



THE EFFECTS OF SACCOS' REGULATIONS ON THE PERFORMANCE OF SAVINGS AND CREDIT SOCIETIES (SACCOS) IN KENYA: A CASE OF SACCOS IN NAIROBI

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Abstract: *Cases of mismanagement and corruption have been reported as the main challenges facing cooperative movements in Kenya. This prompted the establishment of Sacco Societies Regulatory Authority. Since the establishment of SASRA, the performance of SACCOs has been improving (MOCD & M 2012), but there is no study that has been done on the effects of regulations on the performance of SACCOs. This study therefore sought to determine the effects of SACCOs' regulations on the financial performance of savings and credit societies (SACCOs) in Kenya. The study also sought to find out the effects of SACCOs regulation on the share capital, liquidity position and dividends of SACCOs in Kenya. The target population of this study was therefore 170 respondents. The sample size of this study was 34 respondents. The study used primary data which was collected by use of questionnaires. Data was analyzed using descriptive statistics. In addition to measures of central tendencies (mean), measures of dispersion (standard deviation and coefficient of variation) and graphs was used to tabulate the information. Correlation analysis was also used to describe the degree to which one variable is linearly related to another. The study established that there is a positive correlation between Saccos regulation and Share capital with a coefficient of 0.058, with p-value of 0.020 which significant at $\alpha = 5\%$. The study also found that there is a positive correlation between liquidity position and Saccos regulation where the correlation coefficient is 0.64 and a p-value of 0.027 which significant at $\alpha = 5\%$. The study further concludes that there is a positive association between dividends and Saccos regulation where the correlation coefficient is 0.92, with a p-value of 0.025. The study recommends that SASRA should review its regulations so as to safeguard the dividends of the stakeholders, Membership regulations and controlling liquidity in SACCOs.*

Introduction

Cooperatives were borne out of a situation of crisis. Indeed, the very way in which cooperatives were founded leads on to wonder if cooperatives could play a role not only in mitigating the impact of crisis for members, but also contribute to a reconstruction efforts that see a more stable and sustainable economic environment emerge (Abate, Keshava, Mahesh & Lalitha, 2003). The idea of improving the socio-economic situations through mobilization of 'self-help' is central to the history of cooperatives. Cooperative finance in developed countries tends to have a supply of funding that is more stable and less responsive to monetary policy and market rates. Cooperative finance also tends to offer comparatively lower fees than other types of commercial banks, which not only helps to increase access of the poor to credit, but also reduces the cost of remittance transfers (Schenk, 2007).

However, cases of mismanagement and corruption have been reported as the main challenges facing cooperative movements in Kenya. This prompted the establishment of Sacco Societies Regulatory Authority. The Sacco Societies Regulatory Authority (SASRA) is a Semi-Autonomous Government Agency under the Ministry of Cooperative, Development and Marketing (Bernanke, 2003). It is a creation of the Sacco

Societies Act 2008 and was inaugurated in 2009 charged with the prime responsibility to license and supervise deposit taking Sacco Societies in Kenya. The establishment of SASRA falls within the Government of Kenya's reform process in the financial sector which has the dual objectives of protecting the interests of Sacco members and ensuring that there is confidence in the public towards the Sacco sector and spurring Kenya's economic growth through the mobilization of domestic savings (Hesse & Cihák, 2007).

Apart from just being concerned about individual depositors, regulation must also seek to provide a stable framework for making payments. With the vast volume of transactions conducted every day by individuals and businesses, a safe and acceptable means of payment is critical to the health of the economy. Another policy aspect of monetary stability is supervision and regulation of the banking system (Barrell *et al.* 2007). To provide stability, regulation should foster the development of strong financial institutions with adequate liquidity and should discourage banking practices that might harm depositors and disrupt the payments system. In banking regulation, the objective of monetary stability has been closely linked with the goal of depositor protection. Financial crises and unintended fluctuations in the money supply have been prevented primarily by promoting confidence in banks and guaranteeing the safety of deposits (Bernanke, 2003).

Another goal of banking regulation is to protect consumer interests in various aspects of a banking relationship. The previous regulatory objectives serve to protect consumers in a number of ways, most notably through safeguarding their deposits and promoting competitive banking services. However, there are many other ways consumers are protected in their banking activities (Bliss & Kaufman, 2002). Consumer protection objectives are generally consistent with good banking principles. Credit and deposit disclosures and informed customers should be of most benefit to bankers offering competitive services. Likewise, equal and nondiscriminatory treatment of borrowers is necessary for any banker aiming to maximize profits. The growing complexity of financial instruments and the uniqueness of individual customers, though, have made consumer protection a very complicated and detailed regulatory process (Hesse & Cihák, 2007).

Cooperatives play a significant role in the development of Kenya. They contribute or manage about 40% of Kenya's GDP (Bliss & Kaufman, 2007). A large proportion of Kenyan population derives their livelihood from cooperatives. It is estimated that 63% of Kenyans derive their livelihoods directly or indirectly from cooperative based activities or sources. SACCOs have mobilized savings of over Ksh. 230 billion, an equivalent of about 31% of national savings by 2007 and this calls for prudent management of the funds which can only be achieved by ensuring personnel are well trained and the sector is well supervised. Among the many problems that cooperatives have been facing include persistence of low business efficiency, weak capital base, heavy indebtedness, limited worthiness, and the weak entrepreneurial capability of managers and board members and the unbalanced organizational structures of the movement (Mbogo, 2010).

With the liberalization in the management of SACCOs via Co-operative societies Act No. 12 of 2006, SACCO membership has been on declining trends which also affect loan repayments since some members fail to service their loans at the appropriate time due to lack of proper advise (Chambo, Mwangi, & Oloo, 2008). In addition, SACCOs lacked sound cooperate practice in management and governance and the business remain in the competition, particularly with the commercial banks and the microfinance institutions (Manyara, 2003).

This problem has recently called for the establishment of Sacco Society Regulatory Authority to regulate the SACCOs for the common good of the society, investors and other stakeholders. Who are likely to be affected by the SACCOs' frauds, including the fraudulent financial reporting. Sacco Society Regulatory Authority falls within the Government of Kenya's reform process in the financial sector whose objectives

are to protect the interest of Sacco members, ensure that there is confidence in the public in relation to the Sacco sector and to spur Kenya's economic growth through the mobilization of domestic savings (SASRA, 2012).

Since the establishment of SASRA, the performance of SACCOs has been improving, but there is no study that has been done on the effects of regulations on the performance of SACCOs (MOCMD, 2012). It is against this background that this study sought to determine the effects of SACCOs' regulations on the financial performance of savings and credit societies (SACCOs) in Kenya.

The general objective of this study was to determine the effects of SACCOs' regulations on the financial performance of savings and credit societies (SACCOs) in Kenya. The specific objectives of this study were;

1. To determine the effects of SACCOs regulation on the liquidity position of SACCOs in Kenya
2. To find out the effects of SACCOs regulation on the share capital of SACCOs in Kenya
3. To establish the effects of SACCOs regulation on the dividends of SACCOs in Kenya

Theoretical Background

Two theories were considered in this study: static trade-off theory and modigliani and miller theory.

Modigliani and Miller Theory

Modigliani and Miller (1958), assuming perfect capital markets, rational behavior, and zero taxes, showed that the value of a firm is not dependant on its dividend payout ratio. They suggested that the market value of the firm depends on its expected future earnings and not its current earnings (Filbeck & Mullineaux, 2007; Furfine, 2001). As a consequence, they argued that if earnings consist of a transitory and a permanent component and if dividends are related to the permanent component, then dividends will be a proxy for expected future earnings. This has been referred to as the "information-content-of dividends" hypothesis. Similarly, Harikumar (2003) argues that dividend changes provide signals to investors about management's perception of the firm's future earnings stream. Management will not increase dividends unless it is certain that future earnings will be large enough to support the higher dividends.

Conversely, dividend cuts are perceived as "bad news" and send negative signals to investors. Because of this view, reductions of dividends by banks were not commonplace. Accordingly, advocates of signaling theory suggest that abnormal returns for securities (the value of the firm) could be observed as shareholders realign their perception of future cash flows based on management's decision to alter dividend payments (Filbeck & Mullineaux, 2007). Consequently, a bank manager's dividend disbursement decisions can also act as a signal about future cash flow.

Additionally, capital adequacy is an important consideration in the management of the banking firm. Bank management must satisfy the capital requirements imposed by regulators. Furthermore, a bank manager should consider the allocation of sufficient resources for future expansion. Accordingly, one of the decisions that has had a significant impact on the value of the firm is the choice concerning the percentage of earnings to pay out as dividends and/or the amount of earnings to retain. On the other hand, different conditions are associated with dividend decisions made by commercial banks than those associated with firms outside the banking industry (Filbeck & Mullineaux, 2007).

Commercial banks are regulated and monitored by the central bank. Unlike firms outside the banking sphere, banks are periodically monitored by a central bank to ensure that capital ratios, loan loss reserves, and an organization's overall financial foundation are acceptable. Regulators, using "inside information" about the commercial bank, supplement the market monitoring. Regulators also possess a number of enforcement tools that lend weight to their monitoring activities, including cease-and-desist orders, monitoring penalties, and, in the extreme case, the power to close a bank. Thus, regulatory monitors may assist shareholders in the market control process (Hancock & Wilcox, 2007).

Since regulators of commercial banks are concerned about the earning quality of banks, one can assume that if a bank increases dividends, regulators "certified" the action. That is, cash flows have been judged sufficient by a central bank to justify an increase (Harikumar, 2003). Conversely, unexpected dividend reductions, according to signaling theory, convey negative information to investors. In the case of the commercial banking industry, regulators have access to inside information about the quality of the commercial bank's loan portfolio.

Static Trade-off Theory

The Static trade-off theory focuses on the benefits and costs of issuing debt. It predicts that an optimal target financial debt ratio exists, which maximizes the value of the firm (Kester, 2005). The optimal point can be attained when the marginal value of the benefits associated with debts issues exactly offsets the increase in the present value of the costs associated with issuing debt. Trade-off theory allows the bankruptcy cost to exist. It states that there's an advantage to financing with debt (namely, tax benefit of debts) and that there's a cost of financing with (bankruptcy costs of debt). The benefits of debt are the tax deductibility of interest payments. The tax deductibility of corporate interest payments favors the use of debt. The marginal benefit of further increases in debt declines as debt increases, while the marginal cost increases, so that a firm that is optimizing its overall value will focus on this trade-off when choosing how much debt and equity to use for financing. This simple effect however, can be complicated by the existence of personal taxes and non-debt tax shields

Another benefit of debt is that it mitigates the manager-shareholder agency conflict. Corporate managers have the incentive to waste free cash flow on perquisites and bad investment. Debt financing limits the free cash flow available to managers and thereby helps to control this agency problem. The costs associated with issuing more debt are the costs of financial distress and the agency costs triggered by conflicts between shareholders and debtors (Jensen, 2004). Costs of financial distress are likely to arise when a firm uses excessive debt and is unable to meet the interest and principal payments.

Research Gap

Several Research studies have been conducted on SACCOs and financial sector regulation and governance. Gambacorta and Mistrulli (2004) did a study on factors influencing corporate governance of SACCOs in Kenya and established that the significance of corporate governance is now widely recognized and all institutions require good governance in order to succeed and attain sustainable prosperity. Corporate governance refers to the manner in which organizations are directed, controlled and held accountable. Further, Filbeck and Mullineaux (2012) investigated various regulatory constraints on financial institutions dividend payout. They found that financial institutions are constrained by the FED's rule concerning financial institutions' eligibility for dividend payout. Nevertheless, none of these studies focused on the influence of SACCOs regulation on the financial performance of SACCOs in Kenya, research gap.

Conceptual Framework

This research study aims at establishing the effects of SACCOs' regulations on the financial performance of savings and credit societies (SACCOs) in Kenya. The dependent variable in this study was financial performance while the independent variable was SACCOs regulation. On the other hand, the indicators of the dependent variables were liquidity position, share capital and dividends. The study therefore sought to establish the influence of the independent variable (SACCOs regulation) on the dependent variable (financial performance).

The performance of the SACCOs will be indicated by its stable liquidity position, growth in the share capital and also the growth in Dividends. The new regulatory regime is partly meant to check the proliferation of privately operated and un-registered pyramid schemes that have assumed the identity of deposit-taking Saccos.

But leading operators in the movement have expressed fears about the regulations saying they may adversely affect the sub-sector and force many members to migrate to banks or other financial institutions, which have already started to jostle for customers in anticipation that the new regulations could create discontent within the movement. The above indicators of the dependent variable will help to assess the financial performance of the Sacco's.

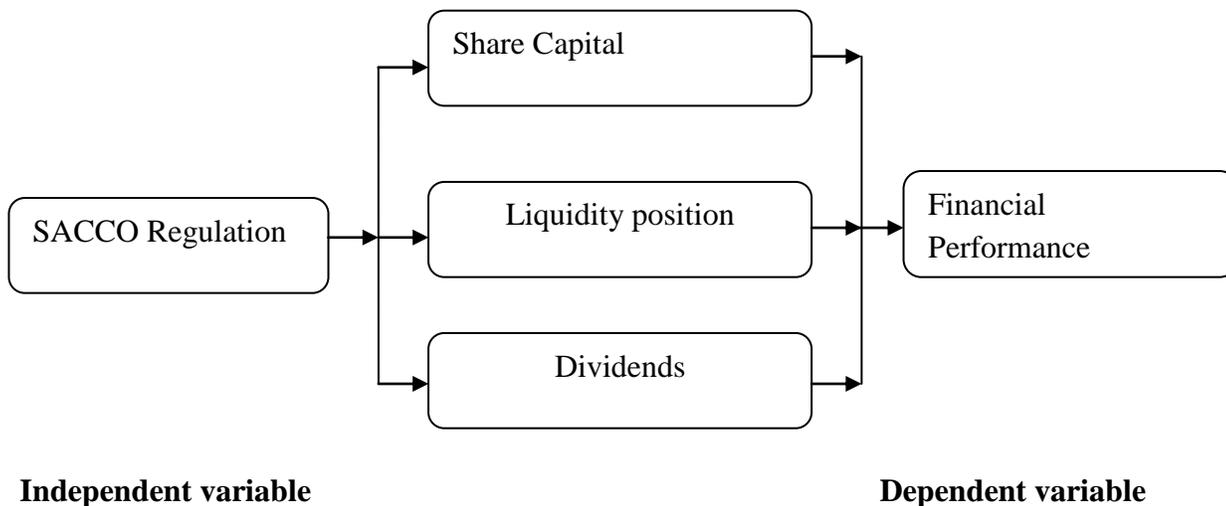


Figure 1: Conceptual framework

Research Methodology

This study used descriptive research design. This design refers to a set of methods and procedures that describe variables. It involves gathering data that describe events and then organizes, tabulates, depicts, and describes the data. Its advantage is that, it is used extensively to describe behavior, attitude, characteristic and values.

The target population of this study was the management of all the deposit taking SACCOs registered with SASRA. There are 34 SACCOs in Nairobi registered with SASRA (SASRA, 2012). Each of the SACCOs has approximately five officials in the top management. The study population was therefore 170 respondents. The sample size of this study was 34 operation managers in all the SACCOs in Nairobi that are

registered with SASRA. This represented 20% of the target population. According to Mugenda and Mugenda (2003) a sample size of between 10 and 30% is a good representation of the target population.

Structured questionnaires were used in this study to collect data. Questionnaires are the most commonly used methods when respondents can be reached and are willing to co-operate. These methods can reach a large number of subjects who are able to read and write independently. The author observed that questionnaires are very economical in terms of time, energy and finances. Similarly, it yields, quantitative data which is easy to collect and analyze. In this study, the researcher used both structured and unstructured questions.

Data was analyzed using descriptive statistics to profile sample characteristics and major patterns emerging from the data. In addition to measures of central tendencies (mean), measures of dispersion (standard deviation and co-efficient of variation) were used to tabulate the information. This was facilitated by use of the Likert Scale which enables easier presentation and interpretation of data. For the purpose of this study, the collected data was analyzed using the Statistical Package for Social Sciences (SPSS). Correlation analysis was also used to describe the degree to which one variable is linearly related to another. It measures the degree of association between two variables.

Results and Discussion

Share Capital

The study established that most of the SACCOs registered with SASRA had not experienced capital problems in the last 5 years. However, for the SACCOs which had experienced capital problems in the last 5 years, high cost of production was the main cause. The study further established that SACCO's regulation affect the share capital in SACCOs. Share capital increases because of the requirement to maintain a minimum capital. The SACCOs were maintaining a core capital of not less than 10%. The study further established that SACCO's regulations were affecting minimum capital requirements, SACCOs' capital reserve, SACCOs' level of leverage and SACCOs' tightening of capital ratio. However, SACCO's regulations were affecting the SACCOs' formal capital requirements to a low extent.

Liquidity Position

The study also established that the capital base of most SACCOs was very strong. The study further revealed that Sacco's regulations affect the Sacco's liquidity position to a moderate extent. Sacco's regulations affect the Sacco's liquidity position because some of the funds are diverted to them. The SACCOs have enough capital and hence do not need to source for extra capital from money markets. Since the core capital of KSH 10 million has to be maintained then the SACCO remains with an amount to disburse as loans. This study found that Sacco's regulation was influencing dividend payment, reserve capital, loaning payment and membership to a great extent.

Dividends

This study further established that SACCO's regulation affect dividends in SACCOs. Further, SACCO's regulations were affecting dividends in SACCOs to a moderate extent. The study also found that Sacco regulation impact on ploughed back profits, on the amount of dividends per share, on the type of payment and on the time of payment to a great extent.

On the criteria the Sacco was using to allocate dividends, the study found the dividends were allocated as per shares held by members. The study also found that SACCOs were using a given percentage per share

and the higher the savings the higher the dividends. The study also found that SACCOs were using cash payment through delegates. It was also established that dividend payment to members improved membership, improved share capital base, improved credit base and created trust to members and public.

Correlation Analysis

A correlation is a number between -1 and +1 that measures the degree of association between two variables. A positive value for the correlation implies a positive. A negative value for the correlation implies a negative or inverse association. The analysis of correlation results between the Saccos regulation and Share capital show a positive coefficient 0.058, with p-value of 0.025. It indicates that the result is significant at $\alpha = 5\%$ and that if the Saccos regulation increases it will have a positive impact on the Share capital. The correlation results between liquidity position and Saccos regulation also indicates the same type of result where the correlation coefficient is 0.64 and a p-value of 0.027 which significant at $\alpha = 5\%$. The results also show that there is a positive association between dividends and Saccos regulation where the correlation coefficient is 0.92, with a p-value of 0.020.

This notwithstanding, all the factors had a significant p-value ($p < 0.05$) at 95% confidence level. The significance values for relationship between SACCOs regulation and share capital, liquidity position and dividends were 0.025, 0.027 and 0.020 respectively. This implies that dividends were the most significant factor, followed by share capital while liquidity position was the least significant.

Table 21: Correlation coefficients

		Saccos regulation	Share capital	Liquidity position	dividends
Saccos regulation	Pearson Correlation	1			
	Sig. (2-tailed)	.			
Share capital	Pearson Correlation	.058	1		
	Sig. (2-tailed)	.025	.		
Liquidity position	Pearson Correlation	.064	.223	1	
	Sig. (2-tailed)	.027	.006	.	
dividends	Pearson Correlation	.092	.243	.497	1
	Sig. (2-tailed)	.020	.002	.000	.

Conclusion

The study concludes that there is a positive correlation between Saccos regulation and Share capital. Share capital increases because of the requirement to maintain a minimum capital. The SACCOs were maintaining core capital. The study further established that SACCO's regulations were affecting minimum capital requirements, SACCOs' capital reserve, SACCOs' level of leverage and SACCOs' tightening of capital ratio. However, SACCO's regulations were affecting the SACCOs' formal capital requirements to a low extent.

The study also concludes that there is a positive correlation between liquidity position and Saccos regulation. The SACCOs need to source for extra capital from their members, since the core capital has to be maintained and the SACCO require to remains with an amount to disburse as loans to the members. This study found that Sacco's regulation was influencing dividend payment, reserve capital, loaning payment and membership to a great extent.

The study further concludes that there is a positive association between dividends and Saccos regulation. The study also found that Sacco regulation impact on ploughed back profits, on the amount of dividends per share, on the type of payment and on the time of payment. It was also established that dividend payment to members improved membership, improved share capital base, improved credit base and created trust to members and the public.

Recommendations

Based on the above conclusions, the study makes recommendations that

1. This study therefore recommends that the regulators should review the regulations related to share capital which will enable SACCOs to build their equity without affecting the member's return.
2. The study also established that liquidity problems that had been experienced in SACCOs were moderate. This study recommends that SASRA should consider establishing an appropriate regulatory framework so as to effectively manage and control liquidity risk, these is because most of the respondent indicated that most of the Sacco's were encountering liquidity problems.
3. This study also established that SACCO's regulation was affecting dividends in the SACCOs. This study recommends that SASRA should review its regulations so as to safeguard the dividends of the stakeholders in SACCOs, these is because most of the Saccos were giving low dividends to the members so that they can retain a high percentage in order to build their institutional capital.

Areas for Further Studies

This study focused on the effects of SACCOs' regulations on the financial performance of savings and credit societies (SACCOs) in Kenya. However, the study focused on the SACCOs located in Nairobi region only. The study therefore recommends further studies in other rural areas. The study also recommends further studies to be done on the area of the relationship between SACCOs regulation and SACCOs operational performance.

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