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THE ROLE OF LENDING DESIGN ON SUSTAINABLE COMPETITIVE ADVANTAGE AMONG DEPOSIT TAKING SACCO'S IN KENYA

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Abstract:

In order to achieve sustainable competitive advantage level that not only matches those of their business rivals' but that exceed the financial industry performance averages, financial institutions have to seek understanding of relative degree on the relationship between lending design and sustainable competitive advantage. The lending design determines the consumer satisfaction that propels the SACCO to attain sustainable competitive advantage .The aim of the study was to establish the role of lending design on sustainable competitive advantage. A descriptive design was adopted where a survey method involving 150 deposit taking SACCO's in Kenya was done. The data obtained was analyzed using descriptive and inferential statistical analysis. The study established that lending design plays a significant role in sustainable competitive advantage in Deposit taking SACCO's. It recommends that organizations must refine their lending design to remain competitive in the financial market.

Key words: lending design, competitive advantage, financial institutions, SACCOs

1.0 Introduction

1.1 Background of the study

Although Savings and credit cooperative societies (SACCO) are formed to promote thrift among members by affording them an opportunity to accumulate savings and deposits to provide credit at fair and reasonable rate of interest, they operate in an competitive environment characterized by banks, micro finance institutions, insurance companies, capital market and pension fund that offer similar or near equal financial services to the same clientele in Kenya. Wanyama F. (2007).

Savings and credit cooperatives societies continue to face challenges after the Government implemented structural adjustment programs in the 1990's to enhance a free market economy which emphasized on unfettered private sector led economic development resulting to withdrawal of direct involvement of management of cooperative societies . The government effected changes in the microeconomic policies so that the economy is adaptable to changing economic realities in a liberalized environment. Ndungu N & Ngugi R (1999).

During this period, SACCO's did not identify lending design that would provide a basis for competitive edge on lending due to lack of training and capacity building ; inadequate legal framework; slow decision making process and competition from other financial institutions. Gamba, P. and Komo, I (2010).

According to Kabugu M. K. (2014), deposit taking SACCO's lost their market share due to competition from financial institutions that had proactive policy of offering easy access transaction and loan services. In fact the SACCO market base continued to be affected by attrition due to retirements in the public sector and preference by younger employees to patronize banks.

At the same period, porter popularized competitive advantage doctrine arguing that companies don't succeed on the basis of only cost, price, and productivity but primarily on strategic superiority which is based on powerful management decisions on the operational dimension. Samli,A.C (2013).

According to Wanyama . O (2009), whereas the future of SACCO's in a liberalized economic environment was bright, the challenge was how to cultivate sustainable competitive advantage in lending business. SACCO's need to reinvent the business wheel that they had lost to the state and claim their place in national policy on financial matters to remain competitive.

In the financial sector, one of the most cited driving forces behind the rapid growth is the competitive pressures exerted by loan products that are close substitutes. Investment banks, mutual funds, insurance companies, and private investment vehicles have entered the market to compete for the core business of lending.

The financial providers compete on three distinct loan market segments namely a purely transactional (product costing) market where it competes with all other financial institutions at arm's length, a captive market in which it differentiates lending relationships with captured borrowers and a contested market where it competes with its nearest neighbors. The market segments are created by the lending design adopted by a firm in its operations. Hauswald R. and Marquez R. (2000)

Lending is the principal business activity for SACCO's and as such, it is one of the greatest sources of risk to a financial institution's safety and soundness. Laxity in developing uniform lending standards, poor credit management or weakness in the lending structures, non competitiveness of products resulted in losses and failures in SACCO's.

According to (Richardson 2002) traditional lending design rely too much on credit quality such as delinquency, nonaccrual, and risk rating trends. Therefore, the historical emphasis on controlling the quality of individual loan approvals and managing the performance of loans continues to be essential to sustainable competitive advantage.

Lending design play a central role in influencing sustainable competitive advantage in SACCO's as it provides the methodology to give credit to the clients at any given time. Clients decide whether to borrow or not depending on the lending format designed by the organization that defines appraisal options, disbursement; repayment and securities required.

1.2. Problem Statement

Until the 1990s, SACCO in Kenya did not have to worry about competition. This period was characterized by strict control on management by the government that focused on closed lending methodology to reach sustainability, but this changed in the late 1990's after liberalization of the economy opening a window for competition. Wanyama F.O (2007)

As business environment became more complex, accompanied by increased competition, changes in lending practices and new regulatory requirements there is unprecedented business failures in the SACCO subsector.

In order to keep afloat in this scenario, SACCO's have to constantly review their competitive advantages by exploiting their lending design mechanisms to keep ahead of competition from other financial providers to guarantee a reasonable rate of return on investment to their members.

However to be able to achieve competitive advantage, Hannula, M. and Pirttimaki, V. (2003), argued that a company's competitive edge is gained through the ability to anticipate information, turn it into knowledge, craft it into intelligence relevant to the business environment, and actually use the knowledge gained from it to out-maneuver its competitors.

What then are the drivers of sustainable competitive advantages in the SACCO industry with the increased level of competition?

It has been shown that the sector contributes 48.5% of the national savings in Kenya ROK (2013), with the number of loanee's standing at 1.9 million as compared with 1.8million in the banking sector and 914.4 million in microfinance institutions AMFI (2013). In 2013 the government of Kenya noted that there is a large spread of lending rates between the financial providers standing at 11% from the expected 6% that has increased competitiveness of the products offered by these institutions. The financial sector growth declined from 7.8% in 2011 to 6.5% in 2012 while the GDP decreased from 6.3% to 5.2% within the same period further, compressing the margins of the financial institutions. The quality of assets has measured as a proportion of net non performing loans to gross loans also declined from1.5% in 2011 to 2.2% in 2012 ROK (2013). The resultant effect is decline in the economic growth that will affect the financial sector causing massive withdrawals from SACCO's, low level of savings and inability to lend to their members.

Given this situation there is need therefore to investigate the role of lending design on sustainable competitive advantage among deposit taking Sacco's in Kenya

1.3 Objectives of the study

The study addressed the following specific objectives;

To establish the role of lending design on sustainable competitive advantage in the deposit taking SACCO's in Kenya.

1.4 Hypothesis

H_0: lending design is not significantly related to sustainable competitive advantage

H_1: Lending design is significantly related to sustainable competitive advantage

2. Literature Review

2.1 The independent variable: Lending design

The proper lending design of financial products and their respective delivery methodologies is fundamental to sustainable competitive advantage. Lending design is defined by the various conditions attached to a product cost and how different the product is as defined by size, term, interest rate, collateral requirements, and repayment terms and from the other loan products in the market.

According to Paterson A. M. (1999), when credit market is competitive, it affects profitability level for institutions as clients borrow depending on the structure of lending design of the organization. Since SACCO's operate in an increasingly competitive environment, lending design is continually evolving as clients have choice to borrow from one financial institution to another.

2.1.1 Cost focus in lending design

SACCO's have devised a Cost focus strategy in lending design where they organize resources for offering loan products at the lowest cost possible. By having the lowest costs they have ensured a unique position of being able to charge your customers the lowest price in the market for their products. The cost focus has been developed in such a style that provides how a member must contribute deposits towards developing capability to borrow after a period of six months. The deposits are contributed in a transactional account in the SACCO to builds funds for borrowing. The constant flow of contributions is facilitated by regular flow of income from employment, business or trade is a prerequisite condition for getting credit facilities in the SACCO's. Session paper No. 1 of 1986, (ROK 2007).This enables the SACCO's to develop a lending design that is different from the other financial service providers.

While SACCO's are able to transform short term liquid deposits into long loans to lower the cost of operations, other financial providers use their customer's savings for lending thus costs become higher for their customers as compared to SACCO members. Arising from the member's deposit contributions, SACCO's price their products at a lower interest rates than those charged by other competitors as the pricing factor considers the opportunity benefit from the deposits.

Does lending cost focus, a component of lending design therefore influence the sustainable competitive advantage of the SACCO's over other financial institutions?

2.1.2 Product differentiation

The lending design has differentiated SACCO's from other financial institutions as they mobilize funds from monthly deposit contributions from members who are at the same time the customers. Loans are grated on the bases of a multiplier of three times the deposits contributed for a minimum period of six months subject to ability to repay. Credit provision is based on the amount contributed, the multiplier of three times the amount of deposit contributed and regular income received in the SACCO's.

The basis for the success is the company's speed in designing its products and ease of procuring the product. This arises due to offering unique brand of products, technology, customer service and products to gain the market share. Ning, H. (2012). Since the member's are the customers, SACCO's often are in close contact with them and are able to respond quickly to the changing trends in provision of their products.

In the banking sector, credit is granted by evaluating the credit worthiness based on the borrower's income, alternative sources of financing, location, and other debts .The banking sector has incorporated 5c's of credit (Character; capital; capacity; condition and collateral) being the fundamental tenets in their lending design. Ranking in order of importance is done to analyze the behaviour of a borrower as Character, Capacity, Capital, Conditions, and Collateral. Baiden J. E (2011)

Microfinance institutions use group lending design that provide the functions of screening, monitoring, and enforcement of repayment by group members. The group characteristics and dynamics ensure high repayment rates of loans in MFIs. The repayment of loans in microfinance heavily rely on Dominno effect , group solidarity, peer pressure, group member homogeneity, loan cycle repayments, information about reputation, characteristics trait of other members, local knowledge of a members assets and effort of each loanee. The success of group lending design is tied to the ability to harness social collateral (peer pressure) to enforce loan repayment through social pressure.

While analyzing factors that affect loan management in financial institutions Magari, J. (2014) observed that the largest share of microfinance operating income is generated from loan portfolio. The income generated by the loan portfolio is affected the lending design that defines how to disburse loans, number of active clients, and effective term of repaying the loan. According to Magari J. (2014), strategies that can optimize the portfolio value include diversification for reducing risk, adequate sources of funding, balancing the mixture of assets to provide growth and operate efficiently so as to maximize cash flow.

Lending design is the lifeblood of each lending institution as it defines the parameters that used from time to time as it ensures sustainable competitive advantage. The managers are keen to develop the lending methodologies that are sustainable. Nandhi M. A. (2013)

2.2 Dependent variable: Sustainable competitive advantage

The rapidly changing competitive landscape of financial intermediation raises questions about the Sacco industry's emerging new structure in lending design that is influenced by sustainable competitive advantage defined as a journey. Foon, L. S. (2010)

While a company's long-term success is driven largely by its ability to maintain sustainable competitive advantage and keep it, its shareholders must remain rewarded in the long term.

According to Turban et al, (2006) Porter's model identifies the forces that influence competitive advantage in the marketplace. Of greater interest to most managers is the development of a strategy aimed at establishing a profitable and sustainable position against these five forces. To establish such a position therefore, a SACCO needs to develop a sustainable competitive advantage on its lending design.

Thompson and Strickland, (2002) concluded that a company has sustainable competitive advantage whenever it has an edge over its rivals in securing customers and defending against competitive forces. This is born out of core competencies that are inherent in the internal processes considered to yield long term benefit to the company. These core competencies are reflected in the process of developing lending design of financial institution.

Prahaland and Hamel (1990) define a core competence as an area of specialized expertise that is the result of harmonizing complex streams of technology and work activity. They further explain that a core competence has three characteristics; one it provides access to a wide variety of markets, secondly it increases perceived customer benefits and lastly, it is hard for a competitor to imitate. This study assesses how lending design incorporates these pillars in SACCO's to achieve sustainable competitive advantage.

According to Bharadwa J (1993), sustainable competitive advantage can be developed from particular resources and capabilities that the firm possesses that are not available to competitors. The transformation of available skills and resources into a strategic position can only take place under conditions that provide a customer benefit from lending design, and normally requires the transformation of multiple competitive methods. This becomes the basis for the achievement of the firm to be able to perform above average industry performance Boro N. (2013)

According to Njanike K. (2009), the main activity of bank is not deposit mobilization and giving credit but effective credit risk management that reduces the risk of customer default. The competitive advantage of a bank is dependent on its capability to handle credit valuably that is embedded in the lending design.

Resource Based Theory

Is lending design a unique resource according to RBV that can drive sustainable competitive advantage for deposit taking savings and credit cooperative societies? According to Wernerfelt (1984) resource based view essentially argues that any form of sustainable competitive advantage that a firm may develop results from the unique resource endowments of the firm.
Sanchez, (2004) established that this view of the importance of a firms resources is reflected in the value resources inimitability organization (VRIO) framework as popularized by Barney, (1991) and concluded that an analysis of a firms internal strengths and weaknesses should address the value and rareness of a resource, ease of imitability of a capability and resource, and organizations capability to exploit its resources.

According to peteraf, M.A (2003), firm's resources must be heterogeneous. The resources and capabilities that a firm develops during formulation of the lending design for its value creation must be distinctive and different from the resources used by or available to other firms.

The heterogeneous resource that makes a firm successful must originate in imperfect factor of markets, which means that a competing firm either cannot acquire the distinctive resources that a successful firm possesses or must pay such a high price for such a resource or capability to an economic profit. The multiplier factor in lending design for SACCO's cannot be imitated by competitors as it is distinctive and entrenched in the principle of being both a member and customer. How then is does it contribute towards sustain competitive advantage?

The distinctive resources that make an organization successful must be imperfectly imitable and substitutable, so that the competing firm cannot imitate or substitute other resource in value creation processes and the distinctive resources of a firm must be subject to imperfect mobility, so that the key resources of the firm cannot easily leave the firm and thus remain inside the firm. In order to implement successful lending methodology, resources and capability must be coordinated. The inputs in lending process include financial resources; need for credit facility and the conditions attached to the facility.

According to Hanningtone J. G, etal., (2013) the resource-based view is used to determine whether the firm's initial bundle of resources and subsequent resource configurations are the sources of a particular firm's superior performance and to what extent the process of customer value creation is resource dependent.

RBV approach recognizes that resources inherent in the company's human capital represent one of the principal strategic factors that a firm currently possesses Barney, (1991), particularly the individual competencies of employee's pfeffer, J. (1994). These individual competencies are utilized to develop lending design and mechanisms that are not propel SACCO's to attain sustainable competitive advantage.

In order to achieve sustainable competitive advantage SACCO's identify organizational capabilities that are construed by efficiently combining the organization's assets with the competencies of its employees to implement strategies; the workforce efficiently becomes the foundation and location of competitive advantage through employees' contributions to the development and maintenance of core competencies. Pfetter, J. (1994).

Khandekar, A. and Sharma, A. (2005) contended that human resource capabilities are positively correlated to organizational performance and human resource capabilities are a significant predictor of sustainable competitive advantage. In this view, an organization utilizes human resource to encourage employees to acquire and develop competencies that are needed in lending design process and build core competencies to maintain employees having valuable competencies for achieving competitive advantage over the competitor's

3.0 Research methodology

3.1 Research design

The research design was a descriptive survey. According to Donald and Pamela (2006) descriptive surveys gather data at a particular point in time with the intention of describing the existing condition, or identifying standards against which existing conditions can be compared on determining relationships that exist between specific events.

3.2 Sample and sampling procedures

The target population was the Sacco societies with deposit taking activity in Kenya was 150. (Source: Sacco societies regulatory authority annual report, 2013) while the target respondents were 150 managers in the sacco sector. The managers were regarded as a suitable unit of analysis as they participate in decision making and implement policies from the board of directors as well as they are in good position to give an opinion on the role of lending design on sustainable competitive advantage.

3.3 Research instruments, Data collection and analysis

Primary data was collected using questionnaires as data collection instrument. The questionnaires were comprised of semi structured and open ended which were formatted to cater for the variables. Data collected was cleaned, sorted, coded and interpreted in line with the purpose of the research which is the role of lending design on sustainable competitive advantage.

Quantitative data was analyzed by employing descriptive statistics and inferential analysis. A five point modified Likert scale was used to measure the role of lending design on sustainable competitive advantage where the respondent's filled one response that fitted their opinion on the semi-structured questionnaire. The open questions were used to capture the opinions of the respondents regarding the variables being studied.

The quantitative data was analyzed using descriptive statistics and inferential statistics using the statistical package for social sciences. The purpose of descriptive statistics such as mean and standard deviation was to enable the researcher to give a summary about the sample data. Apart from descriptive statistics the variables were regressed using multiple regression model to find out if the independent variable predicts a given dependent variable and inferential statistics involving use of correlation, analysis of variance. The hypothesis testing was done at 5% level of significance.

4.0 Results and Discussion

The general objective of this study was to establish the role of lending design on sustainable competitive advantage on deposit taking SACCO's in Kenya.

The response rate was 84 % while the factor threshold was above 30%. According to Babbie, (2002) any response of 50% and above is adequate for analysis and hence 84% is sufficient for the study.

4.1 Correlation between lending design and sustainable competitive advantage

The study averaged the increase in indicators of sustainable competitive advantage and correlated the same with the extent of increase in lending cost focus and product differentiation by using Pearson Correlation Coefficient

Table 1 shows that there is positive significance between lending cost focus with sustainable competitive advantage with a pearson correlation coefficient of .767 with p-value of 0.001 and product differentiation had a coefficient of 0.626 at a significance level of p=0.024.

		Sustainable competitive advantage
Lending cost focus	Correlation Coefficient	.767*
	Sig. (2-tailed)	.001
Product differentiation	Correlation Coefficient	.626*
	Sig. (2-tailed)	.024

*. Correlation is significant at the 0.05 level (2-tailed).

Table1: correlation on lending costs and product differentiation

These findings show that sustainable competitive advantage would be improved by improvements in cost focus and product differentiation. The findings concludes that cost focus and product differentiation would have a greater positive impact on sustainable competitive advantage given the high correlation value in the model

4.2 Regression Analysis between lending design(cost focus and product differentiation) and sustainable competitive advantage

Regression was used to find out if the independent variable (lending design) predicts the given dependent variable (sustainable competitive advantage) . Multiple linear regression yields coefficient of determination (R^2), which was used to evaluate the contribution of each of the independent variable in explaining the dependent variable. The study used table 2 to establish whether lending design has a linear dependence on the independent variables. An R-square value of 0.724 was established and Adjusted R square is 0.692. The coefficient of determination depicts that lending cost focus, product differentiation brings about 72.4% variations in sustainable competitive advantage in deposit taking SACCO's while 27.6% of variations are brought about by factors not captured in the objectives. This implies that lending cost focus, product differentiation plays an important role in explaining sustainable competitive advantage.

R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
.851[a]	.724	.692	.23484	2.169

a. Predictors: (Constant), lending cost focus, product differentiation

b. Dependent Variable: Sustainable competitive advantage

Table 2: Regression analysis with lending cost focus and product differentiation

As shown in table 3 on the test of significance, Analysis of Variance (ANOVA) was used to test the significance of the regression model as pertains to significance in the differences in means of the dependent and independent variables. The ANOVA test produced an f-value of 23.043 which was significant at $p<0.001$. This shows that the regression model is significant at 95% confidence level. That is, has less than 1% probability of misrepresentation.

From the hypothesis

H_0: lending design is not significantly related to sustainable competitive advantage

H_1: Lending design is significantly related to sustainable competitive advantage

Since the P-value which is .000 is less than 0.05(0.00< 0.05) then we reject H_0 and accept H1 that there is significant relationship between Lending design and sustainable competitive advantage

	Sum of Squares	Df	Mean Square	F	Sig.
Regression	6.354	4	1.271	23.043	.000a
Residual	2.427	85	.055		
Total	8.781	89			

a. Predictors: (Constant), cost focus, product differentiation

b. Dependent Variable: Sustainable competitive advantage

Table 3: Analysis of Variance

When the following model was fitted to find out whether the independent variable of lending costs focus and product differentiation predicts dependent variable sustainable competitive, it was found out to have goodness of fit and therefore the model is significant as shown in table 4. The findings show that B_O is 1.418units, that can be interpreted to mean that when there is no change in costs focus and product differentiation the model predicts that sustainable competitive advantage will have 1.418 units. The model indicates that costs focus has a positive B-value of 0.191while product differentiation has a B-value of 0.466. This implies that a positive change in lending cost focus would lead to 0.191 success in dependent variable while product differentiation would lead to a 0.466 success in sustainable competitive advantage. Additionally, if the b-values are substituted in the equation below, the model can be defined as follows:

$Y = 1.448 + 0.191X_1 + 0.466X_2 + e$

$p<0.001$

Y= Sustainable competitive advantage ; X_1 = Lending cost focus; X_2 = product differentiation

e= error term

			Standardized Coefficients	T	Sig.
	B	Std. Error	Beta		
(Constant)	1.448	.560		2.584	.000

Cost focus	.191	.058	.313	3.329	.002
Product differentiation	.466	.123	.312	3.779	.024

a. Dependent Variable: Sustainable competitive advantage

Table 4: Multiple Regression Coefficients

This finding agrees with other researchers who have studied resource allocation on sustainable competitive advantage Vinayan, G. etal, (2012) & Oliver, C. (1997)

5. Conclusions and Recommendations

5.1 Conclusion

The study sought to establish the role of lending design on sustainable competitive advantage among deposit taking SACCO's in Kenya. The findings concludes that lending design positively affect sustainable competitive advantage in deposit taking savings and credit cooperative societies. This is because it has a pearson coefficient of lending cost focus of .767 with p-value competitive advantage. Sustainable competitive advantage allows SACCOs to maintain and improve their competitive position in the financial market.

5.2 Recommendation

The study recommends that for a SACCO to achieve sustainable competitive advantage, it must focus on lending costs and differentiate its products from the other financial service providers while constantly reviewing the lending design.

5.3 Further research

From the findings more research is required to establish the extent to which operational factors affect sustainable competitive advantage in deposit taking SACCO's. This will enable the organizations to establish linkages in lending practices in order to compete effectively in the market.

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