Credit Risk Assessment and Financial Perfomance of SACCOs. A Case of Selected SACCOs in Ibanda Municipality

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***Abstract*; The study examined the influence of credit assessment on financial performance SACCOs in Ibanda municipality. The main purpose was; to examine how credit risk assessment influences the financial performance of SACCOs in Ibanda municipality. The cross sectional descriptive survey design with quantitative approaches of data collection and analysis were used. The study population comprised of employees of SACCOs in Ibanda municipality. In this study credit supervisors and loans officers were the key respondents. A sample of 90 respondents was used~~.~~ Questionnaires and documentary review were used to collect data. Statistical Package for Scientists (SPSS) Version (23) software helped in analyzing the collected data. Credit Risk assessment was found significant impacting on financial performance in the dimensions. The study thus recommended that there is a need for SACCOs to put in place credit assessment strategy.**

***Key Words*: Credit Risk Assessment, Financial Performance, Sacco's**

I. INTRODUCTION

1.1 Study background

Savings and Credit Cooperative Societies (SACCOs) are voluntary associations or cooperative financial institution owned and controlled by their members and operated for the purposes of promoting savings, credit at low interest rates and providing other financial services to its members (Waweru, 2011). SACCOs are the important micro financing institutions for mobilization of financial resources for various development activities. Generally, the idea behind establishment of SACCOS is to promote savings and make credits available to the members (Mumanyi, 2014). More so, SACCOs are able to advance loans at interest rates lower than those charged by other financial providers. In addition, SACCOs have the ability and opportunity to reach clients in areas that are unattractive to banks, such as rural or poor areas. This has made SACCOs more attractive to customers, thus deeply entrenching themselves in the financial sectors of many countries (Musumbi, 2012). In fact, the core objective of SACCOs is to ensure members empowerment through mobilization of savings and disbursement of credit.

The savings and credit cooperative (SACCO) business embraced today arose in Bangladesh in 1976 with the formation of the Grameen Bank (Bouman, 1977). It became popular in the 1980s as a response to doubts and research in the state delivery of subsidized credit to poor farmers. According to Ledgerwood (1980), prior to the 1980s, government agencies were the predominant vehicles for providing productive credit to those with no previous access to credit facilities. World over, systems in these organizations vary from slightly to significantly in terms of total system assets, average institutions' asset price and regulatory control. This ranges from volunteer operations with a few members' organizations to the institutions with several billion asset value (Mumanyi, 2014). The world council of credit unions (WOCCU) defines a credit union as a non-profit making cooperative institution. In real practice however legal provisions relating to these institutions vary by jurisdiction (WOCCU, 2011). These institutions have a relatively unique structure in that agency problems exist given that the owners of the institutions and users of the services are the same people. The members who hold accounts in the SACCOs are at the same time the owners, and they conduct their voting mandate on the one member-one vote basis irrespective of the members' shareholding. This means that only the members of these institutions can deposit and borrow from them.

In Africa, the idea of saving and credit societies was first described and discussed in 1955 in Jipara, a small town the upper west town of Ghana. The idea was brought by the Roman Catholic priest, Father John McNulty from Ireland.. The success Jipara story has been widely replicated throughout the African continent (Mumanyi, 2014). The first entrants into SACCO community include Ghana, Uganda, Nigeria, Tanzania, and Kenya. Most of the NonEnglish speaking nations in Africa started appreciating SACCOs in 1960s, with major influx into SACCO community in 1970s (Mwakajumilo, 2011). The formation of SACCO in Africa grew tremendously to the extent that the African countries formed a continental association of SACCOs, Africa Confederation of Cooperative Society Savings and Credit Association (ACCOSSCA), in 1965. ACCOSSCA was formed with the principal objective of promoting the SACCO principles, offer SACCO insurance, and educate members on SACCO issues (Ng'ombe &Mikwamba, 2004). There are 28 countries in Africa that have established SACCOs (Savings Plus, 2010).

In Kenya, the first Co-operative Society was Lumbwa Co-operative Society formed in 1908 by the European Farmers with the main objective of supporting agricultural activities and products to take advantage of economies of scale (Kenya Union of Saving and Credit Cooperatives [KUSCCO], 2006)**.** Notably, after independence, the Government of Kenya recognized co-operatives as suitable vehicles with appropriate framework to achieve their aspirations and participate in the economic development of the nation. Accordingly, steps were taken by the Government which saw the rapid growth and expansion of the SACCO Society movement in the country (Gardeklint, 2009). In fact, the SACCO movement is considered by the government as one of the economic pillars of the nation. By the year 2010, Kenya had over 5,000 registered SACCOs with a membership of about 7 million. These SACCO societies had mobilized savings of over Ksh.200 billion (Ndungu, 2010).

In Uganda, SACCOs were introduced through the Uganda Cooperative Alliance (UCA). The main purpose of the SACCOs was to provide financial services based on self-reliance that is to say being able to mobilize and manage their financial activities. This happened to be a response to the government's campaign of providing financial services that are affordable to the rural poor (Mpiira et al., 2014). UCA came into existence in 1961 at the height of the Cooperative movement. UCA was tasked with resource sourcing, advocacy, education of members and spokesman ship for the SACCOs. However, in the 1990s, government scaled down on its participation in the Cooperative movement. The withdrawal of government left a huge vacuum with many challenges. UCA re-organised itself to meet challenges arising from the government policy (Mpiira et al., 2014). This led to the formation of SACCOs which were to work as conduits for agricultural credit. As a result, many SACCOs were formed to access that money (Mpiira et al., 2014).

Following the liberalization of the Ugandan economy, the SACCOs have struggled to compete with other financial institutions and many have not been able to provide their members with services they needed (Ege and yet their sustainability is very critical. SACCOs remain one of the best vehicles through which the perceived unbankable population can access savings and credit facilities (Ahimbisibw, 2014). SACCOs offer small sized loans to their members compared to others financial institutions in Uganda, but still experience a high level of loan default (Kasekende, 2014). SACCOs have a high exposure to credit risk; the risk that borrowers are unable to pay or risk of delayed payments as well as operational risks .There has been massive fraud of funds by SACCOs' leaders (Kasirye, 2015) and level of loan default in SACCOs have increased.

In Uganda, SACCOs remain the most essential players in providing of money related services and have broader outreach than some other financial sectors (ICA, 2015). They constitute financial organizations that offer comparative if not similar items like banks and the greater part of them were shaped long time back before most commercial banks, yet their performance is quite wanting compared to other businesses in the same sector (Kiaritha, 2015). Factors like financial management and capital levels challenge SACCOs as they struggle to serve their member's financial needs (Mutesasira, 2015). These organizations do not have access to the lender of last resort, like commercial banks have the Central Bank. In turbulent times, they find it difficult to meet their obligations. This makes them prone to the liquidity shortage, which may cause adverse repercussion to the SACCOs (Namatovu, 2019). The failure of SACCOs to meet their obligation due to lack of sufficient liquidity and low risk management, result in poor creditworthiness and loss of member's confidence. Many Saccos in Uganda are not growing as evidenced by not expanding, not increasing on the work force, not opening other branches and their scale of operations remaining low (Namukasa, 2018). This poor performance may be attributed to poor investment decisions, poor credit risk management and illiquidity among SACCOs.

Savings and Credit Co-operatives (SACCOs) in Uganda are membership based financial institutions in Uganda today they are formed and owned by members themselves with the aim of promoting socio economic interests (Kabuga& Batarinyebwa, 2018). SACCOs offer a broad range of services to its members who include business accounts such as fixed deposits accounts, savings accounts, and other non-financial and financial services to its members. Some of its non-financial services include representation, trainings, advocacy, education, consultancy services and business plan development among others. Its financial services include credit, insurance and savings products (Owen, 2017).

In Uganda, the position of SACCOs has been heightened by the launch of government "Bonna Baga ggawale" ("Prosperity for all") program intended among other interventions to address the inadequate access to financial services. This program is designed to use a SACCO –per-sub county strategy to channel both agricultural and commercial loans at below market rates to borrowers (AMFIU, 2018).

Nevertheless, the SACCOs are bedeviled by corporate governance challenges which include; existence of volunteer board of directors, limited individual influence despite "one person one vote" decision making system and volunteer staff (Kasozi, 2008). These challenges and others are said to be handicapping the operations of SACCOs (Kakungulu *et al*, 2010)

According to Kawanguzi (2015), SACCOs are not only promoted for money but contributes to the promotion of overall human development, it develops people's minds by creating initiatives, motivation, promotion self-development and self-reliance as well as leadership, Unfortunately, the performance of SACCOs in Uganda have remained undesirable (Sewandagi, 2012). According to Micro Finance Support Centre, the portfolio at risk of many SACCOs raised from 87% to 90% in 2013-2015 respectively. This was quite below the standard of less than 10%. For the same period, the coverage risk ratio reduced from 39% to 28% which indicates a worsening situation. This is quite below the recommended 50% and above. However, in only 2 years, over 20 SACCOS closed of their businesses after getting loans from MSC as a result of poor management (AMFIU report, 2018). Despite allot of effort made by Uganda Government and some stake holders to enhance Governance and management competency of

SACCOS, the SACCOS performance in general remained low (Sewandagi, 2015). The performance of SACCOS in Uganda continued to deteriorate, MSC reports, (2013-2015). The coverage risk ratio, the portfolio at risk and profitability continued to reduce for the years 2013-2015. To the extent of worsening, all this are far below the standard.

In Ibanda district out of registered 94 Sacco's majority of them have collapsed due to poor management. Rushango SACCO in Rushango town council sub country started with 400 members, but eventually they reduced to about 150 members only (UCA, report, 2017). Due to these challenges, this study therefore examined the influence of credit management on financial performance of SACCOs in Ibanda municipality.

II. LITERATURE REVIEW

2.1. Credit risk assessment and Financial Performance of SACCOs

Credit risk assessment entails measures to minimize bad loans and the probability of default. According to Abbink, Irlenbusch and Remer (2006), the objectives of credit risk management are to minimize bad loans by improving the risk/return profiles of the portfolio, price credit risk adequately or risk based pricing, maximize benefits from the potential credit opportunities, setting of concentration and exposure limits, active portfolio management,adhere to credit policies and maintain a reliable database. credit risk modeling, the probability of default (PD) is one of the key parameters to be estimated for a financial institutions' performance sustainability to be ensured. It shows however that too little attention is paid to the different possible definitions of default in practice, although a clear understanding of the definition of default is crucial for a correct interpretation of any estimate of a probability of default.

The first step in limiting credit risk involves screening clients to ensure that they have the willingness and ability to repay a loan. Microfinance Institutions use the 5Cs model of credit to evaluate a customer as a potential borrower (Abedi, 2018). The 5Cs help MFIs to increase loan performance, as they get to know their customers better. These 5Cs are: character, capacity, collateral, capital and condition. The 5Cs need to be included in the credit scoring model. The credit scoring model is a classification procedure in which data collected from application forms for new or extended credit line are used to assign credit applicants to „good‟ or „bad‟ credit risk classes (Grover, 2012) notes that capital (equity contributions) and collateral (the security required by lenders) as major stumbling blocks for entrepreneurs trying to access capital. This is especially true for young entrepreneurs or entrepreneurs with no money to invest as equity; or with no assets they can offer as security for a loan. Any effort to improve access to finance has to address the challenges related to access to capital and collateral. One way to guarantee the recovery of loaned money is to take some sort of collateral on a loan. This is a straightforward way of dealing with the aspect of securing depositor's funds. Clear established process for approving new credits and extending the existing credits has been observed to be very important while managing Credit Risks in SACCOs (Hoffman, 2002).

Clear established processes of approving new creditors and extending the existing credits has been observed to be very important while managing credit risks in Saccos. Credit unions must have in place written guidelines on credit approval processes and approval authorities'. The board of directors should always monitor loans, approval authorities will cover new credit approvals, renewal of existing credit changes in terms and conditions of previously approved credits particularly credit restructuring which should be fully documented and recorded. Prudent credit practice requires that persons empowered with the credit approval authority should have customer relationship responsibility. Approval authorities of individuals should be commensurate to their positions within the management ranks as well as their expertise (Mwisho, 2018)

Chijoriga (2016) points out that assessment of a loan proposal from different points of view should be done to decide whether the credit institution should go for finance or not. In order to select the borrower, church hill (2002) opines that security should not be the only thing to be relied upon. In the same breath, Konno (2009) observes that it is the responsibility of the loan officers to investigate the client from different viewpoints, that is, the strength and weakness of the client so that the client will be able to repay the loan according to the repayment schedule with profit included therein. Konno (ibid) further notes that modern concepts of credit investigations cover a well-developed loan appraisal analysis from six points of view, which include managerial aspects comprising of; sincerity, honesty, integrity and educational background, experience of the borrower and ability of the management to run the project efficiently.

Effective credit risk assessment and loan accounting practices should be performed in a systematic way and in accordance with established policies and procedures. To be able to carefully value loans and to determine appropriate loan loss provisions, it is particularly important that credit institutions have a system in place to reliably classify loans on the basis of credit risk. A well-structured credit risk grading system is an important tool in differentiating the degree of credit risk in the various credit exposures of the lending institutions. This allows a more accurate determination of the overall characteristics of the loan portfolio, probability of default and ultimately the adequacy of provisions for loan losses (Shoji, 2009).

Further, monitoring of borrowers is very important as current and potential exposures change with both the passage of time and the movements in the underlying variables, says Mwisho (2019). According to Hussain (2009), monitoring involves, among others, frequent contact with borrowers, creating an environment that the bank can be seen as a solver of problems and trusted adviser; develop the culture of being supportive to borrowers whenever they are recognized to be in difficulties and are striving to deal with the situation; monitoring the flow of borrower's business through the SACCO's account; regular review of the borrower's reports as well as an on-site visit; updating borrowers credit files and periodically reviewing the borrowers rating assigned at the time the credit was granted. SACCOs must have in place written guidelines on the credit approval process and the approval authorities of individuals or committees as well as the basis of those decisions. Approval authorities should be sanctioned by the board of directors.

Approval authorities will cover new credit approvals, renewals of existing credits, and changes in terms and conditions of previously approved credits, particularly credit restructuring, all of which should be fully documented and recorded. Prudent credit practice requires that persons empowered with the credit approval authority should not also have the customer relationship responsibility. Approval authorities of individuals should be commensurate to their positions within management ranks as well as their expertise (Mwisho, 2011). Aboagye and Otieku, (2010) conducted a study on Credit Risk Management and Profitability in financial institutions in Sweden. The main objective was to find out if the management of the risk related to that credit affects the profitability of the financial institutions. They found that credit risk management in financial institutions has become more important not only because of the financial crisis that the world is experiencing nowadays but also the introduction of Basel II. They concluded that since granting credit is one of the main sources of income in financial institutions, the management of the risk related to that credit affects the profitability of the financial institutions (Aboagye & Otiekun, 2010).

III. METHODOLOGY

3.1. Research Design

A descriptive cross sectional survey design with quantitative approaches of data collection and analysis was employed. This design is flexible and enables the study to be carried out at a particular time and the notion of combining qualitative and quantitative data in a cross section survey helps in getting detailed information, as observed by Amin (2005). Sekaran (2003) argues that a combination of both qualitative and quantitative approaches helps to test for consistency of the study findings, while the quantitative techniques were used to examine the relationship between the variables in the study and to test for consistency of findings from both methods.

IV. STUDY FINDINGS

4.1. Credit risk assessment and financial performance of SACCOs

The respondents were asked to reveal whether credit risk assessment affects financial performance of SACCOs in the study area. Respondents were asked to indicate whether they strongly agree (SA), agree (A), Not Sure (NS), disagree (D) and strongly disagree (SD) using 5-likert scale. The analysis was done using the mean and standard deviation. A mean above 3 indicates an agreement of respondents and a mean of below 3 shows disagree by respondents. The standard deviation (SD) of close to 1 shows agreement, while the standard deviation of close to 0 indicates disagreement of the respondents. The analysis further grouped strongly agree and agree to mean agree and strongly disagree, not sure and disagree to mean disagree and average scores were computed for further analysis. The elicited results were shown on table 10.

Table 1: credit risk assessment and financial performance of SACCOs

	Mean	Std.
The SACCO analyses customer credit history regularly	3.41	.726
The SACCO uses client financial records to analyses credit risk	3.11	.701
The SACCO contacts the credit bureau to assist in decision making to lend their customers	3.16	.699
Staffs at the SACCO follow an approved procedure in loan appraisal	3.19	.862
All loans disbursed are covered with an insurance policy	3.02	.818
The SACCO insists on establishing the creditworthiness of a client before advancing a loan	3.18	.722
The SACCO considers client experience in business before approving the loan applied for	3.06	.688
All loans are secured by perfected collateral	3.28	.811
There is a credit committee to screen all loans before disbursement	3.01	.846
Total score	28.42	6.873
Average Score	**3.16**	**.764**

Source: Primary data, 2020

Table 10 shows that majority of the respondents with mean average score of 3.16 and standard deviation average score of 0.764 agreed with the options given to them in relation to credit risk assessment and financial performance of SACCOs while the minority disagreed. This is an indication that credit risk assessment affects the financial performance of SACCOs in the study area.

Testing Hypothesis two.

Hypothesis one stated that there is no significant effect of credit risk assessment on the financial performance of SACCOs in Ibanda municipality. The hypothesis was tested using the Pearson correlation coefficient and the regression analysis and results of the hypothesis are given below.

Table 2: Correlation matrix for Credit risk assessment and financial performance of SACCOs

		Credit risk assessment	Financial performance of SACCOs
Credit risk assessment	Pearson Correlation	1	.780**
	Sig. (2-tailed)		.000
	N	67	67
Financial performance of SACCOs	Pearson Correlation	.780**	1
	Sig. (2-tailed)	.000	
	N	67	67
**. Correlation is significant at the 0.01 level (2-tailed).			

Correlation results indicated a significant and positive relationship between credit risk assessment and financial performance of SACCOs (r = 0.780**, p<.01). This implies that when there is effective on credit risk assessment, this will enhance the effectiveness and efficiency in improving financial performance of SACCOs. Therefore, according to the results there is a positive significant relationship between credit risk assessment and financial performance of SACCOs. This implies that a significant improvement in credit risk assessment positively financial performance of SACCOs.

Table 3:Regression Analysis for the relationship between Credit risk assessment and financial performance of SACCOs

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.780[a]	.609	.604	.39451

Predictors: (Constant), Credit risk assessment

Regression analysis results in table 12 indicated that the credit risk assessment significantly affects Financial performance of SACCOs in Ibanda municipality at a rate of 60.9% and this was indicated by r-squared of 0.609, hence implying that credit risk assessment significantly influences the Financial performance of SACCOs in Ibanda municipality.

Decision on hypothesis

The hypothesis was rejected since the significant value was found to be less than 0.05 (Sig=0. 000).

4.2. The influence of credit risk assessment on the financial performance of SACCOs in Ibanda municipality.

The study indicated that the SACCO analyses customer credit history regularly to establish the credit worthiness of the clients. The findings revealed that the SACCOs in the study area analyze customers' paying history to determine capacity to pay. It was noted that the SACCO considers clients credit repayment history and even how he has been dealing with other institution. It was indicated that loan amounts depend on loan cycles of clients. The findings are in agreement with Pandey (2008) that a quality credit in its policy should require a credit report and other retailer information on your borrower, checking with the customer's previous banker is important, since it's an assurance that the credit worthy borrowers obtain loan from their bank, lending officers need a limit in the lending with specified secured credit, anything above the limit should be in the knowledge of the management groups or directors. Proper loan documentation before disbursement of the loan. This should be so whether disbursed by the chief executive or the most junior loan officer. The findings concur with Kalunda (2016) that there is a significant relationship between evaluations of clients paying history to determine his/her capacity pay. The findings implied that the financial institutions under study analyze customers' paying history to determine capacity to pay. Moti et al. (2012) concur arguing that capacity to repay is critical in client appraisal and hence credit analysis, this further implies that analyzing a customer ability to pay may assist the financial institutions to avoid bad debts. This further indicated that the financial institutions must put in place effective customer analysis practices which may have an implication on the growth of the financial institutions.

The study findings suggest that staffs of the SACCOs in the study area followed an approved procedure in loan appraisal. It was observed that all securities are verified by the credit administration before disbursement of loans. Bategeka (2009) noted that high-quality CRM staffs are critical to ensure that the depth of knowledge, securities are verified and judgment needed is always available, thus successfully managing credit. Behangana (2015) noted that establishment of an appropriate credit environment through policy and strategies (guidelines) that clearly outline the scope and allocation of bank credit facilities; maintenance of an appropriate credit appraisal that involves monitoring process as well as adequate controls over credit; top management support is required to ensure that there are proper and clear guidelines in managing credit.

The findings established that all loans disbursed are covered with an insurance policy with the intention of reducing the default rate in case of a happening of the unfortunate event. The respondents indicated the insurance ranges between 2.5% to 3% of the total loan taken by the client. The findings are in agreement with Bahemuka (2017) that loans in financial institutions are insured to insurance companies at an agreed percentage for any risk depending on a financial institution. It is deducted from the loan upon disbursement but the ranges of the insurance to be deducted vary from institution to institution. Insurance companies charge premiums depending on the type of risk; like accidents, death, permanent disabilities etc. The insurance company covers the outstanding loan amount depending on whether the risk was insured. Insurance covers helps to reduce on the default of the otherwise would be defaulting clients. Credit insurance is very important where large amounts of credit are extended. It is much harder, and much more expensive, to get credit insurance when the risks increase. Both the credit crunch and the recession greatly increase the risk of customers defaulting on the money owed, so it becomes much harder to obtain insurance cover.

The inferential statistics indicated that Credit risk assessment positively influences performance of SACCOs. Brannan, (2000) supports the above findings arguing that credit risk assessment is the primary tool for lenders to control borrower risk, and highlighted the fact that risks arise well before default occurs and warned against the construction of "bullet-proof" portfolios that can under perform. Lopez, (2000), supported this by discussing that there was value in diversification of credit portfolios and pointed out how this value can be measured. According to Abbink et al, (2006) ascertains that the objectives of credit risk management are to minimize bad loans by improving the risk/return profiles of the portfolio, price credit risk adequately or risk based pricing, maximize benefits from the potential credit opportunities, setting of concentration and exposure limits, active portfolio management, adhere to credit policies and maintain a reliable database. In agreement with the findings, Abbink, Irlenbusch and Renner (2006) posit that the objectives of credit risk management are to minimize bad loans by improving the risk/return profiles of the portfolio, price credit risk adequately or risk based pricing, maximize benefits from potential credit opportunities, setting of concentration and exposure limits, active portfolio management, adhere to credit policies and maintain a reliable database.

V. CONCLUSION

5.1. The influence of credit risk assessment on the financial performance of SACCOs in Ibanda municipality.

The findings of this study showed that credit risk assessment positively affects the performance of SACCOs. Credit risk assessment should involve screening clients to ensure that they have the willingness and ability to repay a loan. It can be inferred that, by having in place a credit committee, securing loans by perfected collateral, risk associated with the loans can be minimized, in case the clients default. In addition, ensuring that there is a required team and required resources in place to assess and control risk is a necessary ingredient towards improving financial performance of a SACCOs. Thus, premised on the empirical results of this study, it is concluded that SACCOs undertake the required credit risk assessment which has been vital in improving its financial performance.

VI. RECOMMENDATIONS

6.1. The influence of credit risk assessment on the financial performance of SACCOs in Ibanda municipality.

The findings revealed that credit risk assessment impacted on and the performance of SACCOs. Therefore, management should be committed to ensure that the credit risk assessment processes are not abused by staff and are adhered to by all concerned staff. As this is the medium through which clients' illegibility is assessed in order to extend credit to them.

SACCOs should endeavor to see that the credit rating models are continuously applied. This helps to ascertain how much interest rate to charge for a given loan as it summarizes and quantify risk in a given loan portfolio. Since credit rating had a significant positive relationship with financial performance, it is important that while assessing projects, internal credit rating should be part and partial of the appraisal process. Technical staff should be trained to be able to conceptualize, design, and make operational an internal credit rating system that suits the SACCOs' operations to control risk exposures.

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