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Influence of Credit Appraisal on Loan Performance of Deposit Taking Saccos in Meru County

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Abstract: Empirical studies have proven that saccos make a huge impact to the social-economic and political growth in Kenya and other developing countries. One of the biggest obstacles in micro and small enterprises is access to financial services. Saccos in Kenya have made it easy to access these facilities hence the main stimulus of economic growth. However, they face several challenges in non-performing loans leading to insufficient funds. These nonperforming assets arise due to inadequate or lack of clear lending policies. This has led to a high level of nonperforming loans in majority of the Saccosleading to the suspension of their trading licenses by their regulator. This has prompted the need to restructure their credit appraisal. This study sought to establish the influence of credit appraisal on loan performance in deposit taking SACCO in Meru County. The specific objectives of the study involved were; to assess the influence of borrower's character, ability to pay, availability of collateral and loan usage on loanperformance. The study was informed by the following theories, modern portfolio theories, asymmetric information theory and agency theory. All the independent variables were reviewed against the dependent variables using previous studies done by other researchers. A descriptive research design was adopted in order to analyze the topic thoroughly. The entire population of eleven saccos with their head offices in Meru county was studied. A pilot study was carried out by administering questionnaires to the selected deposit taking saccos in Meru county. Primary data was collected from the chief executive officers, finance managers credit managers and operation managers using structured questionnaires,this is because they possessed relevant information for the study. Reliability was improved by allowing the respondents sufficient time to fill the questionnaire. Computer aided software (SPSS) was used for data analysis and the research finding presented using frequency table, percentages and bar graphs. The findings from the study established that there is a significant positive relationship between the credit appraisal factors and loan performance at 95% confidence level and the conclusion was that credit appraisal factors have influence on loan performance. Regression coefficients were also developed that showed a strong relation between the dependent and independent variables. However in the cause of the study there was a major limitation in using closed ended questionnaires since the respondents were limited in the choices they could make. However this was mitigated through pre-testing the questionnaire. Validity and reliability were mitigated by ensuring that the likert table contained relevant option for each question. The study recommends that before loans are issued out a due diligence on the borrower's character, ability to pay, availability of collateral items for surety of the loan repayment and also the intended purpose of the loan be considered as these factors significantly affect the loan performance. The study recommends a further study of the legal and regulatory procedures on loan recovery since current recovery procedures are highly monitored by the saccos regulator. Future researchers can also study on influence of nonperforming assets on financial performance of the saccos, or even introduce other independent variables apart from the ones factored in this research.

Introduction

1.1 Background of the study

Financial institutions have experienced significant changes in the amounts of financial assets they hold in the last decade. Both internal and external factors have affected the amounts of loans that have been issued in the banking industry. This has fueled an increase in the non- performing loans. Muriithi (2012) described non-performing loans as those assets that are no longer generating income. NPLs in general terms refer to bad debts, whose recovery is highly doubtful, because they are not being serviced as required (Sasra, 2016).

When loans become non-performing, financial institutions liquidity and its earnings are adversely affected. NPLs have been cited as the primary cause of financial institutions failures in Kenya (SASRA, 2016). Between 1984and 1991 there were a total of twenty nine bank failures reported. This is an alarming rate given that it represents on average two or more bank failures per year during that period.

The specific provisions require deposit taking Saccos to forego interest received besides allocating provisions for the NPLs for their own resources. Kifle (2012) observed that to reduce credit risk, Kenyan Saccos charge a premium. This tends to increase the interest rates to borrowers which in turn reduce the demand for loans. These factors produce an unstable macro economy environment which serves to widen the interest spread between the deposit taking and lending rates.

Credit assessment models as argued by Odhiambo (2012) often consider the impact of changes to borrower and loan related variables such as the probability of default, loss given default, exposure amounts, collateral values, rating migration probabilities and internal borrower ratings. According to), SACCOs should periodically employ stress testing and back testing in evaluating the quality of their credit risk assessment models and establish internal tolerance limits for differences between expected and actual outcomes and process for updating limits and conditions warrant.

Despite the development and use of highly sophisticated tools and models to measure the exposure of financial institutions to credit risk, the default rate in the SACCOs in Kenya remain relatively high for instance, the defaulted loans for Kenyan SACCOs increased from Kshs. 5billion in 2007 to Kshs. 10 billion in 2012 (SASRA,2012).

Given this background, it is surprising to observe that not much is known about the extent by which SACCOs engage in the practice of credit risk management practices (SASRA, 2016). Credit policies and procedures are designed to guide lending and ensure prudent lending operations (SASRA, 2016).

1.1.1 Credit Appraisal

According to Sharma, (2015) Credit Appraisal is defined as a complete exercise which starts from the time a potential borrower walks in and concludes in credit delivery and monitoring with the objective of certifying and maintaining the quality of lending and managing credit risk. The authors also observed that, Credit appraisal is the assessment of the viability of proposed long term investments in terms of shareholder wealth and the formal analysis of all project costs and benefits which is used to justify the project proposal.

This is the process by which the lender assesses the credit worthiness of the borrower. It revolves around character, collateral capability and capacity (Muriithi,2012). It takes into account various factors like income of the applicants, number of dependents, monthly expenditure, repayment capacity, employment history, number of years of service and other factors which affect credit rating of the borrower (Sammy, 2013).

A key requirement for effective credit management is the ability to intelligently and efficiently manage customer credit lines (Kimeu, 2008). In order to minimize exposure to bad debts and bankruptcies banks must have insights into customer financial strengths, credit score history and changing patterns (Muriithi, 2012). Collection of reliable information from prospective borrowers becomes critical in accomplishing effective screening as indicated by symmetric information theory (SASRA, 2015). Qualitative and quantitative techniques must be used in assessing the borrowers to minimize default rates (Odhiambo, 2013).

1.1.2 Loan Performance

Performance of loan portfolio refers to the rate of profitability or rate of return of an investment in various loan products (I.C.A, 1996). It looks at the number of clients applying for a loan, how much they are borrowing, timely payments of installments security pledged against the borrowed funds, rate of arrears recovery and the number of loan products on the chain(Jared et,al ,2013). It refers to the total amount of money given out as loans to different types of borrowers.

Loan portfolio in SACCOs is the most important assets and therefore quality reflects on the risk of loan delinquency and determines future revenues as well as an institutions ability to increase outreach and serve existing customers (Jared et,al ,2013). Portfolio quality is measured as portfolio at risk over 30 days.Walukoba (2005) in her study on the causes of default in government micro credit programs identified that the main causes of default as poor business performance and diversion of funds to domestic problems.

Darek(2012) argued that there are many socio-economic and institutional factor influencing loan repayment rates. According to Kabamba (2012) the main factors from the lenders side are high frequency of collections, tight controls, and a good management of information systems, loan officer incentives and good follow ups .The main factors from the borrowers' side include socio-economic characteristics such as, gender, educational level, marital status, and house hold income level and peer pressure in group based schemes.

1.1.3 Credit Appraisal and Loan Performance.

Effective credit appraisal and loan accounting practices should be performed in a systematic way and in accordance with established policies and procedures (Kifle, 2011). Kibui&Moronge (2014) alluded that in order to be able to prudently value loans and to determine appropriate loan provisions, it is particularly important that SACCOs have a system in place to reliably classify loans on the basis of credit risk to facilitate repayment of loans by customers. Kabamba (2012) is of the view that proper and adequate appraisal is the key to controlling or minimizing default. This is the basic stage in the lending process. According to Kibui&Moronge(2014) the appraisal stage is the heart of a high quality portfolio. This includes diagnosing of the business as well as the borrower. Before beginning the process of collecting information on the client for the purpose of determining credit limits, the loan officer should have specific information available which will guarantee that the data and figures provided by the client will have a pro-margin error (Kinyua, 2013). The majority of the information is obtained by the loan officer through direct interaction with the client in such a way that each loan analysis provides valuable insights for evaluating the application for the future client.

Financial institutions should put in place policies that require remedial actions to be taken when policy tolerances are exceeded (Wambugu, 2008). These institutions should also document their validation process and results with regular reporting of the results to the appropriate levels of management (SASRA, 2015).Additionally, the validation of internal credit risk assessment models should be subject to periodic review by qualified, independent individuals for example internal and external auditors (Odhiambo, 2013).

1.1.4 Savings and Credit Co-operative (SACCO) Enterprises in Kenya

A cooperative is an autonomous association of persons united voluntarily to meet their common economic, cultural needs and aspirations through a jointly owned and democratically controlled enterprise (SASRA, 2015). The key idea behind a co-operative society is to pool the scarce resources, eliminate the middlemen and to achieve a common goal or interest (SASRA, 2011).

The co-operative sector in Kenya is clustered in three key models namely their structural organization; their general business purposes; and their legal and regulatory frameworks (SASRA, 2016). According to SASRA (2016) structural clustering is premised on the principle of cooperation among cooperative enterprises, and is founded on the vertical organization of the cooperative enterprises, and is mostly embedded in the Kenyan Co-operative Societies Act based on qualification for membership and service provision to the membership as illustrated below;

Name	**Description**
Primary co-operative enterprises	The membership is restricted to individual persons, and they serve individual members.
Secondary cooperative enterprises	The membership is restricted to two or more primary co-operatives, and serves those primary co-operatives. They are also called cooperative unions.
Tertiary co-operative enterprises	The membership comprises both primary and secondary cooperatives, and not individuals. They serve those members, and not individuals.
Apex co-operative society	Is the national co-operative society formed at the national level by the cooperative movement in Kenya, to promote cooperative development and represents the interests of cooperative societies locally and internationally.
NACO	NACOs emerged to serve the business needs of Primary or secondary cooperatives Societies.

Legal/regulatory framework clustering is principally informed by the applicable legal framework that governs the supervision of the co-operative enterprises. There are two legal and regulatory framework governing cooperative enterprises in Kenya, namely the co-operative societies act (cap 490) and the Sacco Societies Act (Cap 490B).

According to SASRA (2016) financial intermediation objective clustering Co-operative enterprises are generally incorporated for specific purposes and objectives. Financial intermediation involves a situation in which a financial institution stands between counterparties in a transaction; in this case the co-operative enterprise acts as the financial institution in the intermediation, in a near similar way that a banking institution would (SASRA, 2012).

1.1.5 Savings and Credit Co-operative (SACCO) Enterprises in Meru County.

The earliestSacco from Meru County was registered in the early 1970s with Imentisacco (1972) from Imenti North, Ntethiosacco(1975) from Imenti North and Kagumonesacco (1977) from Imenti South being the earliest sacco(Meru, County. Government.2014). Saccos are the fastest growing category of Co-operatives in Meru County. Currently a number of Saccos have diversified their services and activities. Transport saccos like Menya and Menany have opened their own petrol stations in Meru town (Meru County Government, 2016).

By the end of 2014, Meru County had 117 saccos out of which 44 are deposit taking saccos with 221,122 members, 3833 employees and a share capital of ksh486,468,951. (Meru, County government. 2016) At that time, these saccos had withdrawable deposits amounting to Kes 1,432,463,440 and non-withdrawable deposits of ksh 3,318,206,828. By then, these saccos had given out loans amounting to ksh 6,327,411,038 (Meru County Government, 2016).

The governance and management of Co-operatives enterprises is pegged upon elected management committees. These committees are entrusted with the governance and management of Co-operatives on behalf of members and employ managers and staff to perform the day-to-day operations of the Co-operatives (Meru County Government, 2016). In such cases, the leadership provides the guidance and delegates the powers of implementation to the staff, leaving them to act as members' agents. Since the co-operative agents are custodians, trustees and stewards of the Co-operatives, they are accountable and answerable to members, and are expected to be responsible, effective, efficient, responsive, faithful, diligent, prudent and honest.

According to WOCCU (2009), most of problems reported in cooperative financial institution stem from mismanagement. If cooperative financial institutions will be managed properly have big contribution to economy. They play important role on lending, savings mobilization and management at local level (SASRA 2015). Sacco's seem to be very promising vehicles for financial services delivery to the rural poor across the country (SASRA, 2015).

By virtual of their closeness to their members, the transaction and operating costs of saccos are very low (SASRA, 2015). Organizations started and formed by beneficiaries themselves, feel a sense of ownership, ensure that operations are conducted according to established procedures and criteria and hence results in more effective and efficient operations (SASRA, 2015).

1.2 Statement of the Problem

Non-performing loans in deposit taking saccos have been increasing steadily from the year 2014 to the current year 2018. In the year 2014 non-performing loans increased from 4.7% recorded in 2013 to 5.12 % (SASRA, 2014). In the year 2015 non-performing loans increased from 5.12% recorded in 2014 to 5.14 % (SASRA 2015). In 2016 the non-performing loans grew from 5.14% to 5.23% (SASRA, 2017).The loan portfolio at risk of 5.23% is higher than five percent recommended maximum by WOCCU. This steady increase is a worrying trend which has to be stopped.

A number of studies have been done locally and internationally in relation to credit appraisal and loan performance. Njiru (2003) surveyed on credit appraisal practices adopted by farmers in co-operatives in Embu and found out that SACCOs in Embu only used qualitative methods in evaluating credit worthiness of their members. He found some lack of professionalism in areas of credit risk management like, insider feelings, favourism in lending and external influence. Mwithi (2012) found that there was a positive correlation between credit risk assessment and management of micro finance institutions in Nyeri County.

The lack of use of correct appraisal is the cause for increase in non-performing loans in Embu County (Mwaura, 2005). Without strict adherence to credit appraisal practices, no amount of supervision or competition can make SACCOs operate efficiently (Kinyua, 2013). Wambugu(2008) established that majority of the financial institutions used credit metrics to measure the credit migration and default risk.

Mutwiri (2003) carried out a study on the use of 6Cs credit appraisal model and its relationship with the level of non-performing loans of commercial banks in Kenya, The objective of the study was to establish the importance of the use of the 6Cs (character, contribution, capacity, collateral, condition and common sense) and establish whether the use the 6Cs in credit evaluation, assessment and appraisal had some influence on the level of non-performing loans of commercial banks.

Although studies have been done in relation to credit management and loan performance in banks, no studies have focused on the best credit appraisal that will mainly affect loan performance in SACCOs. This study seeks to answer the research question: what is the influence of the best credit appraisal on loan performance of deposit taking SACCOs in Meru County.

1.3 General Objective of the Study

The objective of the study is to determine the influence of credit appraisal on loan performance in deposit taking SACCOs in Meru County.

1.3.1 Specific Objectives

i. To assess how the character of a borrower influences the loan performance in deposit taking SACCOs from Meru County.
ii. To analyze how the borrower's ability to pay influences the loan performance in deposit taking SACCOs from Meru County.
iii. To establish how collateral loan influences loan performance of the borrower in deposit taking SACCOs from Meru County.
iv. To assess how the borrower's uses of the loan influences loan performance in deposit taking SACCOs from Meru County.

1.4. Research Questions

i. How does the character of a borrower influence the loan performance in deposit taking SACCOs from Meru County?
ii. How does loan collateral influence the loan performance in deposit taking SACCOs from Meru County?
iii. How can the ability of a borrower affect loan performance in deposit taking SACCOs from Meru County?
iv. How can the borrower's use of the loan influence the loan performance in deposit taking SACCOs from Meru County?

1.5 Significance of the Study

The focus on deposit taking SACCOs is because they are regulated by SASRA to take deposit hence more contribution to economic growth and development. The study will aim to aid SACCOs in Meru County and Kenya at large to know the influence of credit management on loan performance. The research will assist both County and National governments to know the influence of credit management on loan performance of deposit taking SACCOs in Meru county and Kenya at large.

Imperatively, the researcher will understand what is happening in the sub sector and also will be enabled to grasp the best alternative on how to offer prudent credit management hence better loan performance in the Cooperative industry. Finally JKUAT will get reference study materials, which will be of great use to the students and the lecturers. On fulfilling an academic requirement, the researcher will get a certificate which will boost credibility of University to the public and world at large.

1.6 Scope of the Study

The study focused on the influence of credit appraisal on loan performance of deposit taking SACCOs in Meru County. The study sought to research on activities within the scope of the issues addressed by the research objectives. This study ensured that, all the study analysis is geared towards achievement of the main objective of the study. The study opted for Meru County, focusing on 11 licensed deposit taking SACCOs. The respondents to the study were credit managers, chief executive officers, finance managers and operation managers. The selected area of study was convenient to the researcher.

1.7 Limitations of the Study

The research was carried out using closed ended questionnaire. This limited the choice the respondents could make. This limitation was mitigated through pre-testing the questionnaire for validity and reliability to ensure that the Likert item contained the relevant options for each question. Questionnaires normally have poor response rate. To mitigate this, use of drop and pick method and personalized introduction letter were used to improve the response rate. Some respondents were reluctant in providing information due to the suspicion normally associated with any kind of a research study. This was resolved by assuring the respondents of utmost confidentiality by disclosing the academic purpose and intention of the study.

Literature Review

2.1 Introduction

This chapter will explore the theories that support both the independent and the dependent variable, a conceptual framework showing the relationship between the independent variables and the dependent variables. In addition, there is an empirical review section, which will discuss relevant studies and will relate their findings to this study.

2.2 Theoretical Review

The study will be informed by the following theories; modern portfolio theory, asymmetric information theory, and agency theory. These theories provide theoretical evidence on the relationship between credit appraisal on loan performance in deposit taking Saccos.

2.2.1 Modern Portfolio Theory

The basic portfolio management model was developed by Harry Markowitz in the 1950s and early 1960s.The Portfolio Management theory attempts to maximize portfolio expected return for a given amount of portfolio risk, or equivalently minimize risk for a given level of expected return, by carefully choosing the proportions of various assets. The fundamental concept behind Portfolio theory is that the assets in an investment portfolio should not be selected individually, each on their own merits. Rather, it is important to consider how each asset changes in price relative to how every other asset in the portfolio changes in price.

The portfolio theory integrates the process of efficient portfolio formation to the pricing of individual assets. It explains that some sources of risk associated with individual assets can be eliminated or diversified away, by holding a proper combination of assets (Rees, 2003). The main basic assumption of portfolio theory is that investors often want to maximize returns from their investments for a given level of risk.

The full spectrum of investments must be considered because the returns from all these investments interact hence the relationship between the returns for assets in the portfolio is important (Odhiambo, 2013). The main benefit of forming portfolios is the potential to create combinations with lower risk and possibly higher expected returns that can be obtained from individual securities (Odhiambo, 2012).

In summary, portfolio management theory assesses risk and return relationships for combinations of securities. While the expected return of a portfolio is the simple weighted average of the expected returns of its component securities, portfolio risk must also consider the correlation among the returns of individual securities. Since part of the price fluctuation of a security is unique, it does not relate to price fluctuations of other securities held. This allows the investor to diversify, or eliminate a portion of each security's risk (Muriithi, 2012). In SACCOs, loans constitute the assets in the financials and therefore the theory can be used to expound on the needs of SACCOs forming a portfolio that cuts across different industries and businesses.

2.2.2 Asymmetric Information Theory

The concept of asymmetric information was first introduced in George A. Akerlof (1970) Paper, "The Market for "Lemons": Quality Uncertainty and the Market Mechanism' (Akerlof, 1970). In the paper, Akerlof develops asymmetric information with the example ease of automobile market. His basic argument is that in many markets the buyer uses some market statistic to measure the value of a class of goods- Thus the buyer sees the average of the whole market while the seller has more intimate knowledge of a specific item. Akerlof argues that this information asymmetry gives the seller an incentive to sell goods of less than the average market quality. The average quality of goods in the market will then reduce as will the market size. Such differences in social and private returns can be mitigated by a number of different market institutions. The theory of asymmetric information argues that it may be impossible to distinguish good borrowers from bad borrowers (Auronen, 2003). Which may result in adverse selection and moral hazards problems- Adverse selection and moral hazards have led lo substantial 10 accumulation of non-performing accounts in cooperatives (Kibui&Moronge, 2014). The very existence of cooperatives is often interpreted in terms of its superior ability to overcome three basic problems of information asymmetry namely ex ante, interim and ex post (Kabamba, 2012). The management of CR in banking industry follows the process of risk identification, measurement, assessment monitoring and control. It involves identification of potential risk factors- estimate their consequences, monitor activities exposed to the identified risk factors and pat in place control measures to prevent or reduce the undesirable effects. This process is applied within the strategic and operational framework of the bank.

2.2.3 The Agency Theory

Agency theory largely focuses on methods and systems and their consequences that arise to try to align the interests of the principal and agent (Sammy et al, 2013). An agency relationship is one in which one or more persons (the principal) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent. Perhaps the most recognizable form of agency relationship is that of employer and employee.

According to the agency theory, a firm consists of a nexus of contracts between the owners of economic resources (the principals) and managers (the agents) who are charged with using and controlling those resources (Odhiambo, 2013). The theory posits that agents have more information than principals and that this information asymmetry adversely affects the principals' ability to monitor whether or not their interests are being properly served by agents. As such, the theory describes firms as necessary structures to maintain contracts, and through firms, it is possible to exercise control which minimizes opportunistic behavior of agents (Wambugu, 2008)

According to the theory, in order to harmonize the interests of the agent and the principal, a comprehensive contract is written to address the interest of both the agent and the principal. The agent-principal relationship is strengthened more by the principal employing an expert and systems (auditors and control systems) to monitor the agent (Odhiambo, 2013). The agency theory therefore works on the assumption that principals and agents act rationally and use contracting to maximize their wealth (Kabamba,2012).

This theory was applicable to this study simply because the managers are charged with the responsibility of protecting member funds. They have to lend the money invested by member and get it repaid as expected in the loan contract. Many saccos have run under due to non-performing loans and the managers have faced the hostile takeovers. It is therefore important that the managers and all employees study this theory

2.3 Conceptual Framework

To illustrate the fundamental concepts of credit performance management on financial performance as depicted from the analysis of the literature review, there is need to understand the conceptual framework that integrates the independent and dependent variables. According to Mugenda&Mugenda (2003), an independent variable is a property of a phenomenon which influences or affects others while a dependent variable is one which is influenced by the independent variables. The conceptual framework of credit appraisal practices on loan performance of deposit taking SACCOs is illustrated in figure below:

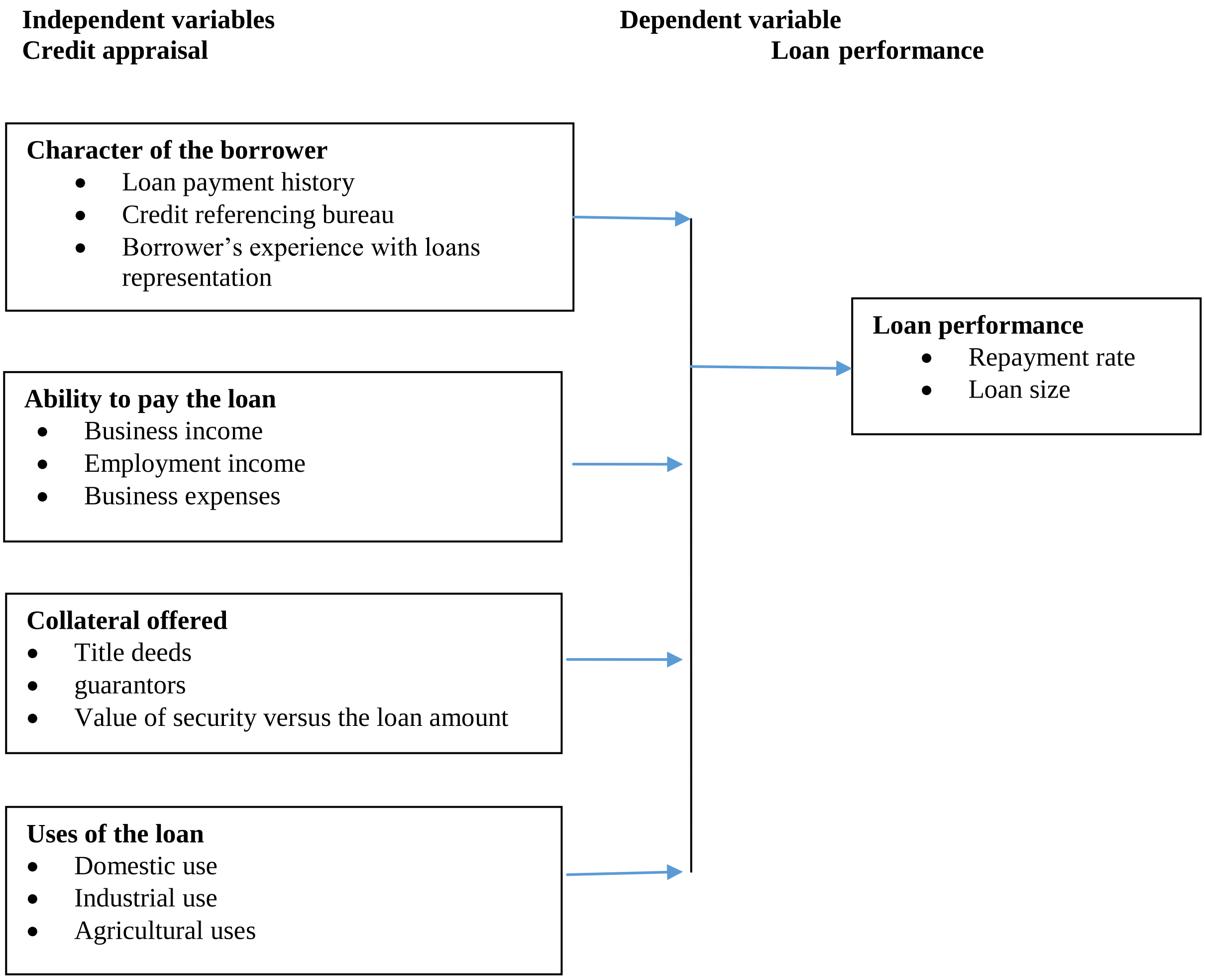

Figure 2.1: Conceptual framework

2.4 Empirical Review

According to Wambugu (2008) repayment performance is significantly affected by borrower's characteristics, lenders characteristics and loan characteristics. Repayment problems can be in form of loan delinquency and default. Whatever the form however, the borrowers alone cannot be held responsible wherever problems arise, it is important to examine the extent to which both borrowers and lenders comply with the loan contract as well as the nature and duties, responsibilities and obligations of both parties as reflected in the design of the credit programme rather than heaping blames only on the borrowers (Kimeu, 2008).

According to Davies and Kearns (1992: 117), when evaluating the character, the lending officer looks at the age as well as health of the prospective borrower; personal stability of the borrower (thus borrower's dependents, marital status, type of employment, duration of current employment and whether the borrower is a tenant or owner); integrity and honesty; borrowers personal resources or wealth; borrowers lifestyle as well as connections.

Credit bureaus also keeps a credit history record of the borrowers that can be used in credit scoring purposes based on the available credit history (SASRA, 2010). Honesty and goodwill of the client are the most paramount factors in a successful loan (Mwaura, 2005). Dishonest borrowers do not feel committed to repay the loan though they are very determined to get the loan using any means at their disposal including misrepresentation (SASRA, 2015). Loan officers have to spread their time over many loan relationships; they may not leave time to uncover the elaborate schemes of such individuals who are out to defraud the bank (SASRA,2016)

The bank has a duty of protecting its interests and hence it must protect itself from dishonest, incompetent or overly subjective borrowers through investigating their credit background (Wambugu, 2008). Other sources of information that can be used in assessing the borrowers' character are: records held by suppliers and past banking relationship with the customers (Warue, 2012). Where the client promptly services principal and interest, it is likely that the future loan balance will be adequately repaid (SASRA, 2015). Where the client has been late in servicing past debts, the reason should be sought (SASRA, 2015). Where previous creditors have experienced losses, the loan officer should almost out rightly reject the application (Mundibo, 2005)

2.4.1 Character of the Borrower and Loan Performance

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Reta (2011) carried out a study on determinants of Loan Repayment Performance using on a Case Study in the Addis Credit and Saving Institution, Addis Ababa, Ethiopia. The objective was to analyze and identify the factors that influence the loan repayment performance of the beneficiaries of AdCSI Microfinance Institution. In order to achieve this objective, primary data was collected from 200 randomly selected clients (100 defaulters and 100 non- defaulters) by using structured interview.

Moreover secondary data were obtained from the record of AdCSI (Sacco) the data analysis involved, descriptive statistics including mean, frequency and percentages to describe the socio-economic characteristics of the borrowers. Moreover, t- test and chi-square analyses were employed to compare the defaulters and non-defaulters group. A binary logit model was used to analyze the socio-economic factors that influence loan repayment. A total of twelve explanatory variables were included in the regression.

Out of these, six variables were found to be significant for the probability of being defaulter. Age and five business types, Petty market, kiosk & shop, services providing, weaving & tailoring and urban agriculture) were important in influencing loan repayment performance of the borrower. In addition, sex and business experience of the respondents were found to be significant determinants of loan repayment rate. Addis microfinance institution has a number of internal and external problems like shortage of loanable funds for further expansion, competition, and improper interference of third party in the decision of loan approval.

2.4.2 Ability to Repay the Loan and Loan Performance

This is measured using information related to income/stability in relation to loan repayments. To get the full picture of a borrower's ability to repay their debt, lenders typically require proof of income. They may also ask for proof of employment that will demonstrate you have a steady job and therefore a solid stream of income. If you do not have a steady job or are self-employed, you may be required to submit some other evidence showing how much you have in your bank account or how much money you make each year. The Sacco's will always be interested in knowing exactly how the customer intends to repay the loan. (SASRA,2014). Under this circumstance the banks analysts accounting, legal and finance skills are crucial in determining the ability of the borrower to repay the loan from the cash flows generated by the business (Central Bank Annual Report, 2010). For a seasonal working capital loans, cash flows are generated by means of orderly liquidation of built up inventories and receivables (Warue (2012).

According to Kibui&Moronge(2014), when evaluating a small business for a loan, lenders ideally like to see a two-year operating history, a stable management group, a desirable niche in the industry, a growth in market share, a strong cash flow, and an ability to obtain short-term financing from other sources as a supplement to the loan. Most lenders will require a small business owner to prepare a loan proposal or complete a loan application. The package of materials provided to a potential lender should include a comprehensive business plan, plus detailed company and personal financial statements.

The lender will then evaluate the loan request by considering a variety of factors. For example, the lender will examine the small business's credit rating and look for evidence of its ability to repay the loan, in the form of past earnings or income projections (Wambugu, 2008). The lender will also inquire into the amount of equity in the business, as well as whether management has sufficient experience and competence to run the business effectively. 12 Some authors link the repayment performance with firm characteristics such as Nannyonga (2000), Arene (1992) and Oke et al. (2007) mention that firm's profit significantly influenced loan repayment. Besides that, Khandker et al., (1995) raise the question of whether default is random, influenced by erratic behavior, or systematically influenced by area characteristics that determine local productions conditions or branch level efficiency.

Their study on Grameen overdue loans supports the idea of partial influence of area characteristics. Rural electrification, road width, primary educational infrastructure and commercial bank density are positively correlated with a low default rate as well as predicted manager's pay. Paxton (1996) shows also that access to other credit sources, market selling activities and urban location were linked to a better repayment performance.

2.4.3 Collateral Offered Against the Loan and Loan Performance

These are additional forms of security or guarantee that are provided by the borrower to the bank (Wmbugu, 2008). They represent those assets the borrower has pledged to the bank that can be sold if he defaults and collection efforts have become futile (Wambugu 2008). Though cash flows from the business operation are deemed to be the main source of loan repayment, where sufficient cash flows fail to materialize, the bank can mitigate loss if it has secured a secondary source of repayment (Tusiime, 2011).

According to Kibanga (2003) giving a lender collateral means that you pledge an asset you own, such as your home, to the lender with an agreement that it will be the main repayment source in case you cannot repay the loan (Mwaura, 2005) A guarantee on the other hand is just that; someone else signs a guarantee document promising to repay the loan if the borrower fails cannot (Kimeu,2008).

However, collections from guarantors often require expensive litigation and results in bad blood between the bank, borrower and guarantor (Mwaura, 2005). It should be noted that strong collateral should not generally overcome deficiencies in either character or capacity. Banks avoid foreclosing on collateral because foreclosure entails much time and expense (Mwaura, 2005). Collateral value should cover the loan amount and the interest due.

According to a study conducted by Moyo and Rohan (2006), borrowers deemed incapable of repayment of unsecured debt are considered uncollectible and of such little value that their continuance as active assets of the bank is not warranted. This classification does not mean that 20 the loan has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be affected in the future. As such, the interest rate is higher which push customers away from accessing it.

According to Omara (2007), in his study of the credit assessment process and repayment of bank loans in Barclays Bank Uganda, the unsecured loans attract more interest than the secured ones. All loans above

UGX20 million are secured by mortgage property. In this regard, credit was given up to 50-60% of the value of security offered by customer. Secured loans also attracted lower interest rates unlike the unsecured that costs between 24 - 38%.

Unsecured loan was limited to a value of UGX 20 million and below. Sindani (2012) carried out a study on effectiveness of credit management system on Loan Performance, Empirical evidence from Micro Finance Sector in Meru, Kenya. The overall objective of the study was to assess the effectiveness of credit management systems on loan performance in microfinance institutions. The study adopted a descriptive survey design. This design investigates the current status and nature of the phenomena.

2.4.4 Uses of the Loan and Loan Performance

Lenders want to restrict how the funds are used. Loan interest rates typically take into account the risk that the lender expects to take, and that depends in part on the purpose of the loan. According to Odhiambo (2013), riskier loans have different terms and are more expensive than less-risky loans. People borrow for different purposes that affect their repayment rates**.**

Personal/domestic Loan are mostly used for, debt management and Consolidation, Paying for a wedding medical expenses home improvement etc. Since a personal loan is an unsecured loan, credit history usually plays a significant role in the approval process. According to Kabamba (2012), causes of loan default include; lack of willingness to pay loans coupled with diversion of funds by borrowers, willful negligence and improper appraisal by credit officers.

In addition, Hurt and Fesolvalyi (1998), found that industrial loan default increases as real gross domestic product decline, and that the exchange rate depreciation directly affects the repayment ability of borrowers. Balogun and Alimi (1988) also identified the major causes of loan default as loan shortages, delay in time of loan delivery, small farm size, high interest rate, age of farmers, poor supervision, non-profitability of farm enterprises and undue government intervention with the operations of government sponsored credit programmers. Moreover,

Akinwumi and Ajayi (1990) found out that farm size, family size, scale of operation, family living expenses and exposure to sound management techniques were some of the factors that can influence the repayment capacity of farmers. According to Odhiambo (2013) loan disbursement lag and high interest rate can significantly increase borrowing transaction cost and can also adversely affect repayment performance. After surveying different banks in India, Berger and De Young (1995) identified the main causes of default of loans from industrial sector as improper selection of an entrepreneur, deficient analysis of project viability, inadequacy of collateral security/equitable mortgage against loans, unrealistic terms and schedule of repayment**.**

The study conducted by Nguta, and Guya (2013) in Kenya showed that one of the causes of loan default is the characteristic of the business. It was revealed that high cases of default of loan repayment were common (67.9%) in the manufacturing sector. This was followed by the service industry (64.0%) then by the agriculture (58.3%).

Njenga (2014) conducted a research on effects of credit management practices on loan performance in deposit taking microfinance institutions in Kenya. This study, focused on nine (9) MFIs licensed under the central bank of Kenya (CBK, 2013). The findings revealed that although most deposit taking microfinance institutions implemented credit management practices, the gross loan portfolio increase steadily over the years. The study further concluded that some microfinance institutions were a bit lenient while giving out credit facilities to their customers.

2.5 Critique of Literature Review

Kosgei, (2012) investigated effects of lending methodology on performance of loan portfolio in microfinance institution in Kenya. Panel data analysis was applied to test hypothesis that there is no relationship between group lending on performance of loan portfolio. After running a regression in which loan portfolio performance is the dependent variable, the study found a positive significant coefficient of 0.79 and (p=0.42) on group lending without moderating factors. When moderating factors were included the coefficient becomes 0.38 and (p=0.19). The null hypothesis is therefore rejected.

There is no significant relationship of individual lending on performance of loan portfolio in the regression despite finding a positive coefficient of 0.41 and (p=0.27). Therefore there is no effect on individual lending on loan performance. Studies revealed that they is negative relationship between loan appraisal methods/practices relationships and loan performance meaning if the loan appraisal is not done properly, it impact negatively on loan performance. Further, other studies focused on commercial banks exonerating SACCOs whose core business is credit lending and therefore credit practices should be pivotal to achieve quality loan performance.

2.7 Summary of the Literature Review

The chapter provides a discussion on key theoretical approaches and findings reported in earlier related studies focusing on aspect of loan appraisal practices and loan performance. The chapter also concentrates on empirical facets of loan appraisal practices and loan performance. From the literature review, loan appraisal practices play a critical role on loan performance in the SACCO sector. The review indicates that financial institutions need to embrace efficient and effective loan appraisal practices in order to ensure a well performing loan portfolio.

The studies have established that major bank losses stem from outright default due to inability of customers to honor their obligations. Local studies have noted that efficiency and effectiveness were the main challenges facing Kenya in the management and sustainability of the loan portfolio. Most of the microfinances are a bit lenient while giving out credit facilities to their customers which have led to an increase in the non-performing loans. However, the studies failed to identify the appropriate methodologies of enactment of the suggested loan practices and the performing loan portfolio in deposit taking SACCOs. Furthermore, they have not also singled out on the credit appraisal practices on loan performance of deposit taking SACCOs on a particular set up such as Meru County. The current study will seek to examine the influence of loan appraisal practices on loan performance of the deposit taking SACCOS in Meru County.

2.6 Research Gaps

From the empirical review above, its vital to appreciate that many studies have been done in line with loan risk management and performance and credit management practices mostly focusing on micro finances and commercial banks, it is important, therefore to consider the under mentioned as gaps that needs to be bridged. To bridge the gap the researcher will want to understand the influence of loan appraisal practices on loan performance of deposit taking SACCOs in Meru county focusing on borrower's character, ability collateral and uses of the loan as independent variables

Research Methodology

3.1 Introduction

This chapter presents the research design, target population, data collection instrument, data collection procedure, data processing and analysis, measurement of study variables. The chapter also specifies the empirical models estimated by the study and provides the techniques of estimating and analyzing the model.

3. 2 Research Design

The research design is a blue print for conducting the research that specifies the procedures necessary to obtain the information needed to structure and solve the research problem (Orodho&Kombo 2002). The research adopted descriptive research design in order to analyze the topic thoroughly. This method of research was preferred because a researcher was able to collect data, describe the state of affairs and answer questions concerning the study.

Descriptive research determines and reports the way things are and also helps a researcher to describe a phenomenon in terms of attitude values and characteristics (Mugenda, 2003). According to Orodho (2004), descriptive survey is a method of collecting information by interviewing or administering a questionnaire to a sample of individuals. The researcher will administer questionnaires to the sample of employees directly involved in credit.

3.3 Target Population

According to orodho&Kombo (2002) population refers to the collection of elements or objects that possess the information sought by the researcher and about each reference are to be made. Target population refers to the section of the aggregate population the researcher narrows down to. There are 138 SACCOs in Meru County by end of 2015 out of which 11 are regulated by SASRA and takes deposit (task force report on performance and governance of Cooperative movement in Meru County, 2016). The study neededthe most convenient and reliable information concerning the role of governance on financial performance of deposits taking SACCOs (DTSs) in Meru.The researcher targeted respondents from 11 DTSs which are as per the table 2 below.

Table 1: Distribution of Deposits taking SACCOs in Meru.

S/N	SACCO Name	Sub county
1.	Capital SACCO	Imenti North
2.	Centinary SACCO	Imenti North
3.	Solution SACCO	Imenti North
4.	Imenti SACCO	Imenti North
5.	Yetu SACCO	Imenti South
6.	Times u SACCO	Imenti South
7.	Nexus SACCO	Imenti South
8.	Smart Champions	Imenti Central
9.	Dhabiti SACCO	Igembe South
10.	MMH SACCO	Igembe South
11.	NyambeneArimi SACCO	Igembe South

The number of target population is 44 as shown in table 3 below.

Table 2: Distribution of target Population

Sub county	Target number of SACCOs	Target Respondents per SACCO	Target population
Imenti North	4	4	16
Imenti South	3	4	12
Imenti Central	1	4	4
Igembe South	3	4	12
Total	**11**		**44**

3.4 Sample and Sampling Techniques.

According to Mugenda and Mugenda (2003), when the target population is small the researcher can result to census methodology whereby the entire population is taken into consideration.

Therefore the study targeted all the 11 SASRA regulated deposit taking SACCOs in Meru County. The respondents were the credit managers, chief executive officers, finance managers and operation managers drawn from all the 11 deposit taking Sacco’s in Meru County that are licensed by SASRA. The total sample size was 44 as shown blow.

Table 3: Sample Size

	Target Population	Percentage %	Sample Drawn
Credit managers	11	100	11
CEOs	11	100	11
Finance managers	11	100	11
Operation managers	11	100	11
Total	44		44

3.5 Research Instruments

According to Orodho&Kombo(2002) data collection is the process of gathering information to serve or prove some facts. The study used primary method of data collection. According to (Mugenda, 2003), primary data refers to data collected at first time specifically for the issue under investigation. Putting the research objectives into consideration, questionnaires and personal interviews with respondents was the main instruments used to collect data in this study.

Orodho (2004) terms the questionnaire as the most appropriate instrument due to its ability to collect a large amount of information in a reasonably quick span of time. It guarantees confidentiality of the source of information through anonymity while ensuring standardization (Kerlinger, 1973). It is for the above reasons that the questionnaire was used as the most appropriate instrument for this study. The questionnaires consisted of properly constructed open and close ended questions in order to make it easier to obtain precise answers from the respondents.

3.6 Data Collection Procedure

Data collection is the act or process of capturing raw primary data from a single or from multiple sources. The research will seek to select the most appropriate data collection methods or techniques in order to gather data on credit appraisal practices on loan performance of deposit taking SACCO's in Meru County. On the other hand the researcher will require data collection tools according to the data collection method he preferred to employ.

The researcher will use questionnaires. The Questionnaires will be administered to the respondents in order to gather information regarding credit appraisal practices on loan performance in deposit taking SACCOs.

3.7 Pilot Test

A pilot test was carried out by administering questionnaires to the selected deposit taking SACCOs in Meru, CEOs, operational Managers, Finance Managers and Credit managers who have an understanding of the credit appraisal. The researcher improved reliability by allowing respondents sufficient time to fill the questionnaire, and also ensured that the unintended people do not fill the questionnaire and were not interviewed.

Validity is defined as the extent to which the instrument measures what it purports to measure (Mugenda&Mugenda, 2003). Content validity pertains to the degree which the instrument fully assesses or measure the construct of interest. Expert opinion was sought in order to validate the content and the structure of the questionnaire during the study. In addition, validity was tested through pre-testing the research instrument among few employees of some DTSs within the town; these sampled were excluded from participation in the final study to avoid bias. It was done in order to enhance validity and accuracy of data collected for the study.

3.8 Data Processing and Analysis

As alluded by Kothari (2004), data analysis is the part of an examination of what has been collected in a survey or experiment and making deductions and inferences. After collecting primary data, it was first checked for correctness, completeness, consistency and accuracy, then tabulated and analyzed using the Statistical Package for Social Sciences (SPSS) software package version 22.Both descriptive statistics (means and standard deviations) and inferentialstatistics Pearson correlation and linear regression were performed to establish the relationship between the dependent and independent variable.

A linear regression model of the form $Y= \beta_0+ \beta_1 x_1+ \beta_2 x_2 + \beta_3 x_3+\beta_4 x_4+\acute{\varepsilon}$ will be derived to show the relationship between the dependent variable (Y) and the independent variable (x) where:
Y = loan performance is a dependent variable which will be measured using non- performing loans divided by the total number of loans by SACCOs in Meru county
X_1 = character
X_2 = ability
X_3 = collateral
X_4=uses of the loan
β_0 = is a regression Constant
β_1, β_2, β_3 = Regression Coefficients
$\acute{\varepsilon}$ = Error term normally distributed about the mean of zero

Research Findings and Discusion

4.0 Introduction

This chapter discusses the results of the process of data analysis. The chapter presents the background information of the respondents, an analysis of the borrower's character, ability to pay, collaterals, use of loan and lastly loan performance.

4.1 Return Rate

The researcher realized 100% return rate with all the questionnaires administered being fully filled and returned. All the questionnaires furthermore, had valid information.

Education level

The respondents were also required to indicate their highest level of education. Their responses were presented in figure 4.2 below.

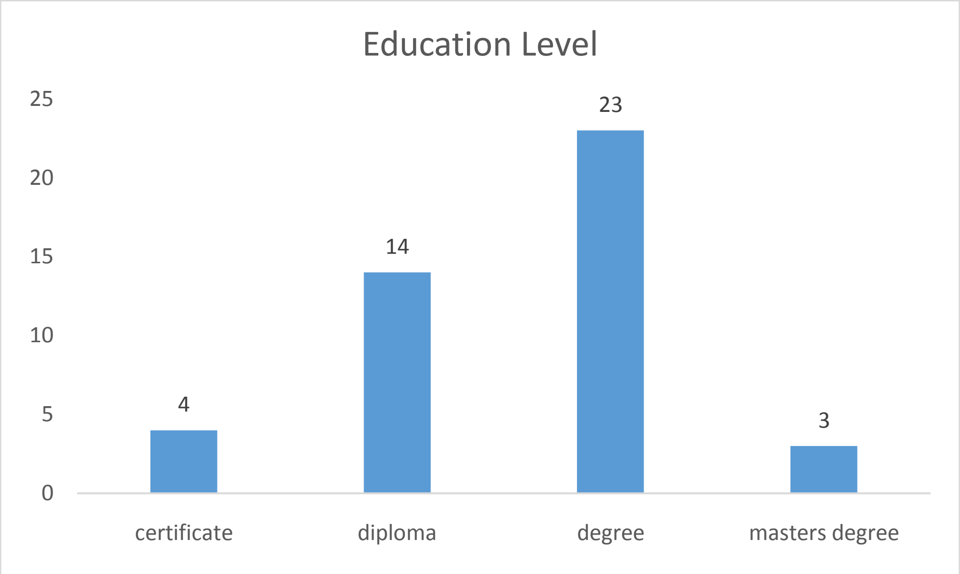

Figure 4.2: Highest Level of Education of Respondents

The researcher noted that most of the respondents had bachelor degree level of education. This was noted in 52 percent of the respondents, 7 percent having master's degree, and 9 percent of the total sample having certificate level while 32 percent had achieved diploma level.

Tenure at the Institution

The researcher also sought to establish the tenure with which the respondent has been serving at the institution. The results are presented in table 4.3 below.

Table 4.3: Respondents Tenure at the Institution

Years	Frequency	Percentage
Less than 1	11	25
1-5	18	41
6-10	12	27
11-15	2	5
Over 16	12	

It was established that most of the respondents had been serving in their respective institution for Tenure between 1-5 years having been affirmed by41 percent of the respondents. 12 respondents had been in the institution for 6-10 years while 11 had less than 1 year. Only 2 percent of the population had served for a period of more than 16 years while 2 of the respondents mentioned to have served for a period of between 11 to 15 years.

Experience at the Position.

Apart from the respondent's position at the institution the study sought to establish also the period with which the respondent has been serving the above mention position. The results of the findings are shown in table 4.4 below

Table 4.4 Respondents Experience at the Current Position.

Years	Frequency	Percentage
Less than 1	15	34
1-5	17	39
6-10	5	11
11-15	6	14
Over 16	1 2	

It was established that most of the respondents had been serving in their respective position for between 1-5 years having 39 percent of respondents. 34 percent of the respondents had been in the institution for less than 1 year while 11 percent had been serving for 6-10 years.2 percent of the respondent had served for a period of more than 16 years while 14 percent of the respondents mentioned to have served for a period of between 11 to 15 years.

4.3 Borrower's Character and Loan Performance

The first objective of the study was to assess how the character of a borrower influences the loan performance in deposit taking SACCOs from Meru County.to establish this the study sought to know whether the Sacco's normally assess the character of the borrowers. The results of the findings are presented in table 4.5 below.

Table 4.5: Assessment of Borrower's Character

Gender	Frequency	Percentage
Yes	41	93
No	3	7

From the results above majority of the Sacco's affirmed to be conducting an assessment of the borrower's character having 93 percent of the respondent affirming it. Only 7 percent of the respondents had contrary view mentioning that their Sacco was not assessing the character of the borrowers.

The study used a Likert scale to further investigate how the character of the borrower influence the loan performance where several attributes were used and the results presented in table 4.6 below.

Table 4.6 Borrower's Character and Loan Performance

Attribute	Strongly agree	Agree	Neutral	Disagree	Strongly disagree
Sacco checks the applicant's loan repayment history before granting the loan	25%	50%	23%	2%	0%
Sacco checks the applicant's credit reference bureau rating before granting the loan	32%	39%	27%	2%	0%
Sacco checks the applicant's experience in using the loan before granting the loan	30%	50%	14%	7%	0%

It was established that borrower's character in general had an effect on loan performance. This was according to a cumulative 75% of the respondents who were in agreement that the Sacco needs to assess the borrower'sloan repayment history, only a cumulative 2 % disagreeing and 23% expressing neutral opinion. With regard to checking the credit reference bureau rating, a cumulative 71% were in agreement, 2% disagreed while 27% expressed neutral opinion. A cumulative 80% of the respondents agreed that Sacco checks the borrowers experience in using the loan before granting them loan 7% disagreeing while 14% being neutral.

From this observation, it was noted that borrower's character was key towards getting loan by the borrowers and also a major factor towards loan performance by the Sacco's. However, in general, the researcher noted that factors associated borrower's character which includesloan repayment history; credit reference bureau rating and experience in using the loan had influence on loan performance.

4.4 Borrower's Ability to Pay and Loan Performance

Table 4.6 Standard Mechanism of Assessing Borrower's Ability to Pay

Gender	Frequency	Percentage
Yes	30	68
No	14	32

From the results above majority of the Sacco's affirmed to be having a standard mechanism to assess the borrower's ability to pay the loan having 68 percent of the respondent.32 percent of the respondents had contrary opinion mentioning that their Sacco did not have the right mechanism of assessing borrower's ability to pay their loan.

The study used also used a Likert scale to further investigate the various mechanism that the Sacco's use to assess borrower's ability to pay their loans. The results are presented in table 4.7 below.

Table 4.7 Borrower's Ability to Pay and Loan Performance

Attribute	Strongly agree	Agree	Neutral	Disagree	Strongly disagree
Sacco looks at business income before granting the loan	32%	50%	18	0%	0%
Sacco looks at the business expense before granting the loan	36%	46%	16%	2%	0%
Sacco looks at borrowers pay slip before granting the loan	25%	39%	27%	6%	6%

From the results in table 4.7 above it was established that borrower's ability to pay is major determiner of loan performance. According to a cumulative 82% of the respondents who were in agreement of the attribute that Sacco looks at the business flow of income before granting loan, 18% of the respondent expressed neutral opinion. With regard to the business expense, a cumulative 82% were in agreement that Sacco's also look at the business expense before granting them loan, 2% disagreed while 18% expressed neutral opinion. Lastly A cumulative 64% of the respondents agreed that Sacco's looks at the borrowers pay slip before granting them loan with a cumulative 12% disagreeing while 27% being neutral.

The study findings noted that ability to of the borrowers is a key factor towards the loan performance and it's a common practice among the Sacco's that participated in the study.

4.5 Collaterals and Loan Performance

The third objective of the study was to establish how collateral loan influences loan performance. To assess this all the respondents affirmed that collateral is always required before loan is granted and this was so as precautionary mechanism for loan safety. Several attribute were used to further shed some light on the use of collateral and loan performance. The results of the attributes are presented in table 4.8

Table 4.8 Collaterals

Attribute	Strongly agree	Agree	Neutral	Disagree	Strongly disagree
Sacco requires guarantors with required number of shares as my collaterals	36%	50%	14%	0%	0%
Sacco requires title deeds as my collateral	23%	41%	32%	5%	0%
Sacco charges the collateral against the loan disbursed	25%	48%	21%	2%	5%

From the results in table 4.7 above it was established that availability of collateral item to secure loan was a key determiner. A cumulative 80% of the respondents were in agreement that Sacco's require guarantors with required number of shares as collateral for loan the attribute that Sacco require title deeds as collateral had a cumulative 64% agreed respondents while accumulative 73% agreed that Sacco's charge the collateral against the loan disbursed. The study findings establish that less than 30 percent of the Sacco's don't take collateral as a security for loan performance.

4.6 Use of the Loan and Loan Performance

The last objective of the study was to assess how borrower's use of the loan influences loan performance. The results of the findings are shown in table 4.9 below.

Table 4.9 Use of the Loan and Loan Performance

Attribute	Strongly agree	Agree	Neutral	Disagree	Strongly disagree
Loan used for domestic purpose	41%	46%	14%	0%	0%
loan used for industrial purpose	30%	52%	16%	2%	0%
loan used for agricultural purpose	21%	61%	16%	0%	2%
loan used for social purpose	21%	43%	11%	5%	21%

From the results in table 4.7 above it was established that a cumulative 87% of the respondents were in agreement that loan were being given to borrowers for domestic purpose while 14 % of the respondents had neutral opinion on the subject.82% of the respondents also affirmed that loan were being given for industrial use 2 % disagreed with the statement while 16 were neutral.64% of the respondent at least mentioned loan that were given out for social purpose and 26% had contrary opinion of the same attribute.

4.7 Loan performance

Table 4.10 Loan performance

Attribute	Strongly agree	Agree	Neutral	Disagree	Strongly disagree
Sacco charges high monthly repayment	25%	39%	32%	6%	0%
Sacco gives big loan size	34%	46%	21%	2%	0%
Sacco delinquency	27%	48%	9%	9%	7%

From the results in table 4.10 above, the study establish that a cumulative 64% of the respondents were in agreement that Sacco's charges high repayment interest on loan while 6% of the respondents had to disagree on the attribute. On the other had accumulative 80 agreed that Sacco's give big loan sizes 21% were neutral while 2 % of the target sample were in disagreement. The study findings establish that loan performance is a factor of many attribute and repayment amount was the dominant factor.

4.8 Correlation Analysis

To establish the relationship between borrowers character, ability to pay, collateral, loan usage and loan performance. The study performed person correlation analysis and the results presented in table 4.11 below

Correlations

		Loan performance score	Borrowers character score	borrower's ability to pay score	borrowers collateral score	loan usage score
Loan performance score	Pearson Correlation	1	.292*	.161*	.196*	.164*
	Sig. (2-tailed)		.012	.026	.036	.048
	N	44	44	44	44	44
Borrows character score	Pearson Correlation	.292*	1	-.338*	.057	.115
	Sig. (2-tailed)	.012		.025	.715	.458
	N	44	44	44	44	44
borrower's ability to pay score	Pearson Correlation	.161*	-.338*	1	-.066	-.061

	Sig. (2-tailed)	.026	.025		.671	.696
	N	44	44	44	44	44
Borrowers collateral score	Pearson Correlation	.196*	.057	-.066	1	.261
	Sig. (2-tailed)	.536	.715	.671		.087
	N	44	44	44	44	44
loan usage score	Pearson Correlation	.164*	.115	-.061	.261	1
	Sig. (2-tailed)	048	.458	.696	.087	
	N	44	44	44	44	44

The specific objectives of the study was to exhibit the influence of the independent variables on loan performance which is the dependent factor and From the results above, the study established there is a positive relationship between borrowers character score, ability to pay score. Collateral score loan usage score and the performance having correlation coefficient of 0.292, 0.161,196 and 0.164 respectively. All the independent variable had significant influence on the loan performance at 95% confidence level having p-value lower than the alpha value 0.05.

The study findings therefore establish that there is a positive influence of the independent variable towards loan performance and improvement in either of the variable will positively influence loan performance and vice versa.

Apart from investigating the relationship between the dependent and independent variable the study also south to establish the effect of the independent variable on loan performance and the regression results is shown below.

Model Summary
Table 4.12 Model Summary

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.926[a]	.858	.842	.59314

From the results above the study obtained the R squared of 0.858.the coefficient of determination therefore indicate that 86 percent of the variability in loan performance can be explained by the model which consist of borrowers character, ability to pay availability of collateral items and lastly loan usage.15 percent of factors that influence loan performance cannot be accounted for by the model. The model is the model is fit for estimation.

Analysis of Variance

Analysis of variance was also performed to establish the overall predictive power of the model and the results are presented in table 4.13 below.

Table 4.13 Analysis of Variance

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
	Regression	1.007	4	.252	.715	.000[b]
1	Residual	13.721	39	.352		
	Total	14.727	43			

at 95 percent confidence level the study established that the model had a significant predictive power having the probability value of 0.000 which is less than the alpha value 0.05.having a powerful coefficient of determination and a significant model for prediction, the study lastly sought to investigate the predictive power of the individual independent variable and T test of significance was performed before interpretation of the parameters. The results are shown in table 4.14 below.

Coefficients
Table 4.14 Regression Coefficients

Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	1.838	2.038		.902	.373
	Borrowers character	.094	.014	.995	6.880	.000
	ability to pay	.001	.000	.581	2.265	.029
	Collateral score	.031	.001	.531	17.10	.000
	Loan usage score	7.76	1.20	1.24	6.45	.000

The T-test results above establish that all the independent variable had a significant prediction of the loan performance having p-value less than the alpha value at 95 percent confidence level. Borrower's character had a p-value of 0.00 which was less than alpha value of 0.05.ability to pay, collateral and loan usage had T test probability value of 0.029, 0.00 and 0.000respectively. The study estimated the parameters into the model as shown below.

$Y=1.8\ 38+0.094X_1+0.01X_2+0.31X_3+7.76X_4$

While holding all the other factors constant, units change in borrower's character score the loan performancesignificantly adjust positively by 9 percent at 95 percent confidence level. On the other hand holding all the other factors constant a unit change in the ability to pay score, the loan performance will positively adjust by less than 1 percent. On the case of availability of collateral item a unit change in the variable loan performance also responds by 9 percent increase. Lastly, a unit change in the loan usage score while all the factors are held constant will translate to 7.76 unit increase in loan performance.

Summary of Findings, Conclusions and Recommendations

5.1Introduction

This chapter presents a discussion of the findings of the study conclusion and the recommendations. The chapter discussed borrower's character, ability to pay, collateral, loan usage and lastly loan performance. The section presents the findings from the study and compare to what other scholars have said.

5.2 Summary of Findings

This section confirms that the study was able to come up with the intended findings of the research .The conclusions and recommendations were extracted out of the overall findings.

5.2.1 Influence of Borrowers Character on Loan Performance

The first objective of the study was to establish how the character of the borrower influences loan performance. The researcher established that borrower's character affected the loan performance as shown in figure 4.6. The findings of this study are consistent with those of Anthony (2006) who established that the borrower's character has a significant relationship with loan performance. On the other hand the study sought to look at the marital status of the borrower wherebyfrom the findings, those who are in a family setting exhibit level of stability and also surety towards the loan repayment. From the Pearson correlation results, the study established a positive correlation between the borrower's character and attributes of loan performance. The relationship has a significant of 95% confidence level. Such findings confirm that borrower's character can either positively or negatively affect the performance of the loan by the Sacco. The same trend was also the same among the other variable

Apart from the marital status education background was a factor of consideration on the borrower's character and a good background was related to proper understanding of the debt process together with the repayment methods and consequences of failure hence a great influence on loan performance. The findings by Oloo O. (2003) correlate the need by Sacco's to focus on borrowers education level since it informs more on loaning, marital status since married people have a higher sense of responsibility and need to have a credit experience since the borrowers are able to relate how they used the previous loans and the mistakes they made

5.2.2 Influence of Borrowers Ability to Pay on Loan Performance

The findings in (table 4.7) informed the study on the ability of the borrowers to pay back the loan as a factor of loan performance and it can be noted that Sacco's look at both the income inflow, business expense and also the pay slip for the case of individual borrowers all these are ways of ensuring that the borrower has the ability to pay back whatever they are asking for and therefore ensuring the loan are safe from bad debt hence the desired performance for the Sacco.From the Pearson correlation results, the study established a positive correlation between the borrower's ability to pay and attributes of loan performance. The relationship has a significant of 95% confidence level. Such findings confirm that, borrower's ability impacts the loan performance.

According to the study 82% agree that ability to pay greatly influences loan performance since ability to pay is mainly based on the sources of income. This guarantees the Sacco of a source of income in the event of failure or inability of the loan holder to paytheir debt (MacDonald et al, 2006). As corroborated by (MacDonald et al, 2006), multiple sources of incomes will ensure multiple way of loan payment should the main one fail. Loaning to a borrowers who have only one source of income should be closely monitored or restricted

5.2.3 Influence of Borrowers Collaterals Offered on Loan Performance

Table 4.7 presents the results on loan collaterals.80% of the respondents showed that collaterals help in loan performance. Shares are the main collaterals that saccos require since loan is easily recovered. They also place major emphasis on title deeds and charging them against the loan before the loan is disbursed. The relationship has a significant of 95% confidence level. Such findings confirm that, collateral provision greatly impacts the loan performance. It was noted by the respondents that collateral issue was a great determinant of the loan performance and the only surety for the loan safety.

The degree of collateral or assets forming the security of the loan is a key feature in any lending and loan pricing decision. Subordinated debentures are riskier because their claims to the assets of a defaulting borrower are junior to those of both mortgage bondholders and debenture holders (Thygerson, 1995). Collateral or security is the most basic consideration before availing credit to the customers by most Sacco's.Elsas and Krahnen (2002) found out that inside collaterals not only define priority over future cash flows of the firm among lenders, but also providing incentives and/or valuable information for monitoring.

5.2.4 Influence of Borrowers Use of the Loan on Loan Performance

This is presented by table 4.8 Use of the loan is also a major influence in loan performance. 87% of the respondents were of the opinion that loan borrowed for domestic purposes are not easily paid. This is because these uses are not income generating. Most of the respondents agreed that industrial loans perform more than domestic loans. With some loans, lenders want to restrict how the funds are used. Loan interest rates typically take into account the risk that the lender expects to take, and that depends in part on the purpose of the loan. Home loans are generally used to purchase a home or refinance an existing home loan.

Loans intended for personal use are normally restricted. According to Oke et al. (2007), Saccos are normally lenient in lending for personal use. These loans are highly nonperforming after expenditure, there is no more cash flows since it is not an investment. 95% significance level was observed hence a high influence on loan performance

5.3 Conclusion

The main income earning activity for any financial institution is its ability to issue healthy and quality loans and have the paid as per the loan terms. However to develop a quality and healthy loan book, credit appraisal must be followed according to the loaning policy. Before loans are issued out a due diligence on the borrower's character, ability to pay availability of collateral items for surety of the loan repayment and also the intended purpose of the loan be considered as this factors significantly affect the loan performance

5.3.1 Borrower's Character on Loan Performance

The study found out a significance influence of the character of the borrower and loan performance. With a significance level of 95%, character of the borrower ought to be strictly studied before a loan is disbursed. Factors to consider in evaluation of the character of the borrower are age, educational background, sex, credit history marital status and experience with the use of the loan.

5.3.2 Borrower's Ability on Loan Performance

The study found a significant influence of 95% of the ability to pay on loan performance. Every organization wants to issue a loan and have it fully paid according to the loan terms. To enable this, loans should be issued strictly considering ability to pay. This is key to getting the loan repaid. The lender should consider multiple sources of income so that should one fail, the other succeeds in paying the loan.

5.3.3 Collaterals and Loan Performance

The study found a significance level of 95% on availability of collateral on loan and loan performance. This is always an alternative source of loan repayment should the borrower fail to pay. The borrower can consider titles, guarantors, shares, corporate bonds and any other reliable security. Ability to easily liquidate the security should also be considered owing to the legal requirements

5.4.4 Use of the Loan and Loan Performance

Having achieved a 95% significance level, the use of the loan is an important factor to consider in lending. Saccos should restrict lending for personal or domestic use. Lending to the borrower who wants to wed or construct a personal house should be restricted. Lending for industrial use should also be closely studied as well as agricultural uses due to prevailing conditions

Loan performance is highly influenced by all the above variables. A positive or negative change in any of the variable will affect the loan performance. Saccos should issue loan that have low repayment rates.

5.3 Recommendation

The study recommends that before a loan is issued the character of the borrower should always be put into consideration. The age of the borrower should be observed since young people and very old people have a high likely hood of repaying the loan. Consequently married people pay loans more than the single people.

The study also recommends a thorough evaluation of the borrower's ability to pay. This should be the main factor. The incomes must be put into careful consideration. Multiple incomes should also be considered as well as the personal expenses

The study also recommends the provision of collaterals before a loan is issued. This provides an extra mode of payments should the borrower totally fails to pay. The sacco can consider pay slips, guarantors and any other collateral of value when paying the loan.

On uses of the loan, the study observed that use for the loan is an important factor in loan repayment. The sacco should closely monitor the personal loans it issues that goes to personal use. Income generating projects should be encouraged and private consumption loans avoided.

The study further recommends that for the loan to perform, all the independent variable must be observed failure to which the loan is likely to turn to a nonperforming asset. The sacco should recommend low repayment rate loans and consider issuing small loans rather than huge loans that may be easily defaulted hence a huge impact on the loan performance.

5.4 Suggestions for further study

The study concentrated on the influence of credit appraisal on loan performance of deposit taking saccos in Meru county. This study however is not exhaustive and therefore suggests studies on influence of legal and regulatory procedures on loan recovery since current recovery procedures are highly monitored by the saccos regulator. The influence of saccos financial performance to the institutions of higher learning or county governments should also be encouraged

Future researchers can also study on influence of nonperforming assets on financial performance of the saccos, or even introduce other independent variables apart from the ones factored in this research

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Questionnaire

Part I: General Information

1. Gender: Male [ ] Female [ ] {Tick Appropriately}
2. What is your highest level of education? {Tick as appropriate}
   Certificate [ ] Diploma [ ] Degree [ ] master degree [ ]
3. How long have you been in this institution?
   Less than 1yr [ ] 1-5yrs [ ] 6-10yrs [ ] 11-15yrs [ ] Over 16yrs [ ]
4. What is your position in this institution? {Tick as appropriate}
   Credit manager [ ] C.E.O [ ] Finance manager [] operations manager []
5. How long have you worked in this position?
   Less than1yr [ ] 1-5yrs [ ] 6-10yrs [ ] 11-15yrs [ ] Over 16yrs [ ]

Part II: Borrowers' Character

a) Does your SACCO assess the character of a borrower? {Tick appropriately}
Yes [ ] No [ ]

b) Kindly indicate your level of agreement with the following statements on the influence of borrower's character on loan performance. 5 [strongly agree] 4 [agree] 3 [neutral] 2 [disagree] 1 [strongly disagree]

	Strongly agree	**agree**	**neutral**	**Dis-agree**	**Strongly dis-agre**
	5	4	3	2	1
My sacco checks the applicant'sloan repayment history before granting the loan					
My sacco checks the applicant'scredit reference bureau rating before granting the loan					
My sacco checks the applicant'sexperience in using the loan before granting the loan					

c) Please give your comment on the effectiveness of character appraisal as used in your sacco.
………
……………………………………………………………………

Part III: Borrowers' Ability To Pay

a) Does your SACCO have standard mechanism of assessing the Borrowers' ability to pay {Tick appropriately}
Yes [ ] No [ ]

b) Kindly indicate your level of agreement with the following statements on ability to pay of the borrower on loan performance. 5 [strongly agree] 4 [agree] 3 [neutral] 2 [disagree] 1 [strongly disagree]

	Strongly agree	**agree**	**neutral**	**Dis-agree**	**Strongly dis-agree**
	5	4	3	2	1
My Sacco looks at the applicant's business incomes before granting a loan					
My Sacco looks at the business expenses before granting a loan					
My Sacco looks at applicant's pay slip before granting a loan					

Part IV: Borrowers' Collaterals

a) Does your SACCO have standard mechanism or tools of assessing the Borrowers' Collaterals?{Tick appropriately}
Yes [ ] No [ ]

b) Kindly indicate your level of agreement with the following statements on borrowers collateral influence on loan performance 5 [strongly agree] 4 [agree] 3 [neutral] 2 [disagree] 1 [strongly disagree]

	Strongly agree	**agree**	**neutral**	**Dis-agree**	**Strongly dis-agree**
	5	4	3	2	1
My Sacco requires guarantors with required number of shares as my collateral					
My Sacco asks for a title deed as my collateral					
My Sacco charges the collateral against the loan disbursed					

c) Briefly give your general comment on the effectiveness of use of collaterals before giving the loan…
………
……………………………………………………………………………..

Part V: Borrower's Use for the Loan
This section concerns the use for which the borrowers request for the loan.
a) Kindly indicate your level of agreement with the following statements on borrowers use for the loan on loan performance. 5 [strongly agree] 4 [agree] 3 [neutral] 2 [disagree] 1 [strongly disagree]

	Strongly agree	**agree**	**neutral**	**Dis-agree**	**Strongly Dis-agree**
	5	4	3	2	1
The applicant used the loan for domestic purposes					
The applicant used the loan for industrial purposes					
The applicant used the loan for agricultural purposes					
The applicant used the loan for social purpose					

b) Please give your comments on the effectiveness of appraising the borrower's uses of the loans before giving the loan
………
………………………………………………………………………………………….

Part VI: Loan Performance

This section concerns loan performance

Kindly indicate your level of agreement with the following statements that affect loan performance. 5[strongly agree] 4 [Agree] 3[Neutral] 2[Disagree] 1[Strongly disagree]

	Strongly agree	Agree	Neutral	Disagree	Strongly disagree
	5	4	3	2	1
My Sacco charges a high monthly repayment					
my Sacco gives a big loan size					
My Sacco has a high loan delinquency					