



Debt Collection Dynamics: Unlocking Financial Performance in Deposit-Taking SACCOs

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Abstract: This study delves into examining the financial performance of Deposit-Taking SACCOs (DTSSs) in Meru County, Kenya. It places particular emphasis on the impact of different debt collection strategies on their overall prosperity, while also shedding light on the essential role played by efficient credit management practices. The financial performance of Deposit-Taking SACCOs (DTSSs) in Meru County, Kenya, is examined in this study in relation to debt collection policies. The goals of the study are to comprehend the ways in which various debt collecting tactics affect financial results and evaluate the wider ramifications of these practices in relation to credit management procedures. The study also examines how credit term constraints affect financial performance and the advantages of capital adequacy. Three theoretical stances transactional cost, portfolio, and agency theories form the foundation of the study. To guarantee a balanced representation of respondents from different departments within DTSSs, a stratified random sample technique was used. Participants were given self-administered questionnaires to complete as part of the study's correlation survey design, which collected primary data. Out of the 16 DTSSs in Meru County, a sample of 120 responders was selected. In order to assess the associations between variables and test hypotheses, the data analysis process involved the use of inferential statistics, including regression analysis and correlation. The results show that while stringent lending term limits can reduce profitability, efficient debt collection practices greatly improve SACCOs' financial success. This study emphasizes how important well-designed debt collection procedures are in assessing DTSSs' financial stability.

Keywords: Financial Performance, Credit Terms, Collection Policy, and Capital Adequacy.

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Introduction

Loan repayment is a critical determinant of the financial performance of financial institutions, including SACCOs. Effective debt collection policies are essential for ensuring that loans are repaid on time, thus maintaining liquidity and reducing the occurrence of non-performing loans (Musabi, 2020). Debt collection strategies include a range of actions such as proactive communication with borrowers, home visits, and legal proceedings, all aimed at minimizing defaults. In Kenya, SACCOs are particularly vulnerable to loan defaults due to the diverse financial capabilities of their members. Meru County, which relies heavily on SACCOs for credit, has experienced challenges related to poor debt recovery practices, which undermine the financial stability of these institutions (SASRA, 2023). Effective debt collection policies are essential for SACCOs to maintain financial health and continue providing credit services to their members.

Studies have shown that proactive and stringent debt collection strategies significantly reduce default rates and improve loan recovery (Tuyishime et al., 2016). This study examines the relationship between debt collection policies and the financial performance of SACCOs in Meru County. Using empirical data from 16 SACCOs, the research assesses the effectiveness of various debt collection strategies and their impact on reducing non-performing loans and improving financial outcomes.

Statement of the Problem

Despite their importance in providing credit to underserved populations, many SACCOs in Meru County struggle with high default rates due to ineffective debt collection policies. Poorly structured debt collection strategies lead to financial instability, reduced profitability, and, in some cases, SACCOs' inability to continue offering credit services. This study sought to evaluate the relationship between debt collection policies and financial

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performance, with the aim of identifying effective practices that SACCOs can adopt to enhance loan recovery and reduce defaults. The deteriorating financial performance of financial institutions is attributed to collecting debts on time, capital inadequacy, and credit terms that are not clearly communicated. For instance in Kenya, 30% of SACCOs don't operate prudently with CMPs in place, (SASRA, 2018). Therefore this remains an area of empirical interest, and thus led to the motivation behind this research.

Research Objective

1. To examine the relationship between debt collection policies and the financial performance of SACCOs in Meru County.
2. To examine the relationship between the type of debt collection strategies employed and the effectiveness of debt recovery.
3. To assess the effect of debt collection policies on the operational efficiency of DTSs.

Research Question

1. How do debt collection policies affect the financial performance of SACCOs in Meru County?
2. Do different types of debt collection strategies display varying levels of effectiveness in recovering overdue loans and reducing default rates within DTSs in Meru County?
3. How do different debt collection policies impact the operational efficiency of DTSs in Meru County?

Literature Review

In Australia, the debt recovery landscape is shaped by thorough policies and procedures put in place by commercial banks to handle situations where customers are unable to fulfill their payment commitments (Marston et al., 2018). These frameworks employ a comprehensive strategy for debt collection, which frequently entails utilizing legal channels such as pursuing cases in court or collaborating with creditors and collection agencies. In today's financial landscape, debt collection approaches have evolved considerably, with a focus on proactive methods to simplify operations (Alliou & Mourdi, 2023). Contemporary approaches utilize a variety of communication avenues, including emails, phone calls, online payment platforms, and text messages, to engage customers efficiently and assist in prompt repayments. Home visits are now seen as a final option for gathering payments after standard methods are unsuccessful, demonstrating the level of dedication necessary for successful recovery endeavors (McKinney, 2015). It is essential to have effective debt collection strategies in place to maintain a consistent cash flow and reduce defaults, thus playing a vital role in the overall success of credit unions and financial institutions.

Study conducted by Tuyishime and colleagues. Studies conducted in 2016 and beyond have highlighted the vital role of efficient collection policies in enhancing the financial performance of institutions such as Equity Bank in Rwanda and microfinance organizations in Zimbabwe. The studies highlight the importance of implementing rigorous and well-organized collection methods as they play a key role in improving the financial stability and

operational effectiveness of banks. This is achieved by reducing loan defaults and ensuring superior cash flow management. On the other hand, research in the microfinance industry in Zimbabwe suggests that ineffective collection policies are linked to a decrease in loan performance, emphasizing the importance of implementing strong strategies. In Kenya, Musabi (2020) highlights the importance of adhering to loan collection policies for the success of Savings and Credit Cooperative Organizations (SACCOs). This underscores how well-crafted policies can enhance financial performance, boost business activities, and strengthen member involvement. The reports from the Central Bank of Kenya reveal a concerning rise in non-performing loans between 2016 and 2019, potentially due to subpar debt collection practices within the financial sector. This highlights the importance of thorough evaluations and improvements in these strategies to protect financial stability.

Theoretical Framework

The theory of agency, put forth by Jensen and Meckling, delves into the possible conflicts that may arise due to the division between owners and managers within a company (Gwala & Mashau, 2023). These conflicts can give rise to agency issues stemming from unequal distribution of information. In this theory, the firm is viewed as a network of contracts involving self-interested individuals. An agency relationship arises when a principal grants authorization to an agent to act on their behalf. According to agency theory, the agent is required to act in the best interests of the principal when performing assigned duties, focusing on the principal's objectives rather than their own personal gain (Wagner, 2019). Understanding the dynamics between agents and principals is essential in a variety of contexts, such as business and politics.

In the realm of business, shareholders act as the principals, with company executives fulfilling the role of agents. According to agency theory, an organization's overarching goals cannot be fully achieved if there are insufficient incentives or proper oversight in place (Panggabean & Jermias, 2020). This is because managers might be inclined to misuse their authority for their own benefit. Ensuring alignment between the interests of principals and agents is essential in order to prevent agency costs, which are expenses that stem from such conflicts of interest. Smaller SACCOs, when compared to larger ones, tend to encounter more pronounced information imbalance challenges, as transparency levels are typically elevated in the latter. This theory holds particular significance for the research study at hand, as financial institutions rely on agents to meet their financial responsibilities. These institutions strive to boost their profitability and overall performance by reducing agency costs and aligning with the principal's interests.

Methodology

The study employed a descriptive survey design, targeting senior managers and staff from 16 SACCOs in Meru County. A total of 120 respondents were selected through stratified random sampling to ensure representation across different levels of management. Data was collected using structured questionnaires distributed in April and May 2024. The data was analyzed using multiple regression techniques to assess the impact of debt collection policies on financial performance.

Results

Relationship between Debt Collection Policies and Financial Performance

The study uncovers a significant positive connection between strict debt collection procedures and the financial success of Deposit-Taking SACCOs (DTSS) in Meru County. The majority of participants, a notable 79. 5%, believe that implementing proactive debt collection approaches can effectively lower default rates, while only a small 6. 3% disagree with this notion. This agreement underscores the importance of well-organized debt collection procedures in improving financial stability. Moreover, it was found that 94. 7% of participants agreed that implementing stricter policies effectively reduces defaults. This underscores the importance for SACCOs to enhance their financial results by embracing robust debt management approaches.

Effectiveness of Different Debt Collection Strategies

The results suggest that different approaches to debt collection result in varied levels of success in retrieving outstanding loans. Significantly, 70. 5% of survey participants strongly indicated the

positive impact of home visits for borrowers experiencing payment delays, highlighting the significance of tailored follow-up strategies in enhancing loan recovery rates. Moreover, 96. 4% of individuals agreed that lenient debt collection policies are linked with increased default rates, highlighting the importance of SACCOs adopting more stringent regulations. The information indicates that by using a blend of proactive strategies and personalized approaches, like conducting home visits, it can greatly improve the effectiveness of debt collection and lower instances of defaults.

Impact of Debt Collection Policies on Operational Efficiency

The research suggests that well-executed debt collection strategies enhance the operational effectiveness of DTSS. A staggering 99. 1% of participants were of the opinion that effective debt collection processes contribute to positive financial results for their SACCOs. This discovery highlights the significance of incorporating effective debt collection methods into general operational procedures to reduce non-performing loans and uphold liquidity. SACCOs can enhance their operational efficiency and ensure long-term financial viability within their communities by investing in staff training and utilizing technology-driven solutions.

TABLE 1: CHOICE OF DEBT COLLECTION AND FINANCIAL PERFORMANCE

ITEM	SA	A	N	D	SD	MEAN ST.	STD
Proactive debt collection policies reduce the rates of defaults	79.5 %	12.5 %	0.0%	6.3%	1.8%	25.00 %	0.37
Lenient debt collection policies are less effective and increases the rate of defaults	59.8 %	36.6 %	1.6%	17.9 %	2.7%	24.11 %	0.24
Stringent debt collection policies help reduce loan defaults	68.8 %	25.9 %	0.0%	0.9%	1.8%	24.33 %	0.32
Home visits are effective for borrowers with delayed loan payments	70.5 %	0.9%	0.0%	5.4%		25.60 %	0.39
Our Sacco debt collection policies are contributing to an overall positive financial performance.	62.5 %	36.6 %	0.0%	0.9%	0.9%	25.22 %	0.30

Discussion

The findings of this study align with existing literature on the importance of stringent debt collection policies in financial institutions. SACCOs that adopt proactive and well-enforced debt collection policies are more successful in recovering overdue loans and maintaining financial stability. These findings underscore the need for SACCOs in Meru County to prioritize debt collection as a critical component of their credit management practices. The results showed that respondents strongly agreed that strict and proactive debt collection practices improve financial performance

and lower loan default rates. As an illustration of the high level of belief in the efficacy of these tactics, 79.5% of respondents strongly agreed that aggressive debt collection practices lower default rates, while 12.5% agreed. On the other hand, 96.4% of participants concurred that lax debt collection practices raise default rates, underscoring the need for stricter regulations. The assumption that harsher measures might greatly improve financial health is further supported by the fact that 94.7% of respondents said that strict debt collection policies were successful in lowering defaults. Seventy-five percent of respondents strongly agreed that home visits were an efficient way to deal with late payments.

Additionally, 99.1% of respondents thought that good financial success was a result of efficient debt collection policies. In order to secure SACCOs' financial viability and performance, the statistics underscored the significance of implementing efficient debt collection techniques, such as proactive and strict policies, as well as individualized approaches like home visits.

Conclusions and Recommendations

The study concludes that stringent and well-structured debt collection policies are essential for improving the financial performance of SACCOs in Meru County. SACCOs that implement proactive debt collection strategies, such as regular communication, home visits, and legal recourse, experience lower default rates and higher loan recovery success, leading to improved financial outcomes. It is recommended that SACCOs invest in training their staff on debt collection practices and regularly review their debt collection policies to ensure they remain effective. SACCOs should also consider adopting technology-driven solutions, such as automated reminders and digital communication platforms, to enhance their debt collection efforts. To further improve debt recovery, SACCOs should establish partnerships with legal firms that specialize in debt recovery and consider outsourcing some aspects of debt collection to professional agencies. These strategies will help SACCOs reduce default rates, improve loan recovery, and enhance their financial performance.

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