Quest Journals
Journal of Research in Business and Management
Volume 12 ~ Issue 7 (2024) pp: 27-30
ISSN(Online):2347-3002
www.questjournals.org

Effect of Risk Identification on Quality of Loan in Deposit Taking Savings and Credit Cooperative Societies in Nairobi County

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Abstract
Credit worthiness and credit performance may have implications on sustainability and financial intermediation efficiency of savings and credit cooperative societies. Therefore, the current study aimed at examining the effect of risk identification on quality of loan in deposit taking savings and credit cooperative societies in Nairobi County. Cross sectional descriptive research design was applied and primary data collected through administration of questionnaires. Results of the study depicted that risk identification has positive statistically significant effect on quality of loan in deposit taking savings and credit cooperative societies in Nairobi County.
Key words: Credit risk identification, quality of loan, savings and credit cooperative society.

***R**eceived 26 June, 2024; **R**evised 02 July, 2024; **A**ccepted 05 July, 2024 © The author(s) 2024.*
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I. Introduction

Risk identification is the process of evaluating and identifying the level of credit exposure for respective customer. The major methods used to identify risks include inspection by credit managers and analysis of financial statements. The major practices used for risk management include: credit scoring, institutionalizing credit standards, evaluation of credit worthiness, assessment of risk rating, and collateral (Amunabi & Koori, 2018).

Credit risk management practices is of interest amongst financial institutions management since it has a pivot function on their intermediation efficiency. In tandem with wealth maximization principle Rundassa and Batra (2016) asserts that organizations always aim at responding to stakeholders needs which are mainly wealth maximization and cost minimization. Hence, there is need for prudent credit evaluation amongst borrowers so as to minimize likelihood of bad debts.

Adoption of proper risk management has been credited by Amunabi and Koori (2018) who argues that there is a positive co-movement between risk management and firm value. Organization value would be derived from enhanced earnings capacity, development of competitive advantage and improvement of customer evaluation models and risk monitoring mechanisms. Thus, financial services providers may their credit quality through risk examination inform of historical borrowing analysis, cash flow management and evaluation of historical repayment patters. Therefore, the current empirical enquiry examined the effect of risk identification on quality of loan of SACCOs in Nairobi County.

Theoretical Review

Credit Risk Theory (CRT) was advanced by Merton (1960). The theory argues that their methods that can be used to evaluate credit default. According to Rossi (2014) borrower has likelihood of loan default which is contingent to prevailing economic conditions which exposes the lender to loss of principal and interest. This calls for examination of credit losses through evaluation of defaulting frequency and loss severity. Customer's credit worthiness is dependent on historical information. This is mainly evaluated through examination of customer's value at risk. The theory is appropriate for the study though there is need for consideration of the availability and quality of information that may be relied on while making decision on the credit worthiness of a borrower.

Empirical Review

Sofayo (2017) investigated the effect of credit risk management practices on quality of loan portfolio of commercial banks in Nigeria. Expo facto and correlation research designs were adopted in the study. Descriptive statistics and regression analysis analyzed the data. Findings indicates that credit risk management practices have significant effect on loan portfolio quality. Loan portfolio was positively affected by credit risk environment, credit analysis and regulatory roles. Credit administration had inverse and significant effect on loan portfolio quality.

Amunabi and Koori (2018) examined the impact of credit risk management on the savings and credit cooperative societies' loan portfolio results in Nairobi City County. In particular, the examination analyzed the impact of credit evaluation strategies, credit hazard recognizable proof, credit chance arrangements and credit relief rehearse on nature of advance portfolio execution. Aftereffects of the investigation shows positive and not critical impact of credit evaluation techniques and credit hazard strategies on credit quality execution. Credit chance recognizable proof and credit hazard moderation has positive and noteworthy impact of advance portfolio quality execution.

Kasana (2017) investigated the determinants of credit risks in commercial banks in Pakistan. Specifically, the study examined the effect of growth in GDP, interest rate, capital adequacy, operational efficiency, loan to deposit ratio, loan loss provision and bank size on credit risks. Causal research design was adopted and secondary data gathered for period 2007 to 2013 among 26 commercial banks. Descriptive statistics, correlation and multivariate statistics analyzed the data. Outcomes of the research indicated that capital capital adequacy and loan loss provision had positive and critical impact on credit risk. Working proficiency, GDP growth rate had critical impact on credit risk.

Muigai and Maina (2017) investigated the effect of credit risk management on performance of commercial banks in Kenya. Descriptive research design was applied and primary data gathered through administration of questionnaires among credit officers and finance managers of 39 banks. Descriptive and inferential statistics analyzed the data. Results of the study indicates that loan appraisal, lending requirements, credit management tools, loan recovery process had positive and significant effect on bank performance. It was recommended that commercial banks should establish credit limits for borrowers and develop methods of approving new loans. Methods of following up on borrowers should be developed so as to remind borrowers when their debts are due for payments.

Lawal (2017) investigated the effect of credit risk management on performance of deposit money banks in Nigeria. Panel research design was adopted and secondary data collected from 2007 to 2015. Multiple regression analysis analyzed the data. Results indicates positive and significant effect of loan loss provision on performance of listed deposit money banks. Capital adequacy had positive and not significant effect on performance. There was an inverse effect of non-performing loans, secured and unsecured loans on performance of deposit money banks in Nigeria. There was need for enhanced of credit analysis and loan administration of deposit money banks so as to optimize on loan loss provisions.

II. Methodology

The current study applied cross sectional descriptive research design and relied on primary data that was collected through administration of questionnaires among 100 respondents who were drawn from different SACCOs in Nairobi metropolitan. Data was collected through administration of questionnaires. Data was analyzed using descriptive and inferential statistics. Descriptive statistics included mean and standard deviation while inferential statistics had correlation and regression analysis.

$Yit = \beta_0 it + \beta_1 x_{1it} + e$

Y = dependent variable (Quality of loan)

β_0 = Constant Term

β_1= Slope coefficient

x_1= Risk identification

e = Error Term

III. Findings and Discussions

Results in Table 4.1 depicts that majority agreed that credit risk identification affected loan quality with a mean of 3.8 and standard deviation of 1.3. There was an agreement that majority of Saccos either has a methodological flow of evaluating historical records of their depositors of they check cash flow management of their members to identify credit risks (mean =3.9). Also, majority mean = 3.8 agreed that their Sacco has developed a framework for credit evaluation, have a framework for evaluating borrowers history while others argued that they have created a work flow chart that ought to adhered to during risk identification.

Table 4.1 Descriptive Statistics on Credit Risk Identification

	Mean	**Std Dev**
Our Sacco has developed framework for credit risk identification	3.8	1.3
Our Sacco has designed work flow chart to be adhered to during risk identification	3.7	1
Our Sacco has procedural criterion for risk identification	3.7	1.3
Our Sacco has a methodological flow of evaluating historical records of our DTs	3.9	1.3
Our Sacco checks on cash flow management of members to identify credit risks	3.9	1.3
Our Sacco has a framework for evaluating borrowers borrowing history	3.8	1.4
Our Sacco has a framework for evaluating borrowers repayment history	3.7	1.2
Our Sacco has a framework for evaluating borrowers cash flows management criterion	3.9	1.2
Overall average	**3.8**	**1.3**

Concerning the quality of loans majority mean =3.7 agreed that their Sacco has clearly defined credit collection process or their credit collection team ensures that their loan letter of issues adheres to all terms and conditions. Majority mean = 3.5 either agreed that their Sacco has designed functional work flows to be used in credit collection or their collection ensures that they have no cases that do not comply with their collateral guidelines. While majority mean = 3.6 agreed that they Sacco credit collection team undergo regular training to enhance their skills.

Table 4.2 Quality of Loan

	Mean	**Std. Dev**
Our Sacco has clearly defined credit collection process	3.7	1.3
Our Sacco has designed functional work flow to be used in credit collection	3.5	1.4
Our Sacco credit collection team undergo regular training to enhance their skills	3.6	1.4
Our credit collection team ensures that our loan letter of issues adheres to all terms and conditions	3.7	1.2
Our collection ensures that we have no cases that do not comply with our collateral guidelines	3.5	1.3
Overall average	**3.6**	**1.3**

Results in Table 4.3 has an r squared of 0.356, that depicts that 35.6% of changes in loan quality can be explained by credit risk identification while the remaining percentage is associated with other aspects. Analysis of variance has an F of 14.523 with p value < 0.05, this indicates that the model satisfied the condition for the goodness of fit. Credit risk identification has positive statistically significant effect on loan quality ($\beta = 0.142$, p value < 0.05). Therefore, a unit increase in credit risk identification has led to 0.142 unit increase in loan quality. Therefore, there is need for enhanced of the credit risk identification so as to optimize loan portfolio.

Table 4.3 Regression Analysis

Loan Quality	**Coef.**	**St. Err.**	**t-value**	**p-value**
Credit Risk Identification	0.142	0.069	2.045	0.001
Constant	0.105	0.097	1.08	0.072
R-squared	0.356			
F-test	14.523	Prob > F	0.000	

IV. Conclusion and Recommendations

From the results of the study its appropriate for lending institutions to develop framework for loan identification so as to enhance the quality of their loan portfolio and optimize organization performance. There is need for thorough background check of the borrowers through identification of their borrowing history, payment patterns and their cashflows.

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