The relationship between loan assessment and financial performance of SACCOs: Evidence from Uganda

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Abstract

The study set out to examine the relationship between loan assessment and financial performance of SACCOs in Mbarara Municipality. The study adopted a non-experimental cross-sectional research design. The study was both descriptive and analytical in nature with a quantitative approach of data collection and analysis. The study gathered quantitative data from 109 participants using questionnaires. Quantitative data gathered using questionnaires was coded and entered into SPSS version 20 for analysis. The analysis was done and findings presented using descriptive statistics in form of frequencies, percentages, mean and standard deviations. Pearson correlation coefficient was utilized to ascertain the statistical significance between the independent and dependent variables. Findings from the study revealed that there is a strong positive relationship between loan assessment and financial performance of SACCOs ($r=0.870^{**}$, $p<0.000$). The study concluded that loan assessment positively influences financial performance of SACCOs. The study recommends that SACCOs need to adopt well thought and efficient loan assessment strategies as means to improve their financial performance.

Key word: Loan Assessment, Financial performance

Background

According to Turyahebya (2013), financial performance is a measure of the organizations results in monetary terms attained through use of human capital set policies and operations and reflected in measurable units. Arko (2012) reported that huge portion of the loans distributed by SACCOs unfortunately become delinquent and finally result in loss which contributes to negative impact on their overall performance. Financial performance of SACCOs has been inhibited by several challenges relating to effective credit assessment (Chelogoi, 2013).

Loan assessment is one of the most vital process in banks and other financial institutions' credit management decisions (Obbuyi, 2011). This process includes collecting, analyzing and classifying different credit elements and variables to assess the credit decisions. According to Micah and Gibbs (2013), loan assessment is a function of the level of collaterals, the ability to pay (earnings), availability of liquidity, the rate of chargeable interest rates, capacity to handle the varying challenges of the lending institutions. The loan uptake in SACCO's is not different from other financial institutions and is subject to the above conditions.

Loan delinquency is one of the leading causes of SACCOs' failures in many countries including Uganda (Tumwine, Mbabazi, & Shukla, 2015). For instance in Mbarara District, records from the Commercial Officer's office FY 2016/2017 indicated that a number of SACCOs were experiencing financial challenges like failing to meet their operating costs as a result of non-performing loans due to poor loan assessment systems applied in the process of issuing loans, these systems were being poorly managed leading to low profitability of SACCOs thus leading to financial performance related challenges.

Much as SACCOs in Mbarara Municipality are trying to conduct loan assessment as a means to manage loan delinquency issues, there is a loophole in implementing loan assessment which has greatly led to a compromised financial performance. A case in point was Mwizi SACCO Limited which fell in a deficit of UGX 600 million unrecovered loans in the financial year 2017, prompting the Board to interdict employees in its branches. To this end, there is scanty of empirical evidence on how loan assessment influences financial performance of SACCOs in Mbarara Municipality thus bothering the researcher to carry out the study which aimed at examining the relationship between loan assessment and financial performance of SACCOs in Mbarara Municipality.

Purpose of the Study

The purpose of the study was to examine the relationship between loan assessment and financial performance of SACCOs in Mbarara Municipality.

Hypothesis

H_1 There is a relationship between loan assessment and financial performance of SACCOs in Mbarara Municipality.

Literature review

Theoretical Review

The Modern Portfolio Theory explains how a loan portfolio can be used to maximize returns and minimize loan default risk by carefully combining different loan types. The idea behind this theory is that, the loans in a given portfolio should be selected with consideration on the effect they have on each other's returns. This theory was developed by Markowitz (1991) where he argues that investors are risk averse. The theory explains how an individual or institution can achieve the highest returns by practicing diversification of loans in a given loan portfolio. This takes care of borrowers' diverse loan needs and also minimizes loan default risks during adverse economic times.

Craig (2016) asserts that risk and return are correlated meaning that an investor must take on higher risk to achieve greater returns. This thought has been reinforced by Capital Pricing Model (CAPM) which is a theory based on the notion that the risk of a given unit's return is a sum of its systematic risk which is a consequence of its operating environment. The underlying idea is that the performance of a firm is directly linked to its economic environment and its asset portfolio. The practical reality of this is evidenced in SACCOs because the demand and default of different loans is influenced by incomes/earnings of the members and incase of default it will inject cost to the income statement.

Therefore SACCOs management should design different loan types which take advantage of different circumstances and operating environments faced by the borrower. Increasing the loan ceiling as per the result of this study has a negative effect to the SACCOs financial performance. In practice, there is increased demand for general developments when SACCOs have enough cash in circulation, emergency loans when the members are faced with unforeseen circumstances, holiday loans at the end of the year and asset financing loans when the borrower anticipates to acquire an asset. These different types of loan when backed with good loan policies will improve the SACCOs' cash flows and oblige the borrowers to service their loans promptly in order to reduce the risk of loan default and auctioning of assets pledged as security or denial of loans to guarantors (Mwengei, 2013). However, in most instances church based SACCOs are characterized with sidestepping of internal control systems put in place due to trust and faith in their members which results in loan defaults.

Loan assessment and financial performance of SACCOs

Loan assessment plays an important role to keep the loan losses to minimum levels hence if those officers appointed for loan appraisal are not competent enough then there would be high chances of lending money to non-creditworthy customers, Boldizzoni (2008).

Collateral is a form of property or assets such as equipment, automobiles, or real estate or tools that is assured as security for a loan. Financial institutions will use collateral retention to make sure they are in a more stable situation when a loan is made. If a bank wants to make a larger loan to a business or consumer, it may require some type of collateral retention. When a bank has collateral as security, it assists to reduce its debt recovery and risk. When a customer evades on agreement of a loan, the bank can foreclose or repossess to take possession of the stated collateral, collateral reduces the loss that a financial institutions will incur incase the borrower fails to pay back the loan.

SACCOs will sometimes evaluate and appraise the collateral making sure it can be used as collateral. They do not commonly make a loan for extra than what the collateral is worth. When a bank decides to use collateral retention, it usually files a lien on a mortgage, against the property, with the county courthouse. This information is entered into the public records. If a customer has a loan and the bank has collateral, the customer should pay off the loan of the bank from the profits of the sale. When a customer records an appeal for liquidation because he has too much debt, he must go on to pay a bank loan if he wants to keep the collateral. Collateral also plays a major role in loaning decisions. Collateral retention represents as a secondary source of repayment for loan and is usually the measure of final resort when all other debt recovery efforts have failed. The collateral in use should have traits like be easily transferable and have a ready market, have intrinsic & extrinsic value. The collateral taken should be incredible that the borrower would generally not want to lose, in addition to tangible collateral retention and forced savings, there exists social force for a person to pay, so as to stay of good standing in society.

The findings of the study by Gatuhu (2013) on the effect of credit management on the financial performance of microfinance institutions in Kenya, realized that client appraisal, credit risk control and collection policy significantly influence financial performance of MFIs in Kenya. In support of this claim, Nzotta (2004) asserted that credit management greatly influences the success or failure of commercial banks and other financial institutions. Kato (2013) on loan performance and profitability of microfinance institutions, notes that loan portfolio of MFIs would be well managed if there was selections of credit worth customers, delinquency management, loan approval authority, and good product design and contract enforcement. The study further revealed that there still exist problems in loan portfolios management that lead to poor performance of loan portfolios. Forced savings, use of group peer pressure, visiting clients who miss repayment and presence of monitoring systems to ensure loan recovery were noted to be some of the loan recovery methods used to boost loan recovery and increase profits of the bank. The findings further indicated that there was a negative relationship between loan performance and profitability of MFIs.

Lagat et al (2013) found that credits' risk identification, analysis, monitoring, evaluation and mitigation influenced the lending portfolio for SACCOS' in Kenya. Mwaura (2005) cited in Njeru, Njeru, Memba and Ondabu (2015) insist that lack of credit follow up, credit analysis, and hostile lending of money are some of the factors that have contributed to financial gap and poor performance in Kenya. Njeru et al (2015) established that the main loan products offered by the SACCOS were: staff members loan; nominal loan; investment loans; agribusiness loan; smart loan; personal loan; premier loan; fanikisha loan; Tosa pride loan; mortgage loan; normal loan; micro credit loan; development loan and business loans. It was observed that the rate of loan default was on an increase and that it was not hard for prospective loanees to access guarantees though the members were fearful in loan guarantees.

Sheila (2011) is of the view that proper and adequate appraisal is key to controlling or minimizing default. This is the basic stage in the lending process. The appraisal stage is the initial step of quality portfolio. This includes diagnosing of the business as well as the borrower. Before beginning the process of collecting information on the client for the purpose of determining credit limits, the loan officer should have specific information available which will guarantee that the data and figures provided by the client will have a pro-margin error (Sheila, 2011).

Njiru (2006) carried a study on a list of nonperforming loans including all relevant details should be assessed on a case by case basis to determine if the situation is reversible. Exactly what can be done to improve repayment capacity and whether or not worked out or collection plans have been used. Provision level should be considered to determine the SACCOs capability to withstand loan defaults. Njiru (2003) carried out a study to determine how a Coffee Cooperative Societies in Embu district manage their credit risk, this was in respect of the systems procedures and controls which are put in place to ensure the efficient collection of credit so as to minimise the risk of nonpayment. The study found out the coffee societies in Embu district use quantitative method to evaluate the creditworthiness of their members and that all the coffee societies use qualitative method only the borrower and the amount of credit due.

Tesfamariam et al (2013) analyzed the variables which influence the efficiency of rural SACCOS in Ethiopia and they revealed that loans, income and expenses positively influenced the efficiency of SACCOS in Ethiopia. They also noted that loan appraisal techniques that were being implemented were not adhered to. These led to an increase in default rate which also jeopardized the growth and the future of these SACCOs. The study therefore, recommended that the management should comply with the set policies and also provide stringent appraisal methods which will enable them to identify the clients whose financial records and ability to repay their loans can be predetermined. The study concluded that SACCOs have a potential to grow financially and promote the economic standards of the country if only more commitment and proper regulations are put in place.

Methodology

The study adopted a cross-sectional survey research design. The study was both descriptive and analytical in nature with a quantitative approach of data collection and analysis. A sample size of 92 managers, credit managers, accountants and credit officers from 24 registered SACCOs in Mbarara Municipality were selected using simple random sampling techniques. These were subjected to questionnaire method of data collection set on a five level Likert scale. Before processing, data was cleaned, coded, entered and analyzed using Statistical Package for Social Scientists (Version 20) for windows. Findings were presented in frequencies, percentages, mean and standard deviations. Pearson correlation coefficient was run to determine the relationship between loan assessment and financial performance of SACCOs.

Analysis and Results

Relationship between Loan Assessment and financial performance of SACCOs

The analysis was done using the percentages, mean and the standard deviation. Data was collected using a five point Likert scale, that is, strongly agree, agree, neutral, disagree and strongly disagree. The mean above 3 indicates an agreement of respondents, a mean of 3 shows undecided and a mean of below 3 shows disagreement by respondents. The standard deviation (SD) of close to 1 show agreement, while the standard deviation of close to Zero show the disagreement of the respondents. The elicited results are presented in Table 1.

Table 1: Descriptive Statistics on Loan Assessment

Responses	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree	Mean	Std. deviation
We conduct efficient evaluation of clients collateral versus loan requested	0 (0.0%)	0 (0.0%)	0 (0.0%)	49 (53.3%)	43 (46.7%)	4.46	.701
We conduct thorough analysis of loan condition set	0 (0.0%)	0 (0.0%)	0 (0.0%)	43 (46.7%)	49 (53.3%)	4.85	.856
Approvals are made objectively based on the level of trust	0 (0.0%)	17 (18.5%)	0 (0.0%)	26 (28.3%)	49 (53.3%)	4.20	.804
We practice compulsory demand of collateral securities before loan is issued	0 (0.0%)	0 (0.0%)	0 (0.0%)	24 (26.1%)	68 (73.9%)	4.74	.839
Loan repayment is restricted to credit terms	0 (0.0%)	9 (9.8%)	7 (7.6%)	42 (45.7%)	34 (37%)	4.11	.896
Disbursement is timely	0 (0.0%)	7 (7.6%)	0 (0.0%)	25 (27.2%)	60 (65.2%)	4.51	.835
We have a strong guarantee system	0 (0.0%)	8 (8.7%)	1 (1.1%)	50 (54.3%)	33 (35.9%)	4.17	.815
We adhere to internal controls in place	0 (0.0%)	0 (0.0%)	1 (1.1%)	31 (33.7%)	60 (65.2%)	4.66	.795
We have restructured loan recovery performance	0 (0.0%)	0 (0.0%)	18 (19.2%)	36 (39.1%)	38 (41.3%)	4.24	.744
There is a robust appraisal system for guarantors	0 (0.0%)	9 (9.8%)	0 (0.0%)	49 (53.3%)	34 (37%)	4.21	.851

Table 1 shows that all respondents agreed with the statements put to them. This is explained by their mean which is above 3, and their standard deviations which is close to 1.

Results from table 1 indicate that majority of the respondents (53.3%) agreed that their SACCO conducts efficient evaluation of clients collateral versus loan requested. In the same line (46.7%) strongly agreed with this statement (Mean= 4.46; Standard deviation= 0.701). This analysis shows that the evaluation of clients' collateral versus loan requested is mandatory in every SACCO.

Also, majority of the respondents (53.3%) strongly agreed that they conduct thorough analysis of loan condition set whereas the rest (46.7%) agreed with this opinion. This is indicated by the mean of (4.85) and the standard deviation of (0.701). This analysis attest to the fact that SACCOs conducts thorough analysis of loan condition set.

The analysis further shows that majority of the respondents (53.3%) strongly agreed; (28.3%) agreed) agreed that approvals are made objectively based on the level of trust. In the same line (18.5%) of the participants disagreed with this argument. This confirmed by the mean (4.20) and the standard deviation of (0.804). This analysis confirms that loan approvals are made based on the level of trust the SACCO has towards the member before the loan is disbursed.

In addition, majority of the participants (73.9%) strongly agreed that they practice compulsory demand of collateral securities before loan is issued whereas the least (26.1%) agreed with this view. This is confirmed by the mean of (4.74) and the standard deviation of (0.839). This analysis confirm that SACCO practice compulsory demand of collateral securities before loan is issued.

With regard to loan repayment, majority of the respondents (37%) strongly agreed; (45.7%) agreed that loan repayment is restricted to credit terms. In the same line (9.8%) disagreed with this opinion whereas (7.6%) were not sure. This is confirmed by the mean of (4.11) and the standard deviation of (0.896) which is close to 1. This analysis affirms that loan repayment is tied on the credit terms.

The majority of the respondents (65.2%= strongly agreed; 27.2%= agreed) further agreed that loan disbursement is timely. On this issue, (7.6%) disagreed with this argument. This is indicated by the mean of (4.51) and the standard deviation of (0.835). This shows that members who apply for loans enjoy the privilege of timely disbursement.

In addition, majority of the participants (35.9%= strongly agreed; 54.3%=agreed) reported that they have a strong guarantee system. On this, (8.7%) disagreed with this view whereas (0.9%) were not sure. This is confirmed by the mean of (4.17) and the standard deviation of (0.813). This analysis further reveal that SACCOs have strong guarantee system.

The analysis further revealed that majority of the participants (65.2%) strongly agreed that they adhere to internal controls, (33.7%) agreed whereas the least (1.1%) were not sure. This is statistically confirmed by the mean of (4.66) standard deviation of (0.795). This indicates that controls in SACCOs are highly adhered to.

In regard to guarantors, majority of the respondents (41.3%) strongly agreed that there is a robust appraisal system for guarantors, (39.1%) agreed whereas (19.2%) were not sure. This is statistically confirmed by the mean of (4.21) and the standard deviation of (0.851). This analysis shows that guarantors are highly appraised as a means to strengthen loan recovery.

Financial performance of the SACCOs

In an effort to understand the Financial Performance of SACCOs. The researcher used the statements from the questionnaire together with their responses which scored on the five-point Likert scale (strongly agree, agree, neutral, disagree and strongly disagree).the analysis was done and presented using percentages, mean and standard deviation. The mean above 3 indicates an agreement of respondents, a mean of 3 shows undecided and a mean of below 3 shows disagreement by respondents. The standard deviation (SD) of close to 1 show agreement, while the standard deviation of close to Zero show the disagreement of the respondents. The elicited results are presented in Table 2.

Table 2: Descriptive Statistics on Financial performance of the SACCOs

Responses	**Strongly Disagree**	**Disagree**	**Neutral**	**Agree**	**Strongly Agree**	**Mean**	**Std. deviation**
We consider Profitability as an indicator of financial performance within this SACCO	0 (0.0%)	0 (0.0%)	0 (0.0%)	25 (27.2%)	67 (72.8%)	4.71	.858
Our Membership increment predicts the financial performance of this SACCO	0 (0.0%)	0 (0.0%)	0 (0.0%)	15 (16.3%)	77 (83.7%)	4.84	.764
Our Share capital growth within this SACCO is an indicator of financial performance	0 (0.0%)	0 (0.0%)	8 (8.7%)	7 (7.6%)	77 (83.7%)	4.76	.692
We consider Increase in savings as an indicator of financial performance within this SACCO	0 (0.0%)	0 (0.0%)	0 (0.0%)	7 (7.6%)	85 (92.4%)	4.93	.862
ROE is an indicator efficiency of this SACCO to generate profit from equity.	0 (0.0%)	0 (0.0%)	24 (26.1%)	25 (27.2%)	43 (46.7%)	4.21	.817
Our Return on investment predicts financial performance within this SACCO	0 (0.0%)	0 (0.0%)	7 (7.6%)	24 (26.1%)	61 (66.3%)	4.61	.824
The level of our loan recovery predicts financial performance of this SACCO	0 (0.0%)	0 (0.0%)	0 (0.0%)	27 (29.3%)	65 (70.7%)	4.72	.753
Our Growth in market share is an indicator of this SACCOs' financial performance	0 (0.0%)	7 (7.6%)	17 (18.5%)	32 (34.8%)	36 (39.1%)	4.06	.926

Table 2 shows that all respondents agreed with the statements put to them. This is explained by their mean which is above 3, and their standard deviations which is close to 1.

Results on table 2 indicate that majority of the respondents (72.8%) strongly agreed that profitability is an indicator of financial performance within the SACCO whereas the least (27.2%) agreed with this statement. This is confirmed by the mean of (4.71) and the standard deviation of (0.858). This implies that profitability within the SACCO business is a clear indication that the SACCO is performing financially.

Also, majority of the respondents (83.7%) strongly agreed in harmony that membership increment predicts the financial performance of the SACCO whereas the rest as (16.3%) agreed with this statement. This is affirmed by the mean of (4.84) and the standard deviation of (0.764). This analysis shows that when members increase in a SACCO, it is an indication of increased financial performance and the reverse is true.

In addition, majority of the participants (84.4%= strongly agreed; 7.3%= agreed) that share capital growth within the SACCO is an indicator of financial performance (Mean= 4.76; Standard deviation= 0.692). This shows that share capital growth is as a result of improved financial performance in SACCOs and vice-versa.

The analysis further show that majority of the respondents (92.4%) strongly agreed that increase in savings is an indicator of financial performance within the SACCO whereas the rest (7.6%) also agreed (Mean= 4.93; Standard deviation= 0.862). This implies that the growth in savings is an indicator of improved financial performance and the reverse is true.

Results also indicate that majority of the participants (46.7%) strongly agreed that return on equity is an indicator of the efficiency of the SACCO to generate profit from equity while (27.2%) also agreed (Mean= 4.21; Standard deviation= 0.817). This is an indication that the higher the return on equity the higher the financial performance.

It was found out that majority of the participants (45.9%= strongly agreed; 29.4%= agreed) that return on investment predicts financial performance within the SACCO (Mean= 4.61; Standard deviation= 0.824). This analysis show that the higher the return on investment, the higher the financial performance and vice-versa.

With regard to loan recovery, majority of the respondents (70.7%) strongly agreed that the level of loan recovery predicts financial performance of the SACCO while (29.3%) also agreed with this statement (Mean= 4.72; Standard deviation= 0.753). This shows that the capability to recover loans is an indication of excellent financial performance in SACCOs operations.

Finally, majority of the participants (38.5%= strongly agree; 36.7%= agreed) that growth in market share is an indicator of SACCOs financial performance (Mean= 4.06; Standard deviation= 0.926). On the same view, (17.4%) were not sure about this argument whereas the least (7.3%) disagreed. This analysis shows that growth in market share is an indication that SACCOs are financially performing well.

Correlations

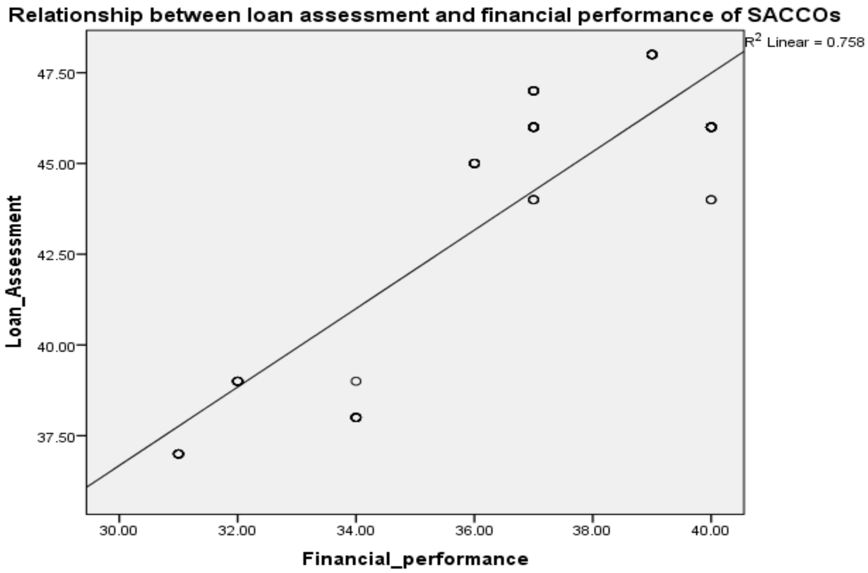
Table 3: Correlations results on loan assessment and financial performance of SACCOs in Mbarara Municipality

Correlations			
		Loan Assessment	Financial performance
Loan Assessment	Pearson Correlation	1	.870**
	Sig. (2-tailed)		.000
	N	92	92
Financial performance	Pearson Correlation	.870**	1
	Sig. (2-tailed)	.000	
	N	92	92

**. Correlation is significant at the 0.01 level (2-tailed).

Table 3 shows a strong positive relationship between loan assessment and financial performance of SACCOs (r=0.870**, p<0.000). This observation shows that there is evidence that loan assessment positively influences financial performance of SACCOs. This analysis indicates that if loan assessment is efficiently conducted and executed in its true fashion, with other factors held constant, there are higher chances that financial performance of SACCOs will be improved. This is an indication that any unit positive change in loan assessment leads to a positive change in financial performance by 87%.

Figure 1: Scatter plot on loan assessment and financial performance of SACCOs



From figure 1 above, findings show that there is a positive relationship between loan assessment and financial performance of SACCOs. It further clearly shows that as loan assessment increases, financial performance also increases. Thus, the stated alternative hypothesis is accepted.

Discussion

The relationship between loan assessment and financial performance of SACCOs in Mbarara Municipality

Findings obtained in relation to examining the relationship between loan assessment and financial performance of SACCOs in Mbarara Municipality revealed that there is strong, positive and significant relationship between loan assessment and financial performance of SACCOs. The statistical significance confirm that loan assessment is associated with financial performance of SACCOs and it has a lot of meaning in the financial business operation of SACCOs. Findings from the present study means that loan assessment in the process of loan delinquency management plays a significant role in influencing the financial performance of SACCOs. This could further be demonstrated in ways through which SACCOs do evaluation, analysis of loan condition set, approval and appraisal. All these mechanism predict the level at which loan delinquency management is and how it will influence the overall financial performance of a given SACCO.

These findings are in agreement with Lagat et al (2013) who found that credits' risk identification, analysis, monitoring, evaluation and mitigation influenced the lending portfolio for SACCOS' in Kenya. Mwaura (2005) cited in Njeru, Memba and Ondabu (2015) insist that lack of credit follow up, credit analysis, and hostile lending of money are some of the factors that have contributed to financial gap and poor financial performance in Kenya. Njeru et al (2015) established that the main loan products offered by the SACCOs were; staff members loan, nominal loan, investment loans, agribusiness loan, smart loan, personal loan, premier loan, fanikisha loan, Tosa pride loan, mortgage loan, normal loan, micro credit loan, development loan and business loans. It was observed that the rate of loan default was on an increase and that it was not hard for prospective loanees to access guarantees though the members were fearful in loan guarantees.

Conclusion

From the present study's findings and discussion, it can be concluded that there is a strong positive relationship between loan assessment and financial performance of SACCOs ($r=0.870^{**}$, $p<0.000$). It was confirmed that loan assessment is the cornerstone that guarantees loan payment by the Borrowers since it is always done before the loan is advanced to the borrower and this ultimately leads to improved financial performance among the SACCOs since loans are only given to credit worth customers.

Recommendations

Loan assessment should be effectively conducted and executed in its true fashion in order to reduce possibilities of loan delinquency since it is done before the loan is issued to the borrower.

Acknowledgement

The authors acknowledge the support rendered by Directorate of Graduate Studies, Research and Innovations. Also, the contributions made by the respondents in providing relevant feedback made this work a success.

Conflict of Interest

The authors declare no conflict of interest.

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