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Credit Information Sharing Influence On Loan Default in Deposit Taking Saccos in Meru County

Maina, J.N.¹, Kinyariro, D.K.² and Lalampaa, T.J.²

¹Karatina University, P. O. Box 1957-10101, Karatina

²Kenya Methodist University, P. O. Box 267-60200, Meru. Email: andyndeck@gmail.com. Tel.: 0708915965

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ABSTRACT

The study assessed influence of credit information sharing on loan default in deposit taking SACCOS in Meru County. It was guided by the influence of credit report and credit scoring on loan default. SACCOS in Kenya experience high level of loan default. This trend threatens the ability and sustainability of SACCOS and hinders achievement of goals. Since provision of credit facilities is the core function of every SACCO, success largely depends on profiling borrowers through the information availed. The study adopted a descriptive research design and the population consisted of 57 credit officers of SACCOS in Meru County. Questionnaire was used to collect data. Descriptive statistics and multiple linear regression were used in data analysis. There existed a significant relationship between credit report credit scoring and loan default in SACCOS. Thus credit information sharing significantly influenced loan default in SACCOS in Meru County. Regulations of SACCOS in sharing information on non-performing loans to aid in risk mitigation should be operationalised. Credit information sharing should be extended to all other SACCOS, including the non-deposit taking ones, to increase data for borrowers' profiling.

Keywords: SACCOS, Credit information sharing, Loan default.

INTRODUCTION

Saving and credit cooperative societies are a self-governing association of persons which are organized and operated under the principles of cooperatives to meet their common financial and social needs (ICA, 2005). The essential aim of a SACCO is to promote the financial and social welfare of its members by granting loans to cover their financial needs, supporting the spirit of initiative in agricultural or industrial work and careful use of the saving produced locally (WOCCU, 2005).

The history of cooperatives started with the Rockdale Society of Equitable Pioneers, founded in 1844. However, Africa has a membership of 16 million making it third in membership size after North America and Asia which have 102 million and 36 million respectively. Compared to other continents Africa mobilizes only 0.4% of the global savings which is USD 1.1 trillion and 0.4% of global loans provided to the membership standing at USD 912 billion. North America, generally consisting of Canada and United States are the major players with savings and loans up to 83% and 84% of the statistics respectively

(WOCCU, 2009). In Kenya, the first cooperative society in Kenya was organized by Europeans settlers in Rift Valley in 1908. The society was supposed to market cereal crops, fruits and dairy products. That time there was no Co-operative Law to govern it until 1931. In 1966, the cooperative societies Act was enacted which introduced control measures to counteract mismanagement and misappropriation of funds. The savings and credit cooperative societies were formed in late 1970's. SACCOs have grown significantly and they play a major role in providing financial services to majority of Kenyans particularly in the rural areas for example between 1985 and 2006 the number of registered SACCOs rose from 1285 to 4876 (Ministry of Co-operative Development and Marketing, 2007). Co-operatives remain the best vehicles for the perceived unbankable population can access savings and credit facilities (Kioko, 2014).

SACCOs offer small sized loans to their members compared to others financial institutions in Kenya, but still experience a high level of loan default rate (Karumuna and Akyoo, 2011). 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 (Alfred, 2011). There has been massive fraud of funds by SACCOs' leaders (Mugisa, 2010) and loan default in SACCOs have increased. Credit information sharing is expected to create an incentive for defaulters to make payments against the defaulted debts (Kairu and Amandi, 2014). Credit information sharing undoubtedly plays a pivotal role in reducing the information asymmetry that exists between lenders and borrowers.

Problem Statement

Financial intermediation is the main business of financial institutions and loans are generally the main source of revenue for SACCOs (Kwambai and Wandera, 2013). Nevertheless, many SACCOs have collapsed in Kenya since 1986 due to loan defaults which have resulted from national economic downturn, failure by loan applicants to disclose vital information during loan processing and lack of an aggressive debt collection policy (Waweru and Kalani, 2009). This deters the essential aim of a SACCO of promoting the financial and social welfare of its members by granting loans to cover their financial needs so as to help members achieve their standard of living (Lagat, Mugo, and Otuya, 2013). The issue of bad debt can fuel credit crisis and result in the collapse of some of these institutions hence the economy as a whole. Locally few studies have been done on credit information sharing, among them includes Kioko (2014) on Credit information sharing influence on performance of licensed deposit taking SACCO businesses in Kenya and Kisengese (2014) on impact of credit information sharing on the level of non - performing loans of commercial banks in Kenya. While the above research outcomes provide insight on credit risk management techniques, there is no known study to the researcher which has been done on credit information sharing influence on loan default in SACCOs hence the need for the study.

General Objective

The general objective of this study was to analyze the influence of credit information sharing on loan default in deposit taking SACCOs in Meru County.

Specific Objective

- (i) To determine influence of credit report on loan default in deposit taking SACCOs in Meru County.
- (ii) To establish influence of credit scoring on loan default in deposit taking SACCOs in Meru County.

LITERATURE REVIEW

Asymmetric Information Theory

Information asymmetry refers to a situation where enterprise owners or manager know more about the risks facing their business, than do the lenders (PWHC, 2002) cited in Eppy (2005). Information asymmetries arise when gaining information on the characteristics or behavior of the borrower and it's costly for the financial institution. Information asymmetries generate problems of allocation of loans to borrowers with undesirable characteristics such as a high level of risk or inability to take advantage of the loan (Lown and Morgan, 2003). The theory describes a situation in which all parties involved in an undertaking do not know

relevant information. In a debt market, information asymmetry arises when a borrower who takes a loan usually has better information about the potential risks and returns associated with an enterprise for which the funds are earmarked. The lender on the other hand does not have sufficient information concerning the borrower (Edwards and Turnbull, 1994). Perceived information asymmetry poses two problems for the SACCOs; moral hazard and adverse selection (Binks and Ennew, 1992). Credit information sharing improves borrowers' incentives to repay the loans and helps overcome moral hazard of borrowers (Padilla and Pagano, 2000). It also allows loans to be extended to safe borrowers who had previously been priced out of the market, resulting in higher aggregate lending.

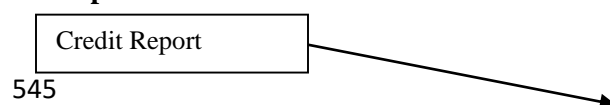
Empirical Review

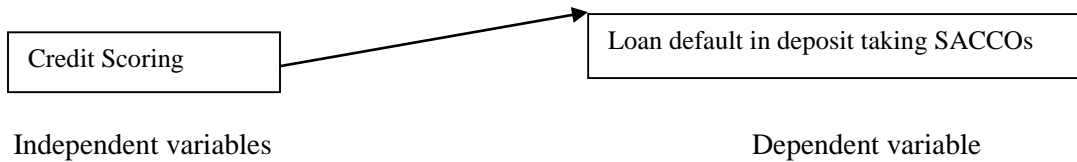
Furletti (2002) in his study on the overview and history of credit reporting was of the view that credit reports give businesses insights into a consumer's past behavior, similar to the ways in which an insurance company might use a driving record or a prospective employer might use a college transcript. These insights, which include a consumer's record of meeting financial obligations, can be used to make decisions about his or her stability and his or her ability and willingness to repay debt. Without such information, borrowers would likely be required to provide more information about them when applying for any type of credit and pay more for access to credit. In fact, in countries that do not have a well-developed credit reporting system, creditors can make the mistake of lending to consumers who are already over extended or in default with another creditor. These mistakes result in a higher cost of borrowing for all consumers.

Turner and Varghese (2007) in their study on factors influencing loan default observed that credit bureaus help to solve a problem that is inherent in lending: imprecise knowledge of a borrower's likelihood of repaying. The lender must instead infer the risk profile of the borrower. Incorrect assessments result in two symmetrical problems. Low-risk borrowers are mistaken as high-risk and high-risk borrowers are mistaken as low-risk. Consequently, low-risk borrowers face high interest rates that act as subsidies for high-risk borrowers. High-risk borrowers receive subsidies and are hereby drawn into the market. Average prices go up to reflect the disproportionate presence of high-risk borrowers, and delinquency rates are higher. In response, lenders ration loans in a way that given two individuals with identical risk profiles and preferences, one will receive a loan and another will not. The study concluded that credit referencing drastically reduces the levels of default. A research study carried out by Brown and Zehnder (2006) showed that information sharing increases repayment rates, as borrowers anticipate that a good credit record improves their access to credit. This incentive effect of information sharing is substantial when repayment is not third-party enforceable and lending is dominated by one-shot transactions.

According to a survey carried out by Cowan and Cowan (2006) on financial institution use of credit scoring for small business lending established that effectively developed and managed credit scoring would help meet their needs in a variety of ways. Some of the ways that credit scoring would meet their needs included: the reduction of reliance on collateral, risk-based pricing that may lower their interest rates and greater credit availability for higher-risk customers, who, without risk-based pricing, would simply be denied loans. In addition, turn-around times from application to approval and funding would likely decrease. Finally, as lenders become more confident in scoring's accuracy, risk-adjusted approval rates may increase. Aduda, Magutu, and Wangu, (2012) stated that SME's lack the collateral necessary for financing their loans and are also subjected to higher interest rates. The average loan amount issued to SME's in Kenya is 5 Million. Credit scoring reduces informational dullness and improves the quality of lending for SME's looking to access long term financing. Credit scoring increases access of credit for SME's because banks can quantify risk. However despite availability of credit scoring in US, relationship lending is still a dominant factor as relationships and loan purpose were considered more important than credit scoring regardless of whether a bank used credit scoring or not (Cowan and Cowan, 2006).

Conceptual Framework





METHODOLOGY

The study used a descriptive research design. Descriptive research design was used since it provides insights into the research problem by describing the variables of interest. It was used for defining, estimating, predicting and examining associative relationships. This helped in providing useful and accurate information to answer the questions based on who, what, when, and how. The study was conducted in Meru County, Kenya. The study was conducted in Meru County owing to its being cosmopolitan in various SACCOs. The target population consisted of all the 9 deposit taking SACCOs in Meru County. The respondents were the 57 credit officers of these deposit taking SACCOs. The study used census study methodology which enabled the researcher to gather more information to assist in analysis and arriving at accurate results. The 57 credit officers or respondents who were more than the threshold of 30 participated in the study. Data was collected from primary sources. Self-administered questionnaires were issued to the respondents.

Descriptive statistics was used to analyze the data. Data was edited, coded, classified and summarized into categories. Multiple linear regression was also used to link the relationship between independent variables (credit report and credit scoring) and dependent variable (loan default) and was guided by the following model:

$$LD = \beta_0 + \beta_1 CR + \beta_2 Cs + \epsilon$$

Where, LD is the dependent variable (Loan Default),
 β_0 is the intercept
 CR =Independent variable Credit Report.
 CS =Independent variable Credit Scoring.
 Ei is the error term.

FINDINGS/RESULTS

Credit Report Influence on Loan Default

The first objective was to find out the influence of credit report on loan default. 100% of the respondents stated that credit report for customer is requested on all loan applications. Only 41.2% of the respondents said that credit report contain demographic information of a client while 58.8% said they don't contain. Majority of the respondents (85.3%) said that credit report contain payment profile information, 23.5% of the respondents said that credit report contains account information while 38.2% said they contain enquiries made on customers account.

The respondents stated that customers are entitled to one credit report yearly. 76.5% of the respondents were in agreement that credit report is used for approving or declining the loan. From the findings the researcher found that 61.8% of the respondents disagreed that credit report is used for charging high or low interest and for deciding what amount to give the customer. Majority of the respondents (50%) rated the influence of credit reporting on loan default as being high.

Credit Scoring Influence on Loan Default

The Second objective of the study was to establish the influence of credit scoring on Loan default. Credit referencing advisories were found to provide credit score of customers. Majority of the respondents i.e.

44.1% were of the view that score attained from credit referencing advisory was extremely important to issuance of credit to a customer 32.4%, 20.6% and 2.9% of the respondents stated it as being very important, important and less important respectively. 35.3% of the respondents agreed that access to accurate credit scores reduces the value of relationship lending 14.7% were uncertain while 50% disagreed. The researcher found that risky customers receive loans with high interest rates and less risky customers receive loans at a lower interest rate. Credit scoring was highly rated by majority of the respondents who were 61.8%.

In reference to Table 1 above, the two independent variables that were studied, explain 81.1% of credit information sharing influence on loan default in deposit taking SACCOs in Meru County as represented by the adjusted R². This therefore means that other factors not studied in this research contribute 18.9 % of the credit information sharing influence on loan default in deposit taking SACCOs in Meru County. Therefore, further research should be conducted to investigate the other influencers (18.9%) of credit information sharing on loan default.

Regression Analysis

Table 1: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.906 ^a	0.821	0.811	0.215

Table 2: ANOVA

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	7.454	2	3.727	80.252	.000 ^a
	Residual	1.625	35	.046		
	Total	9.079	37			

Table 2 above shows the significance value is 0.000 which is less than 0.05 thus the model is statistically significant in predicting how credit report and credit scoring influence loan default in deposit taking SACCOs in Meru County. The F critical at 5% level of significance was 2.32. Since F calculated is greater than the F critical (value = 80.252), this shows that the overall model was significant.

Table 3: Coefficients

Model		B	Std. Error	Sig.
1	Constant	.499	.201	.018
	Credit Report	.712	.121	.000
	Credit Scoring	.132	.076	.092

The researcher conducted a multiple linear regression analysis so as to explain the influence of credit information sharing on loan default. The two variables as per the SPSS generated, the equation: LD= 0.712CR + 0.132CS + 0.499. To assess the significance of each independent variable on the dependent variable, the researcher established that credit report and credit scoring were significant and influenced loan default as their P values were less than 5%. The model revealed that there exists a significant relationship between credit report and loan default. This concurs with Furletti (2002) in his study on the overview and history of credit reporting who was of the affirmed that countries that do not have a well-developed credit reporting system, creditors can make the mistake of lending to consumers who are already over extended or in default with another creditor. These mistakes result in a higher cost of borrowing for all consumers.

It also revealed that there exists no significant relationship between credit scoring and loan default in deposit taking SACCOs which is in agreement with the study of Cowan and Cowan (2006) on financial institution use of credit scoring for small business lending which stated that relationship lending was still a dominant factor as relationships and loan purpose were considered more important than credit scoring regardless of whether a bank used credit scoring or not.

CONCLUSIONS

The study concludes that credit referencing advisory and loan default are indeed related. Credit referencing advisory, increases transparency among financial institutions, helps the SACCOs lend prudently, lowers the risk level to the SACCOs, acts as a borrowers discipline against defaulting and it also reduces the borrowing cost i.e. interest charge on loans. Credit referencing bureaus has come of age and has helped the financial institutions to lend with care. The effect of it therefore has led to reduced loan default.

RECOMMENDATIONS

Based on the findings of this study, the following recommendations have been suggested:

- (i) The credit referencing advisories to expand their field and ensure that they gather more financial history data from other sources such as county offices, the Kenya Revenue Authorities, utility providers and other service providers so that one's credit worthiness is viewed holistically.
- (ii) Financial institutions are also advised to utilize the information gathered for the intended use as it was noted that the use of credit scores hasn't greatly reduced the occurrence of relationship lending.
- (iii) The public also to be sensitized on the importance of getting to know what is contained in one's credit report early enough. Each individual is entitled to one free credit report per year.
- (iv) To operationalize regulations that can govern SACCOs on sharing information on non-performing loans to aid in risk mitigation.
- (v) There is need to extend credit information sharing to include the whole SACCO subsector including the non-deposit taking SACCOs to increase data for borrowers' profiling.

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