. The study used the Market Power Theory, Efficient Structure Theory, and Behavioural Finance Theory as guiding models and established that the Collections Policy as employed by a SACCO society is a major significant determinant of financial performance. The study recommends a stringent recovery framework as opposed to a lenient one as the firm aims to reduce default risk and boost performance.

RESEARCH METHODOLOGY

Research Design

A descriptive research design or approach was applied to the study at hand. According to Bulmberg, Cooper, and Schindler (2011), a descriptive study is concerned with finding out the what, where and how of a phenomenon. Kothari (2011) asserts that a descriptive research design involves establishing what is happening with regard to a particular study variable. According to Mugenda and Mugenda (2003), a descriptive research design involves the discovery of relationships that exists as regards certain variables without having to alter anything in the environment. The researcher justifies the choice of this research design or approach with the fact that, the phenomena under study cannot be manipulated as it involves an already existing state of affairs. As such, the study was concerned with explaining already existing relationships, relationships that could only be described but not altered.

Target Population

According to Ott and Longnecker (2015), a study population or the target population is essentially the total group of individuals or elements from which the sample might be drawn and consists of

individuals or elements with the same characteristics or attributes. The study population was made up of 15 deposits taking SACCOs Societies that are active in Nyeri Central Sub County as gathered from the Directorate of Cooperative Development of Nyeri County Government. From the population, 90 respondents were identified who included CEOs, Credit Managers and members of the executive board members.

Sample Design.

The researcher embraced a census study approach in the study at hand where all the 90 respondents drawn from all the 15 active deposits taking SACCOs in the Sub County were considered. The information on the number of SACCOs was gathered from the Directorate of Cooperative Development of Nyeri County Government as shown in Appendix 1. The census study was preferred by the researcher as the population of the study was considered small making it possible for the researcher to get contact with the respondents within a reasonable time. Kothari (2011), posits that where economically feasible, a census study is preferred since it generates more accurate results and reduces errors associated with sampling. The study purposively selected CEOs, Credit Managers and all the 4 Members of the Executive Board of all the 15-deposit taking SACCOs within the Sub County as the respondents of choice. The 90 respondents targeted met and even surpassed the threshold size of thirty (30) as argued by Kothari (2011) and Mugenda and Mugenda (2003) as a rule of thumb for normal statistical approximations.

Table 3.1: Table of target Respondents

	Number per SACCO	TOTAL	Proportion of population
C.E.Os.	1	15	100%
Credit Managers	1	15	100%
Executive Board Members	4	60	100%
TOTAL RESPONDENTS	6	90	100%

Source: Researcher (2016)

Data collection instruments and procedure.

The research study exploited both primary and secondary data sources. Primary data was collected by way of questionnaires which were administered through the ‘drop and pick later’ method. Secondary data was collected from the annual financial statements of the companies as well as other corporate handbooks. Secondary resources from the regulatory authorities such as reports by the SACCOs Societies Regulatory Authority were also very useful. The researcher obtained an introduction letter from the university to smoothen the data collection process by providing assurance to the respondents that the information sought would be used purely for academic purposes.

Validity and Reliability.

The researcher carried out tests to assess the validity and reliability status of the research instrument. According to Mugenda and Mugenda (2003), Validity entails the extent to which an instrument measures what it is supposed to measure and performs as it is designed to perform. If the data collected is a true reflection of the variables, then inferences based on such data will be considered accurate and meaningful. The researcher carried out tests to ensure that the questionnaire which was the research instrument exploited would actually measure what it was intended to measure. To this end, a pilot study was conducted to pre-test the research instrument for validity. The researcher also sought Expert Opinion regarding the research instrument from useful resource persons such as the supervisor and other lecturers to ensure that the research instrument was valid. Adjustments were made based on their input, until the researcher and experts were all satisfied to the validity status of the instrument. Expert Opinion and Pilot studies are some operative methods advanced by Mugenda and Mugenda (2003) as useful methods of testing the validity of research instruments.

According to Ott and Longnecker (2015), reliability is the extent to which an experiment, test, or any measuring procedure yields the same result on repeated trials. If the research tools and procedures fail to yield consistent measurements, researchers would be unable to satisfactorily draw conclusions, formulate theories, or make claims about the generalizability of their research. The researcher also tested the extent to which the research instrument, administered more than once yielded consistent results. Kothari (2011) argues that the idea behind reliability is that any significant results must be more than a one-time instance finding and must be inherently repeatable. Establishing the internal consistency reliability status of the research instrument will be the major goal of the researcher. Specifically, researcher will use the split half correlation measures. To achieve this, the researcher employed Cronbach's Alpha Reliability Test using SPSS to test for reliability of the instrument. The Cronbach's alpha evaluates internal consistency by calculating an equivalent to the average of all possible split half correlation.

Table 3.2: Chronbach's Alpha Reliability Statistics

Cronbach's Alpha	Cronbach's Alpha Based on Standardized Items	N of Items
.704	.783	26

Source: Survey data (2016)

From the results in table 3.2, the Cronbach's alpha coefficient for 26 items was 0.783 which represented a relatively high internal consistency. According to Gliem & Gliem (2003), a chronbach's alpha reliability coefficient of greater than 0.70 would be considered acceptable in social science research situations.

Data analysis

Upon Successful data collection, data was then cleaned and categorised in line with the objectives and hypothesis of the study. Quantitative data was analysed using both descriptive statistics and inferential statistics. Besides the regression model, correlation analysis was also conducted to explain the strength of relationships unveiled between the variables under study. The researcher

aimed to develop a regression model of the type given below as adopted from Kutner, Nachtsheim, and Neter (2004) and would be generated using SPSS software.

Model Speciation

$$Y = \beta_0 + \beta_1 X_1 + \epsilon$$

Where; Y= Financial Performance

X_1 = Collection Policy

While β_0 = Regression intercept

β_1 = gradient

ϵ = error term.

The research findings were presented using tables, charts, frequencies and percentages. The study results on each hypothesis and objective was subjected to a thorough and critical discussion based on past comparative findings or theoretical models.

RESEARCH FINDINGS AND DISCUSSIONS

Response rate

Table 4.1 statistics gathered concerning the response rate achieved. It is followed by a justification why the number and rate of responses attained were considered adequate.

Table 4.1: Response Rate

Targeted respondents	Responses received	Response rate
90	75	83.33%

Source: Survey data (2016)

The researcher distributed a total of 90 questionnaires to the various Deposit taking SACCO Societies. Out of this, only 75 questionnaires were returned. As such, the response rate stood at 83.33 %. Going by conventional wisdom presented by Mugenda & Mugenda (2003), a conclusion was made that the response rate was good. The author argue that a response rate of 50% is considered adequate, 60% good and above 70% as very good.

Financial Performance of SACCOs

This part presents descriptive statistics on the financial performance condition for SACCOs in Nyeri Central Sub County of Kenya. Table 4.2 presents descriptive statistics regarding the financial performance of the SACCOs as indicated by the Return on Assets also called the Return on Investment.

Table 4.2: SACCO's Return on Investments ratio

N	Valid	75
	Missing	0
Mean		15.0000
Range		11.00
Minimum		10.00
Maximum		21.00

Source: Survey data (2016)

The average Return on Investment ratio for the SACCO Subsector in Nyeri Central Sub County stood at 15.00% as indicated by the mean. The highest ROI reported was 21% with the least being 10% therefore giving a range of 11%. This information could be an earlier indication that SACCOs' performance is widely variant with some SACCO's profitability being far much better than others. The findings marry with those of Gisemba (2010) who also reported wide performance variances for SACCOs.

Table 4.3 presents statistics regarding the SACCOs' profitability as indicated by the Return on Equity (ROE).

Table 4.3: Return on Equity for SACCOs

N	Valid	75
	Missing	0
Mean		13.8667
Range		11.00
Minimum		9.00
Maximum		20.00

Source: Survey data (2016)

The average Return on Equity ratio for the SACCO Sub sector in Nyeri Central Sub County stood at 13.86 % as indicated by the mean. The highest ROE reported was 20.00 % with the least being 9.00 % therefore giving a range of 11%. Again, the findings are indicative of highly spread profitability performance levels for the SACCOs in Nyeri Central Subcounty. The findings are consistent with those of Gisemba (2010) who also reported wide disparities in performance of Kenyan SACCOs.

Table 4.4 presents statistics on the Write-Off Ratio for SACCOs.

Table 4.4: Write Off Ratio in the SACCOs

N	Valid	75
	Missing	0
Mean		17.4533
Range		22.00
Minimum		2.00
Maximum		24.00

Source: Survey data (2016)

The average write off ratio for the SACCO Sub sector in Nyeri Central Sub County stood at 17.4533% as indicated by the mean. The least write off ratio was 2% with the highest being 24% representing a range of 22 as indicated in the table. The findings are indicative of fairly good loan

repayment but there is need to work towards diffusing the rate further. The findings seem to disapprove red alerts by Mugwe (2011) on extremely high default rate in the SACCO Sub sector. Though there's need for further diffusion, there is no cause for alarm yet, going by the findings.

Table 4.5 presents statistics on loan repayment rate in the SACCOs Sub Sector in Nyeri Central Sub County.

Table 4.5: Loan Repayment Rate in the SACCOs

N	Valid	75
	Missing	0
Mean		87.5200
Range		3.00
Minimum		60.00
Maximum		96.00

Source: Survey data (2016)

The average loan repayment rate for the SACCO Sub Sector in Nyeri Central Sub County was reported at 87.52% as indicated by the mean. The least repayment rate reported stood at 60% with the highest being 96% therefore representing a range of 36.00%. The findings are indicative of fairly good repayments in the SACCOs but there's need to device ways of pushing the repayments to 100% which is the goal of Credit Administration in the SACCOs. The findings are in conflict with pessimistic opinions fronted by Mugwe (2011) on high default rates in the SACCO Sub sector.

Collections Policy

This section covers descriptive statistics concerning the collections policy of the Savings and Credit Cooperative Societies in Nyeri Central Sub County of Kenya. Figure 4.1 presents statistics on the extent to which the SACCOs apply Collections Policy in their credit management undertakings. 40.00% of the respondents indicated that their SACCOs applied Collections Policy to a very great extent. 36.00% of the respondents indicated that the application of collections policy was to a great extent, 18.67% to a moderate extent and 5.33% indicated that the application of collections policy in the SACCOs was only to a small or little extent. The findings support the observations of Wachira (2015) who reports that SACCOs were employing collections policies to ensure and enforce loan repayments.

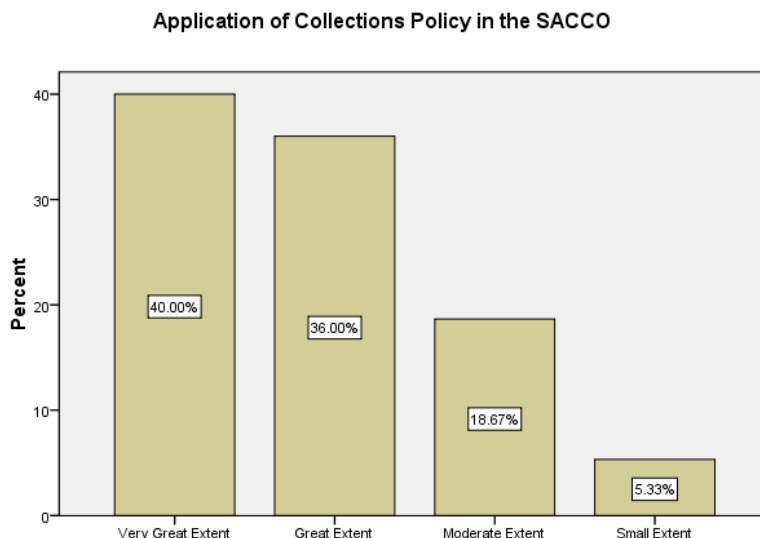


Figure 4.1: Application of Collections Policy in the SACCO
 Source: Survey data (2016)

Table 4.6 presents statistics on the respondents’ level of agreement on the proposition that collections policy has assisted towards effective credit management in the SACCO.

Table 4.6: Collections Policy enhances effective Credit Management

		Frequency	Percent
Valid	Strongly Agree	22	29.3
	Agree	21	28.0
	Neutral	15	20.0
	Disagree	9	12.0
	Strongly Disagree	8	10.7
Total		75	100.0

Source: Survey data (2016)

29.3% of the respondents strongly agreed with the proposition that Collections Policy enhances effective Credit Management in the SACCO. 28.00% just agreed, 20.00% were neutral about this condition with 12.00% and 10.70% disagreeing and strongly disagreeing respectively. As such majority of the respondents share with the empirical conclusions presented by Gatuhu (2013) who relates superior loan portfolio performance to Collections Policy.

Figure 4.2 presents statistics on the level to which enforcement of guarantee policies provides chances for loan recovery in case of loan defaults. 38.67% of the respondents agreed with the proposition that enforcement of guarantee policies provided chances for recovery of the loan in case of loan defaults. 25.33% were strongly in agreement with the proposition. 21.33% were neutral about this condition while 8.00% and 6.67 % disagreed and strongly disagreed respectively. The respondents’ observations are associated closely with the conventional wisdom presented by structural theorists such as Bielecki and Rutkowski (2013) who prescribe guarantees as one of the effective measures of checking default on loans.

Enforcement of guarantee policies provides chances for loan recovery in case of loan defaults

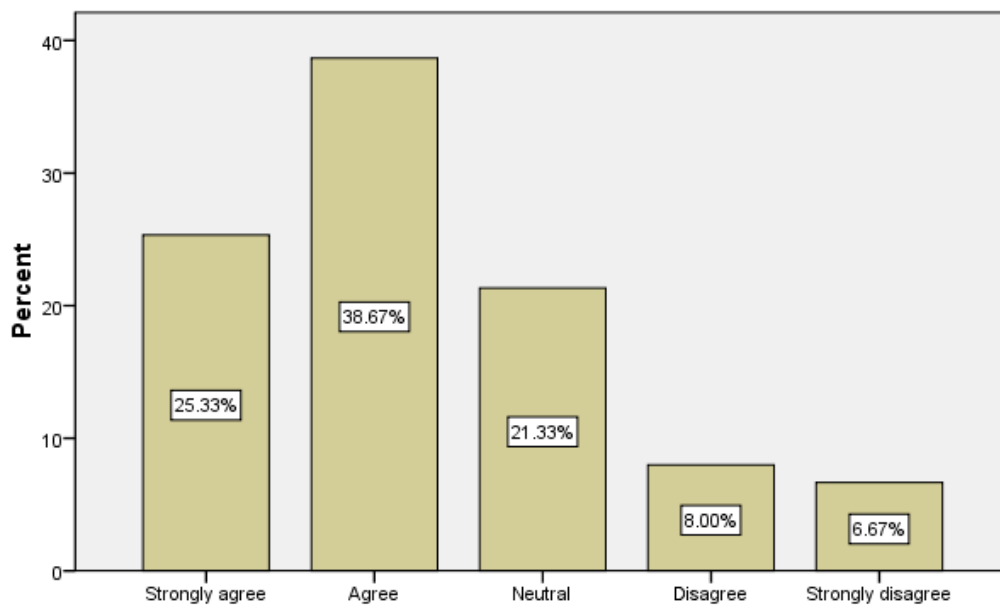


Figure 4.2: Enforcement of Guarantees for Loan Recovery
 Source: Survey data (2016)

Table 4.7 presents statistics on the level of respondents’ agreement to the proposition that formulation of collections policies have been a challenge in SACCOs’ Credit management undertakings.

Table 4.7: Challenge in Formulation of Collection policies

	Frequency	Percent
Valid Strongly agree	8	10.7
Agree	8	10.7
Neutral	14	18.7
Disagree	25	33.3
Strongly disagree	20	26.7
Total	75	100.0

Source: Survey data (2016)

10.7% of the respondents strongly agreed that formulation of collection policies had been a challenge with a further 10.7% agreeing with this condition. 18.7% were neutral about this condition while 33.3% and 26.7% of the respondents disagreed and strongly disagreed respectively. As such, a conclusion was made that the SACCOs did not have major issues with regard to formulation of collection policies. The findings support earlier results established by Wachira (2015).

Figure 4.3 presents statistics on the level to which the respondents share with the proposition that staff incentives are effective in improving loan recovery for delinquent cases. 37.33% of the respondents strongly agreed with the proposition that staff incentives were effective in improving

recovery of delinquent loans. 32.00% of the respondents just agree with this proposition. 12.00% were neutral about this condition while 13.33% and 5.33% disagreed and strongly disagreed respectively. As such, there was therefore need to motivate staff with incentives to motivate them to deal with delinquencies and improve repayment rates in the SACCOs. The findings agree with conventional wisdom presented by Hu (2009) and also further agrees with past studies such as Gatuhu (2013).

Staff incentives are effective in improving recovery of delinquent loans.

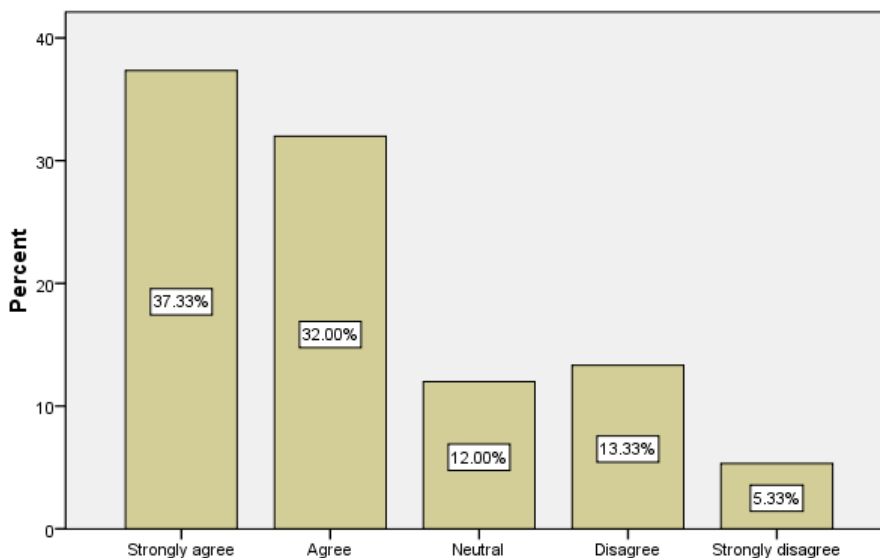


Figure 4.3: Staff incentives are key in dealing with delinquents
 Source: Survey data (2016)

Table 4.8 presents statistics on the proposition that there are usually regular review of credit policies in the SACCO to improve the state of Credit Management.

Table 4.8: Regular Review of Collections Policies

	Frequency	Percent
Valid Strongly agree	8	10.7
Agree	10	13.3
Neutral	22	29.3
Disagree	26	34.7
Strongly disagree	9	12.0
Total	75	100.0

Source: Survey data (2016)

10.70% and a further 13.30% of respondents strongly agreed and agreed respectively with the statement that regular reviews were done on collection policies to improve the state of credit management in the SACCO. 29.30% of the respondents about this argument while 34.7 and 12.0% disagreed and strongly disagreed respectively. The high number of respondents holding the contrary view about the level of reviews mean that the SACCOs need to upscale their reviews on collection policies on a more regular basis to ensure they are up to date with current conditions. The findings seem to support past observations by Wachira (2015).

Figure 4.4 presents statistics on the respondents’ level of agreement with the proposition that a stringent policy is more effective for debt recovery than a lenient policy. A whopping majority of respondents 80% agreed (37.33% strongly agreed and 42.67% agreed) with the proposition that a stringent policy was more effective than a lenient one in debt recovery. 10.67% of the respondents were neutral about this condition while the lower cut class of disagreeing respondents was made up of 9.33% of respondents (5.33% disagreeing and 4.00% strongly disagreeing). As such a conclusion was made that a stringent policy was favoured by majority of the respondents which was consistent with earlier observations by Gatuhu (2013) and as argued by agency theorists such as Miller and Sardais (2011) who advocate for stringent policy on collections.

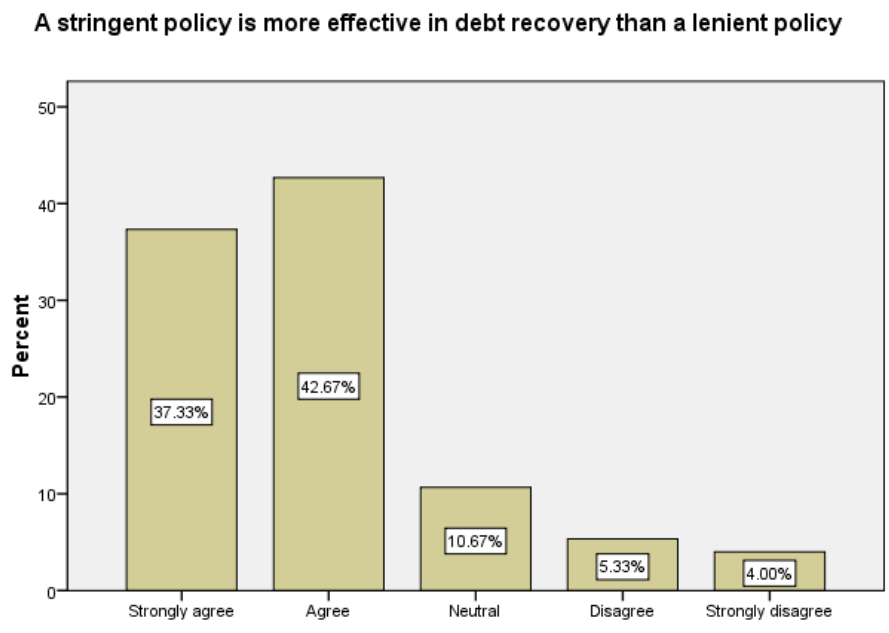


Figure 4.4: Stringent Vs. Lenient Policy
Source: Survey data (2016)

Multiple Regression Analysis

Table 4.9 presents the regression model summary.

Table 4.9: Regression Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.902 ^a	.815	.587	2.09375

a. Predictors: (Constant), Delinquency Management, Credit Risk Control, Credit Appraisal, Collections Policy

b. Dependent Variable: Financial Performance

Source: Survey data (2016)

As explained by R Square, the Coefficient of Determination, 81.50 % of the variation in the Financial Performance (the dependent variable) is explained by variability in the independent variables i.e., Delinquency Management, Credit Risk Control, Credit Appraisal and Collections

Policy. As such, we can assert that only 18.50 % of the variation in the financial performance is explained by other predictors not included in the model.

Table 4.10 presents multiple linear regression coefficients output with financial performance as the dependent variable and Collections Policy, Credit Appraisal, Credit Risk Control and Delinquency Management as the independent Variables.

Table 4.10: Regression Model generated using SPSS

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	8.822	.761		11.586	.000
	Collections Policy	1.425	.497	.556	2.867	.005
	Credit Risk Control	.628	.337	.232	1.864	.046
	Credit Appraisal	.060	.383	.027	.157	.037
	Delinquency Management	1.020	.276	.429	3.692	.023

a. Dependent Variable: **Financial Performance**

Source: Survey data (2016)

As observable from the regression analysis results i.e., the "Sig." column, all the independent variables coefficients are statistically significantly different from 0 (zero). The coefficient for Collections Policy (1.425) is significantly different from 0 because its p-value is 0.05, which is smaller than 0.05 level of significance. As such, collections policy influences financial performance of the SACCOs. The findings agree with Gatuhu (2013) and Wachira (2015) who also found enough evidence to support such condition. The findings agree with prescriptions of the transaction cost theorists who prescribe strict collections policy framework as a precondition for loan performance Schwartz (1974), Tadelis & Williamson (2012) and Saussier (2000). The findings of the study further support agency propositions as fronted by Hillier, Grinblatt, and Titman (2011) and Leland, 1998).

The regression model was therefore developed as follows;

$$\text{Financial Performance} = 8.822 + 1.425 (\text{Collections Policy}) + 0.068 (\text{Credit Risk Control}) + 0.60 (\text{Credit Appraisal}) + 1.020 (\text{Delinquency Management})$$

Pearson Correlation analysis

The researcher also used Pearson Correlation analysis to understand the magnitude and direction of relationship, if any, between each credit management variable with financial performance.

Table 4.11 indicates the Correlation Output as derived from SPSS.

Table 4.11: Pearson Correlation Analysis

		Financial Performance
Collections Policy	Pearson Correlation	.721**
	Sig. (2-tailed)	.030
	N	75

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

Source: Survey data (2016)

As evidenced by the Pearson Correlation output, there is a significant positive relationship between Collections Policy and financial performance. The strength of association is very strong since the Pearson Correlation Co-efficient is 0.721 and statistically significant since the Sig. (2-tailed) value of 0.030 is less than 0.05 level of significance. The condition agrees with Gatuhu (2013) & Wachira (2015) who also found similar conditions. The results are also in agreement with agency and transaction cost theorists who prescribe strict collections policy framework as a precondition for loan performance Schwartz (1974), Tadelis & Williamson (2012), Saussier (2000), Hillier, Grinblatt, & Titman (2011) and Leland (1998).

Summary, Conclusions and Recommendations of the Study

Collections Policy was widely in practice by the SACCOs. It was also established that SACCOs were using guarantees as an effective measure of checking default on loans. The study established that SACCOs did not have major issues or challenges with regard to formulation of collection policies. The study results supported the role of a motivated staff in delinquency management and supported measures to motivate staff with incentives to motivate them to deal with delinquencies and improve repayment rates in the SACCOs. It was established that there was so much disagreement on the level of reviews on collections policy and as such SACCOs needed to upscale their reviews on collection policies on a more regular basis to ensure they are up to date with current conditions. Majority of the respondents seemed to support a stringent as opposed to a lenient collections policy as argued by agency who advocate for stringent policy on collections.

Going by the regression analysis results, it was concluded that collections policy is a significant influencer of financial performance. The Pearson Correlation Analysis results further informed a conclusion on existence of a positive relationship between collections policy and financial performance. The study provided evidence of wide performance disparities for the SACCOs. Such evidence was scarce and had not been encountered in past studies. Stakeholders therefore need to work on the wide performance disparities in the SACCO sub sector in order to ensure survival and sustainable growth of all the sector players. The researcher recommends that SACCOs need to upscale their reviews on collection policies on a more regular basis to ensure they are up to date with current conditions. The researcher also filled a knowledge gap by providing evidence that a stringent policy works better than a lenient one. A recommendation was therefore made for SACCOs to embrace a stringent as opposed to a lenient collections policy as held by agency theorists and majority of empirical studies.

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