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Credit Risk Identification and Financial Performance of Saccos. A Case of Selected Saccos in Ibanda Municipality.

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ABSTRACT: The study determined the effect of credit risk Identification on financial performance SACCOs in Ibanda municipality. The study anchored of an objective; to determine the effect of credit risk Identification on the financial performance of SACCOs in Ibanda municipality. The researcher used a positivism paradigm as well as a cross sectional descriptive survey design with quantitative approaches of data collection and analysis. 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 determined with the help of Yamane (1967) formula. Data was majorly collected using a questionnaire as a tool for quantitative data collection and analysis was done used a data management tool SPSS (Version 23) where descriptive and correlational statistics were derived to find out the relationship between the two variables under the study. The study results indicated a moderate significant positive relationship between credit risk Identification and financial performance of SACCOs (r = 0.623**, p<.01). The study recommended that there is a need for SACCOs to put in place credit risk strategy which can be followed to ensure that finances are not lost in courtesy of credit risk Identification.

I. INTRODUCTION

1.1 Study Background.

SACCOs are referred to as cooperative financial institutions that play the role of mobilizing the savings from the community members for safe custody at the same time giving out credit to those who look at money multiplier concept (Ndiege et al., 2016). SACCOS all over the world have played a great role in bridging the gap between the surplus spending units and the deficit spending units by ensuring the smooth circulation of money from one hand to another (Ajibola et al., 2020). SACCOS globally have led to economic growth and development by ensuring that the community members understand the concept of financial management and literacy hence improving the peoples standards of living as a result of SACCO evolution globally (Ajibola et al., 2020).

In African countries, SACCOs have been looked as competing financial institutions with commercial banks and the community members credit the SACCOs because they are community based and therefore considers the locals in most case (Gaitho, 2010). In the same vein, SACCOs major aim is to make profits and keep sustained in the market of SACCO business and this calls for SACCOs to maintain strategies to ensure that the profitability level is granted at all time (Essendi, 2013). The profitability of the SACCO is mostly determine by the portfolio quality which grantees a SACCO to receive loan payments together with interest at the agreed time (Maina et al., 2016).

For SACCOs in east African countries, have lied strategies to ensure portfolio quality and loan repayment on time because it is basically what brings in profits to the SACCOs (Ssekiziyivu& Nabeeta, n.d.) these strategies are mostly concerned with the credit risk measures because it is through credit that the SACCO is able to earn profits (Hesborn et al., 2016). These credit risk measures have played a very big role in the financial sector regarding the SACCO financial operations to minimize the risks involved (Keben&Maina, 2018) credit risk management strategies are mostly implemented by the credit officers of a given financial institution to ensure that their minimum loan delinquency and that credit is only extended to capable clients to pay back their loans to the SACCO (Bwoma et al., 2017).

In east Africa currently, there is a rapid growth of SACCO business because has highly been adapted by the natives (Yitayaw, 2021). Therefore, the SACCOs are trying hard to maintain their status quo of financial performance too remain sustainable in the market and this has been as a result of managing credit related risks that would be compromising the profitability of the SACCOs (Magali, 2013)

In Uganda, the performance of SACCOs have remained undesirable (Nalusiba, 2019). According to Micro Finance Support Centre, the portfolio at risk of many SACCOs raised from 87% to 90% in 2015-2018 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 (Kule et al., 2020). The performance of SACCOS in Uganda continued to deteriorate, MSC reports, (2018-2020). The coverage risk ratio, the portfolio at risk and profitability continued to reduce for the years from 2017 to 2020. This portrayed a picture of SACCO performance below the required standards and there a need to find out the cause and the solution before the SACCO sector gets more financial challenges. In Ibanda district out of registered 94 SACCO’s majority of them have collapsed due to poor management of credit risk a case in a point is Kagongo Rural Development SACCO in Kagongo Division which started with 400 members, but eventually they reduced to few and is now closed. And if these challenges are not given an in depth understanding and solutions, the financial sector is likely to collapse hence this study therefore determined the effect of credit risk Identification on the financial performance of SACCOs in Ibanda Municipality.

II. STUDY PURPOSE

This study purposed to determine the effect of credit risk monitoring on financial performance of SACCOs in Ibanda Municipality.

3. Theoretical Literature Review

The study was pinned on the modern portfolio theory which clearly shows how a given credit risk management strategy ensures minimization of loan default and encourages portfolio qualify for the better financial performance of an institution. Credit risk identification is one of the management strategies in relation to credit risk that helps much in controlling the risks faced by the SACCOs (Hesborn et al., 2016). The theory is very clear that portfolio can be termed as quality if the loan repayment rate is in accordance to the loan agreement between the lender and the borrower (Njogu&Omagwa, 2018). Credit monitoring in this case is very relevant in controlling and minimizing the default rate by the borrowers since it involves supervising the borrowers and perhaps guiding them on the usage of the loan to ensure timely payment (Makori&Sile, 2017). The theory clearly stipulates how no single business starts without projecting risks a head and therefore, must take and plan for the risk to continue in operation and for the case of SACCOs, credit risk management strategies are inseparable from the Sacco operations if it is to realize profits at the end of the period (Kariuki, 2017). When modern portfolio theory is well used and incorporated in all SACCO operations, then risks will be controlled to open clear ways for profitability to manifest itself in the possible time (Mamet, 2018)

The management of the SACCO should in relation to the modern portfolio theory, look into ways and strategies on how to control credit related risks in order to maximize profitability of the financial institutions (Shieler et al., 2017). Credit risk monitoring is one of the strategies a SACCO can used to control the loan default and financially realise profits (Juma et al., n.d.)

3.1. Credit Risk Identification and Performance of SACCOs

Risk identification comprises of the process of identifying dangerous or hazardous situations and trying to characterize it. It is a procedure to deliberately analyze, review and anticipate possible risks (Barton, 2012). The first step in organizing the implementation of the risk management function is to establish the crucial observation areas inside and outside the corporation. The departments and the employees must be assigned with responsibilities to identify specific risks for example interest rate risks or foreign exchange risks are the main domain of the financial department. It is important to ensure that the risk management function is established throughout the whole corporation; apart from parent company, the subsidiaries too have to identify risks and analyze them (Owusu, 2008). Other approaches for risk identification include scenario analysis or risk mapping. An organization can identify the frequency and severity of the risks through risk mapping which could assist the organization to stay away from high frequency and low severity risks and instead focus more on the low frequency and high severity risk. Risk identification process includes risk-ranking components where these ranking are usually based on impact, severity or dollar effects (Barton, 2002). Accordingly, the analysis helps to sort risk according to their importance and assists the management to develop risk management strategy to allocate resources efficiently.

Risk identification is vital for effective risk management, for Sacco's to manage risks facing them effectively they need to know how to identify the credit risks. The first step in risk identification identifying and prioritizing key risks which are reviewed and approved by the management committee (Githingi, 2010). There is also need to determine the degree of risk the Sacco should tolerate and to conduct assessments for each risk of the potential negative impact if it is not controlled. Finally analyze the risk faced by the Sacco in the areas of interest rates risk, liquidity, credit, operations and strategic risks (Biryabarema, 2013). Risk identification in credit risk management determines what risks exist or are anticipated and their characteristics and the possible outcome. In the same view, Pritchard (2005) highlights Credit risk identification is a critical step in the risk management process since it is an organized, thorough approach to finding real risk associated with lending in financial institutions. It should be noted that risks can't be assessed or managed until they are identified and described in an understandable way.

According to Bofondi (2013) argued that risk identification has been heavily influenced by known problems or prior incidents. This reactionary mode typically limits the amount of creative thought that is invested in identifying all potential scenarios of what could go wrong. Fortunately, many organizations are evolving towards a more proactive approach by assembling organizational teams and utilizing outside expertise to recognize risks to the enterprise. One popular approach is to identify risks through compartmentalization that is focusing on each process, department or organizational group as a unique entity. Berger &Udell (2013) contend that Often, risks are characterized as internal or external in origin, consistent with the level of organizational control; classifies these as business (external) risks and operational (internal) risks. Risk identification on this parameter is influenced by the need have prior knowledge of the possible knowledge that could cause harm to the operations of business. The state of work environment provides for tools to use under evaluation of the risks of the projects. The presentation did provide an aspect of risk prior knowledge that seem to be right though difficult in assessing for risk contingency.

Ngugi (2011) did a study on Commercial banking crises in Kenya and investigated the causes of nonperforming loans. Their objectives included, to investigate the actions that bank managers have taken to mitigate that problem and the level of success of such actions. Using a sample of 30 managers selected from the ten largest banks the study found that national economic downturn was perceived as the most important external factor. Customer failure to disclose vital information during the loan application process was considered to be the main customer specific factor. They found that many financial institutions that collapsed in Kenya since 1986 failed due to non-performing loans. The study concluded that lack of an aggressive debt collection policy was perceived as the main bank specific factor, contributing to the non performing debt problem in Kenya.

In related studies, Basel (2010) notes that credit risk identification covers the entire credit cycle, starting from origination of a credit facility to its completion. It is from this cycle that risk events are identified and clearly described. For instance, a high quality risk event describes the potential occurrence and how it would influence the financial institution. Therefore, a financial institution must have in place written guidelines on the credit approval process and a checklist to ensure that all required information is factual and well captured. This is where the 5 C's of credit should be considered, that is, the borrower's character, capacity, capital, collateral and condition of the economy. This is why the researcher was interested in undertaking a study like this to verify whether pride microfinance do ensure the 5C's of credit. At the end of the study it was established that these are not ensured and it had impacted greatly on financial performance of the microfinance.

In order to manage credit risks effectively, management of SACCO have to know what risks face the SACCO. The important thing during risk identification is not to miss any risks out and this can be done through establishing an appropriate credit risk environment (Kromschroder& Luck, 2008). This is the responsibility of the board of directors who should approve and periodically (at least annually) review the credit risk strategy and significant credit risk policies of the SACCO. Gates (2006) argued that the strategy should reflect the SACCO's tolerance for risk and the level of profitability the SACCO expects to achieve for incurring credit risk. Inspection by branch managers and financial statement analysis are the main methods used in risk identification. The main techniques used in risk management are establishing standards, credit worthiness analysis, risk rating and collateral. Senior management of a SACCO is responsible for implementing the credit risk strategy approved by the board of directors (Bategeka, 2009). This includes ensuring that the SACCO's credit-granting activities conform to the established strategy, that written procedures are developed and implemented, and that loan approval and review responsibilities are clearly and properly assigned. Senior management must also ensure that there is a periodic independent internal assessment of the SACCOs credit-granting and management functions.

Relatedly, Gavinic (2010), asserts that the risk identification process must be comprehensive as risks that have not been identified can't be assessed and their emergence at a later time may threaten the success of the project and cause unpleasant surprises. Information used in the risk identification process may include historical background, documentation analysis, site visiting, interviewing and this should assist in coming up with a risk register for reference. Waweru and Kalani (2009) further observed that establishing sound, well defined risk identification criteria is essential to approving credit in a safe and sound manner. The criteria should set out who is eligible for credit and for how much, what types of credit available, and under what terms and conditions the credits should be granted. This study will establish if Credit Risk Identification is associated with the performance of SACCOs in the study area. It will establish if mechanisms used in credit risk identification, such as site visiting, historical background checks, among others are being applied in the study area.

III. METHODOLOGY OF THE STUDY.

3.1.1 Research design

The study adopted a descriptive and analytical cross sectional survey design based on only a quantitative approach of data collection and analysis a questionnaire was employed to capture quantitative data from the respondents concerning the subject matter under study. The study population comprised of employees of SACCOs in Ibanda municipality. In this study credit supervisors and loans officers were the key respondents. There are 19 registered SACCOs in Ibanda municipality (Ibanda municipal council commercial office, 2019). However, for the purpose of this study, only SACCOs that have been in existence for the period greater than five years were considered due to the experience they are having in the business of credit risk management and how it has influenced their performance. This helped the researcher to get reliable and dependable information. The study considered employees of ISSIA SACCO, Ankole farmers SACCO, Bisheshe SACCO, Nyabuhikye SACCO, Allied entrepreneurs' SACCO; Kagongo peoples SACCO, Ibanda young entrepreneurs SACCO, EBO SACCO and Ibanda Begyesa SACCO. Target populations of 113 respondents were used in this study and were determined use random sampling techniques where the target population was stratified into strata of managerial and operational staff from whom the sample was gotten using simple random sampling by the help of krejcie and Morgan standard table of sample size determination which finally led to a sample of 88 respondents who participated in the study.

3.1.2 Data Collection Tool.

A five point Linkert scale questionnaire was employed by the study to collect data. It was self-administered to the respondents where it had statements to rate regarding credit risk monitoring and the financial performance as the variables of the study which were under consideration. The role of the respondents was to give their opinion on the statements given to them on the variables under consideration.

3.1.3 Measurement of Study Variables.

The variables of the study were credit risk identification as the independent variable and financial performance as the dependent variable. Credit risk identification was measured through identifying new risks, loan portfolio analysis and review credit collection policy whereas financial performance was measured through; profitability, financial sustainability, portfolio quality and market share.

3.1.4 Analysis of data collected.

Data was majorly collected using a questionnaire as a tool for quantitative data collection and analysis was done used a data management tool SPSS (Version 23) where descriptive and correlational statistics were derived to find out the relationship between the two variables under the study. The study findings were presented in form of mean and standard deviation, Pearson correlation was also used to derive conclusions on how credit risk Identification affects financial performance of SACCOs.

3.1.5 Study results on credit risk Identification and financial performance of SACCOs in IbandaMunicipality.

Findings on how participants responded and rated the questions presented to them on a five point Linkert scale are presented in a way that the mean of 3 and below indicated the level of disagreement by the respondents to the statements presented to the concerning the subject matter where as a mean above 3 clearly indicated the level of agreement with the statements presented to the respondents in the questionnaire given.

***The descriptive statistical expression is here presented below about the credit* Risk Identification and financial performance of SACCOs**

Response	**Mean**	**Std.**
The SACCO does have a credit committee that is operational in place	3.23	.888
The SACCO has a well -documented credit risk management policy that is known by all her staff	3.58	.614
The SACCO has a sound and well defined credit granting criteria	3.29	.763
The SACCO has adequate checks to ensure that all the credit granting criteria is met during loan processing	3.61	.618
The SACCO has overall credit limits at the level of individual borrower	3.18	.666
The SACCOcontacts third parties for references and all loan clients must have guarantors with clear records	3.2	.829
The SACCO has clearly established processes for approving new credits and amendment, renewal and re-financing of existing credits	3.43	.736
Total score	23.52	5.114
Average score	**3.36**	**.731**

Source: Primary data, 2020

Table 7 shows that majority of the respondents with mean average score of 3.36 and standard deviation average score of 0.731 agreed with the options given to them in relation to credit risk identification and financial performance of SACCOs while the minority disagreed. This is an indication that credit risk identification affects the financial performance of SACCOs in the study area.

Testing Hypothesis one

Hypothesis one stated that there is no significant effect of credit risk identification 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.

Correlation matrix for Credit Risk Identification and financial performance of SACCOs

		Credit Risk Identification	Financial performance of SACCOs
Credit Risk Identification	Pearson Correlation	1	.623**
	Sig. (2-tailed)		.000
	N	67	67
Financial performance of SACCOs	Pearson Correlation	.623**	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 identification and financial performance of SACCOs ($r = 0.623^{**}$, $p<.01$). This implies that when there is effective on credit risk identification, 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 identification and financial performance of SACCOs. This implies that a significant improvement in credit risk identification positively financial performance of SACCOs.

Regression analysis showing the effect of credit risk identification on financial performance of SACCOs

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.623[a]	.388	.381	.49354

a. Predictors: (Constant), Credit risk identification

Regression analysis results in table 9 revealed that credit risk identification accounted for 38.8% on the financial performance of SACCOs in the study area and this was indicated by r-squared of 0.388, implying that to small extent credit risk identification as an aspect of credit risk management contributes to the SACCOs profitability by 38.8%.

Decision on hypothesis

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

IV. DISCUSSION OF STUDY FINDINGS.

Credit Risk Identification and Financial Performance of SACCOs in Ibanda Municipality.

From the findings of the study, it is revealed that credit risk Identification positively affects financial performance of SACCOs in Ibanda municipality. Meaning that when credit risk identification strategy is well implemented, it has the capacity to positively affect the financial performance of the SACCO Business. Indicating that the monitoring of clients and SACCO business operation then there is minimum levels of loan default and hence granting profitability. The findings are in agreement with (Shieler et al., 2017) who conducted a study on credit risk management and financial performance of microfinance institutions in Uganda and found out that the construct of credit risk identification positively affects the financial performance of financial institutions.

(Hesborn et al., 2016) also concluded that credit risk dentification has a positive relationship with the financial performance of SACCOs and recommended for strengthening the credit risk strategies in order to realize profits for the financial institution.

A study by (Kule et al., 2020) on credit risk management systems and financial performance also revealed finds which are in agreement with the present study findings that credit risk management systems positively affects the financial performance. This means that if SACCOs are to maintain the status quo of performing financial well, then the concept of credit risk needs to be given attention. (Korir& others, 2012) and (Muriki, 2017) also emphases the ientification of borrowers so that there is minimum loan default for the better financial performance of financial institution through registering good portfolio quality for profitability purposes towards the performance of the institutions financially.

V. CONCLUSION.

From the study findings, it can be concluded there credit risk identification positively affects financial performance of SACCOs in Ibanda Municipality. (r = 0.623**, p<.01). it can therefore be noted that among the credit risk management strategies, credit risk identification plays a great and positive role towards improving the financial performance of financial institutions.it does so simply because it's through identifying the credit risk that the SACCOs can best select potential clients to access credit.

VI. STUDY RECOMMENDATIONS.

Credit risk identification need to be given ultimate consideration by the SACCO management to ensure the quality of borrowers will grant portfolio quality and eventually a better financial performance for the sustainability and development of the financial institution. Information about the clients who intend to borrow from the SACCO should fully and critically be collected for proper credit identification to minimize the default rates that may compromise the profitability of the SACCOs.

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