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Influence of Credit Risk Supervision Strategies on Financial Performance of Deposit-Taking SACCOs in Mombasa County, Kenya

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Abstract

The objective of the study was to investigate the influence of credit risk supervision strategies on the financial performance of Deposit-Taking Saccos in Mombasa County, Kenya. The study was supported by the credit risk theory. The study adopted the descriptive research design. The target population included 109 participants from all the six-deposit taking SACCOs in Mombasa County. The stratified random sampling technique resulted into having 86 units of analysis. The study used primary data which was collected using questionnaires. The gathered data underwent decoding and analysis using the Statistical Package for the Social Sciences version 26. The study employed simple linear regression model in data analysis. The study found a strong positive correlation of 0.407 between credit risk supervision strategies and financial performance. Additionally, the results of the regression analysis indicated that credit risk supervision strategies explained more than 40.8% of the variability in the financial performance of the SACCOs in Mombasa County. The hypothesis testing led to the rejection of H_{01}. The rejection of H_{01} confirmed that credit risk supervision strategies have a positive and significant influence on the financial performance of SACCOs in Mombasa County, Kenya. The study concludes that credit risk supervision strategies a significant role in enhancing the financial performance of the SACCO sector in Mombasa County, Kenya. The study recommends that deposit taking SACCOs in Mombasa County should prioritize the implementation of robust credit risk supervision strategies to enhance their financial performance. Additionally, SACCOs should invest in comprehensive employee training programs to ensure that their workforce is well-equipped to adhere to optimal lending practices and risk management protocols. The study also recommends that policy formulating and regulatory bodies such as SASRA should devise mechanisms and enforce policies which are geared towards enabling SACCOs to develop strategies which will enable them monitor their credit

Keywords: *Credit risk supervision strategies, financial performance, deposit-taking saccos Mombasa County, Kenya*

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1.0 Introduction

Credit is the act of postponing the payment for goods or services, allowing the individual to utilize them without making an immediate payment (Liao, 2020). With the understanding that payment can be made at a later date, a company can utilize credit as one tool among many to increase sales (Lagat, Mugo, & Otuya, 2016). Businesses can gain from extending credit only if doing so results in a net profit that is more than the extra expenses brought by the influx of receivables (Liao, 2020). As high default rates cause a decline in cash flows, liquidity, and ultimately financial crisis, early detection of impending loan default is crucial (Akinleye & Olarewaju, 2019). Contrarily, a lesser credit exposure indicates a debtor level appropriate for minimizing bad debts and maintaining fiscal health (Maina, Kiai, & Kyalo, 2020). Credit risk is the likelihood of facing a financial loss arising from a borrower's inability to make timely and regular payments on a loan or any other type of credit (Akinleye & Olarewaju, 2019). This includes the potential of non-payment of the principal amount, interest (coupon), or a combination of both (Anjom, 2021). The greatest risk is borne by lenders, who may miss out on principal and interest payments, have cash flow interruptions, and incur greater collection costs (Byusa & Nkusi, 2020).

Companies must therefore come up with mechanisms of bringing down the number of customers' non-performing assets, which are steadily increasing and recoup them at the right moment through the adoption of appropriate measures (Agustiani, 2020). Efficient handling of credit risk is crucial for financial institutions as it offers valuable insights into the comparative levels of exposure to counterparties and contracts (Chebungwen & Kwasira, 2020). Effective risk allows companies to maximize value for its shareholders while minimizing bad debts and the costs associated with collecting them (Akinleye & Olarewaju, 2019). In Kenya, SACCOs serve as a primary source of credit for both households and businesses and agricultural sector (Rawal, 2021). For optimal growth and development, it is advisable for any business to adopt an entrepreneurial vision and employ risk strategies (Li, 2023). It is in this endeavor that this study sought to whether the risk strategies employed by the SACCOs in Mombasa County are sufficient to enable them to record positive performance results.

The justification for conducting the study was anchored in addressing the observed decline in the performance of SACCOs (Savings and Credit Cooperative Organizations) in Kenya, particularly in Mombasa County. The study was crucial as it sought to explore and clarify the relationship between credit risk supervision strategies and their influence on the performance of SACCOs. By focusing on this particular sector and geographical area, the study aimed to provide targeted insights and recommendations that could be instrumental in enhancing SACCOs' performance, thereby improving the overall health of the financial industry in Kenya. The study's focus on Mombasa county's SACCOs was justified by the need to address the observed performance decline and provide actionable recommendations to improve credit risk supervision strategies, ultimately safeguarding the interests of members and contributing to the overall stability of the financial sector in Kenya.

1.1 Statement of the Problem

A report by SASRA found that the percentage of defaulted loans in Kenya is increasing, thus SACCOs were anticipated to allocate provisions for loan disasters and correct their credit checking techniques. Measures of defaulted advances grow as the rate of non-performing loans rises, which

in turn reduces interest revenue and operating capital for the afflicted SACCOs (SASRA, 2020). SACCOs have faced a delay in refunding member deposits as a result of liquidity challenges linked to cash flow issues. The inability of members to fulfil their duties regarding monthly contributions and loan repayment is the major cause of the delayed cash flow in SACCO'S repayment (Kungu, Wanjau, Waititu, & Gekara, 2021). The majority of SACCOS in Kenya have substantial loan backlogs, which exposes them to credit risk brought on by defaulting customers. A SASRA assessment report found that overall, DT-SACCO performance has declined over the previous five years and again, the amount of non-performing loans increased above the SASRA's recommended 5% level (SASRA, 2020). According to SASRA (2022), non-performing loans witnessed a concerning rise, escalating from 6.30 percent in 2018 to 9.12 percent in 2020. This present study, therefore, sought to undertake an investigation in an attempt to address the identified problem of poor performance in the SACCO sector. This study, therefore, undertook to investigate and unravel the influence of credit risk supervision strategies on the financial performance of Deposit-Taking Saccos in Mombasa County, Kenya.

1.2 Objective of the study

The objective of the study was to investigate the influence of credit risk supervision strategies on the financial performance of Deposit-Taking Saccos in Mombasa County, Kenya

1.3 Hypothesis

The study was guided by the null hypothesis.

H_{01}: Credit risk supervision strategies have no significant influence on the Financial Performance of Deposit-Taking Saccos in Mombasa County, Kenya

2.0 Literature Review

2.1 Credit Risk Theory

In 1974, Melton made significant progress in the field of credit risk theory, asserting that the lender is obligated to monitor various aspects, ranging from the borrower's ongoing creditworthiness to their adherence to the terms stipulated in the contract (Kungu, Wanjau, Waititu, & Gekara, 2021). It also discusses how commercial banks and other financial institutions can handle unforeseen circumstances that emerge throughout the loan servicing process (Maina, Kiai, & Kyalo, 2020).The theory sees default as a put option that can be exercised by the borrower when the circumstances are such that it would be economically beneficial for the borrower to do so (Kungu, Wanjau, Waititu, & Gekara, 2021). It also describes how financial institutions might cope with concerns should they develop during the time of credit risk (Chebungwen & Kwasira, 2020). Lending money always involves some aspects of risks that might arise from circumstances that are the result of the borrower failing to honor loan obligations when they become due (Kamotho & Njoka, 2022).The idea of credit risk is founded on the significant presumption that there is an associated cost for each of the following: transaction costs, taxes, and bankruptcy costs (Kamotho & Njoka, 2022). The theory further postulates that as the credit risks increases, the performance of entities declines, and this calls for prudence when awarding loans to customers so as to avoid default cases (Akinleye & Olarewaju, 2019). The theory was imperative in this study as in

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underpinned the study variable credit risk supervision. Due to its call that credit advanced must be supervised and monitored well so as to evade defaults.

2.2 Conceptual Framework

A conceptual framework a diagrammatic representation of the relationship between the independent and the dependent variables under investigation (Cooper & Schindler, 2019). Figure 1 illustrates the conceptual framework.

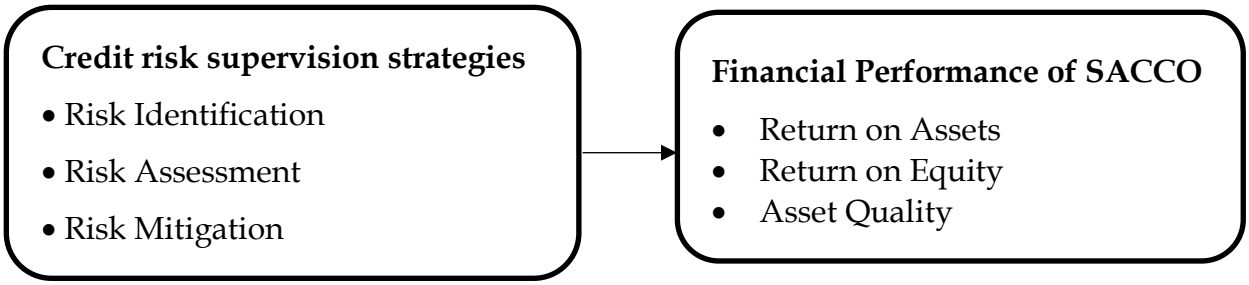

Figure 1: Conceptual framework

2.3 Empirical Literature

A research study carried out by Kungu, Wanjau, Waititu and Gekara (2021) investigated how credit risk strategies affected SACCOs lending in Kenya. The research examined risk identification, appraisal, analysis, monitoring, and mitigation strategies. The findings demonstrated that credit risk supervision strategies affect the lending of SACCOs in Kenya. The study by Kungu, Wanjau, Waititu and Gekara (2021) used both research questions and hypotheses, as well as the multiple linear regression model enshrined in SPSS. A study conducted by Ho and Yusoff (2019) aimed to investigate the management of credit risk in Malaysian financial institutions. The study utilized a sample of 15 financial institutions, both foreign and domestic, from which data was gathered via questionnaires. The findings indicate that diversifying loan services can enhance risk management, but it necessitates employee training and dedication to ensure that the financial institution adheres to the standards of optimal lending practices. The study further reported that credit risk management has a significant effect on performance. The study by Ho and Yusoff (2019) used the multiple linear regression model in undertaking its study. Muteti (2014) reported a positive correlation between credit risk supervision, bank deposits, bank size, and the financial competitiveness of commercial banks in Kenya in his investigation entitled "Relationship between financial risk management and financial performance of commercial banks in Kenya." The study by Muteti (2014) employed a mixed research design as well as the STAT package in data analysis. The study also used both primary and secondary data.

2.4 Research gap

The reviewed empirical literature brought about the research gap which this study endeavored to address. For instance, the study by Ho and Yusoff (2019) was conducted in financial institutions in Malaysia, while this present study was done in Kenya, precisely in the SACCOs sector in Mombasa County. The reviewed studies also embraced different methodologies; for instance, Muteti (2014) used a mixed research design, whereas Kungu, Wanjau, Waititu and Gekara (2021)

used the multiple linear regression model. This present study used a descriptive research design as well as a simple linear regression model in data analysis. Therefore, in response to the identified research gaps, this study sought to investigate the influence of credit risk supervision strategies on the financial performance of Deposit-Taking Saccos in Mombasa County, Kenya.

3.0 Research Methodology

This research study employed the descriptive research design, and the study population comprised of 109 participants from Finance Department, Internal Audit Department and Loan Department in all 6-deposit taking SACCOs located in Mombasa County. The study employed the Yamane (1967) formula in ascertaining the sample size, thus resulting into a total sample size of 86 units of analysis. The stratified random sampling technique was used in distributing the total sample size proportionately in all strata of the SACCOs in Mombasa County. Data for the study was collected using questionnaires. The collected data was analyzed through the Statistical Package for Social Sciences. Descriptive statistics, correlation statistics as well as the regression statistics were generated in this study. Diagnostic tests were conducted on the data before running the simple linear regression model. The regression coefficients generated were used in testing the hypothesis at 0.05 level of significance and decision made on whether to reject or fail to reject the null hypothesis. The regression model guiding this study was formulated in the following manner.

$Y = \beta_0 + \beta X + \varepsilon$

Where: Y: Financial Performance; X: Credit risk supervision strategies

4.0 Research Findings and Disscussion

The research findings and disscussion were presented in sections.

4.1 Diagnostic Test Results

Diagnostic tests were conducted on the data as a prerequisite for the successful running of the simple linear regression model.

4.1.1 Normality Test

The determination of normality in data distribution is confirmed when the normal (Probability to Probability) (P-P) plot displays a tendency to follow a linear pattern (Kothari & Garg, 2019). The findings, as illustrated in Figure 2, indicated that the data followed a normal distribution pattern, thus confirming that the data set was normally distributed.

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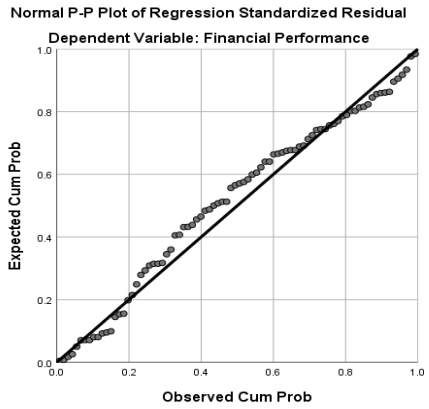

Figure 2: Normal P-P Plot

4.1.2 Test for Linearity

Researchers confirm the presence of linear relationship between the independent and the dependent variables when the scatter plot portray an oval shape distribution (Mugenda & Mugenda, 2013). The oval shape distribution pattern of the scatter plot presented in figure 3 confirmed the presence of linearity, thus paving way for the successful application of the linear regression model.

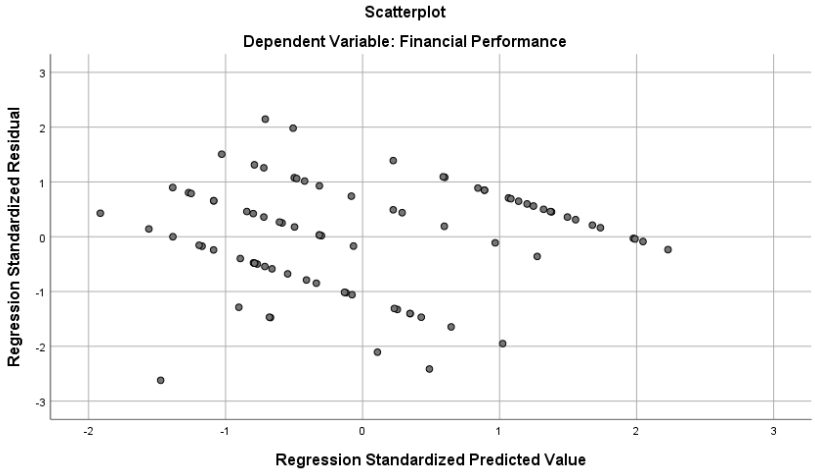

Figure 2: Scatter Plot

4.2 Descriptive Test Results

The descriptive statistics for the credit risk supervision strategies as well as the financial performance were generated and presented in the table 1

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Table 1: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Credit risk supervision strategies	84	1.000	5.000	3.17460	.858809
Financial performance	84	3.000	5.000	4.41667	.471049
Valid N (listwise)	84				

Table 1 reveals that the total units analyzed for the credit risk supervision strategies variable was 84 units. The table further displayed the minimum and maximum values for the credit risk supervision strategies variable as ranging from 1.0 to 5.000, thus resulting into having an overall mean of 3.17460. The overall mean value of 3.17460 indicating a consensus among the respondents that the credit risk supervision strategies have been implemented in the SACCO. The standard deviation, with a value of .858809 which was less than the mean value, indicated that that the data for the credit risk supervision strategies variable was well distributed around the central tendency. Table 1 reveals that a total of 84 units were analyzed for the financial performance variable. The table also outlines the minimum and maximum values for the financial performance variable as ranging from 3.000 to 5.000. This resulted in an overall mean of 4.41667. The standard deviation, with a value of .471049 which was less than the mean, indicated that the data for the financial performance variable was well dispersed around the central tendency.

4.3 Pearson's Correlation Coefficients

The Pearson's correlation analysis for this study were conducted and presented in table 2

Table 2: The Pearson's Correlation Coefficients

		Financial Performance	Credit risk supervision Strategies
Financial Performance	Pearson Correlation	1.000	
	Sig. (2-tailed)		
	N	84	
Credit risk supervision Strategies	Pearson Correlation	.407**	1.000
	Sig. (2-tailed)	.000	
	N	84	84

**. Correlation is significant at the 0.01 level (2-tailed).
*. Correlation is significant at the 0.05 level (2-tailed).

The outcomes of the Pearson's correlation analysis in Table 2, revealed a robust positive relationship of 0.407 between credit risk supervision strategies and financial performance. This relationship was statistically significant at the 0.05 level (2-tailed). The results suggest that for every unit increase in credit risk supervision strategies, there is a corresponding increase of 0.407 units in financial performance. The implication for this correlation is that as the SACCOs invest in credit risk supervision strategies, they should expect corresponding increase in financial

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performance, thus highlightin the crucial role of credit risk supervision in enhancing the overall performance of entities.

4.4 Multiple Linear Regression Model

In this study, the multiple linear regression model served as the guiding framework. Prior to executing the regression model, the Model Summary and ANOVA tables were generated and subsequently interpreted.

Table 3: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.639[a]	.408	.378	.371451

a. Predictors: (Constant), Credit risk supervision Strategies
b. Dependent Variable: Financial Performance

The R-square outcomes of 0.408 from the model summary in table 3 indicated that over 40.8% of the variability of the dependent variable could be explained by the independent variable. The R-square results showed that the model was a good fit.

Table 4: ANOVA

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	7.517	4	1.879	13.619	.000[b]
	Residual	10.900	79	.138		
	Total	18.417	83			

a. Dependent Variable: Financial Performance

b. Predictors: (Constant), Credit risk supervision Strategies

The significant F-test statistic presented in Table 4, with a value of 0.000 which less than 0.05, implied that the model was both fit and statistically significant, thus paving way for the successful running of the regression model employed in this study.

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Table 5: The Regression Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	1.175	.583		2.016	.047
	Credit risk supervision Strategies	.166	.050	.302	3.315	.001

a. Dependent Variable: Financial Performance

The regression coefficients were utilized to fit the model, as illustrated in Equation below;

$Y= 1.175 + 0.166X_1$

Where, Y: is financial performance; X_1: is credit risk supervision strategies

4.5 Hypothesis Testing

The null hypothesis was tested using the regression coefficients generated in this study and the results were presented in table 6

Table 6: Hypothesis Testing and Decision Rule

Hypothesis Statement	P-value	Decision Rule
H_{01}: Credit risk supervision strategy has no significant influence on the financial performance of deposit taking SACCOs in Mombasa County, Kenya	.001	Reject **H_{01}**, Since P-value <0.05

The study rejected the null hypothesis based on the p-value statistics obtained from the regression model, as presented in Table 5 and detailed in Table 6 for hypothesis testing. The hypothesis, which posited that credit risk supervision strategies have no significant influence on the financial performance of deposit taking SACCOs in Mombasa County, Kenya, was tested at a 0.05 level of significance. The results, showing a p-value of .001, were well below the 0.05 threshold, leading to the rejection of the null hypothesis (H01). This rejection indicates that there is a statistically significant influence of credit risk supervision strategies on the financial performance of deposit taking SACCOs in Mombasa County, Kenya. These outcomes affirmed the importance of credit risk supervision strategies in influencing the financial performance of entities in the financial sector in Mombasa County, Kenya. These findings agree with the findings of Kungu, Wanjau, Waititu and Gekara (2021) that credit risk supervision strategies affect the lending of SACCOs in Kenya. Similar findings were reported by Ho and Yusoff (2019) in their study on Malaysian financial institutions. Muteti (2014) also reported a positive correlation between credit risk

supervision and the financial competitiveness of commercial banks in Kenya in their investigation entitled "Relationship between financial risk management and financial performance of commercial banks in Kenya."

5.0 Conclusion

The study concludes that credit risk supervision strategies play a significant role in enhancing the financial performance of SACCOs in Mombasa County, Kenya. This conclusion is drawn from the statistical analysis, which revealed a strong correlation between credit risk supervision strategies and financial performance. The rejection of the null hypothesis, based on the p-value of 0.01 which was significantly lower than the 0.05 threshold, further substantiates the impact of credit risk supervision strategies on financial performance. The findings indicate that when SACCOs invest in credit risk supervision strategies, they are likely to see a marked improvement in their financial performance and overall organizational performance. This insight is crucial for the SACCOs management, highlighting the need for well-structured and effective credit risk supervision strategies, policies and practices to drive better performances and contribute positively to the growth and success of the financial industry in the region.

6.0 Recommendations

The study recommends that deposit-taking SACCOs in Mombasa County should prioritize the implementation of robust credit risk supervision strategies to enhance their financial performance. This entails adopting effective risk identification, appraisal, analysis, monitoring, and mitigation measures to minimize the risk of loan defaults and maintain a healthy loan portfolio. Additionally, the study recommends that SACCOs invest in comprehensive employee training programs to ensure that their workforce is well-equipped to adhere to optimal lending practices and risk management protocols. Furthermore, the study suggests that SACCOs should consider diversifying their loan services while maintaining a balanced risk profile, as diversification can potentially enhance risk management capabilities. Regular review and evaluation of existing credit risk supervision strategies are also recommended to identify areas for improvement and align with industry best practices and regulatory requirements. The study also recomends that policy formulating and regulatory bodies such as the SASRA should devise mechanisms and enforce policies which are geared towards enabling SACCOs to develop strategies which will enable them monitor their credit.

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