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Prudent Borrowing Practices and Growth of Savings and Credit Cooperative Societies

Rosebella Oruko Adhiambo

MBA Student, Jomo Kenyatta University of Agriculture and Technology, Kenya

Josphat Kwasira

Lecturer, Jomo Kenyatta University of Agriculture and Technology, Kenya

Abstract:

Poverty has resulted to limited means of living, leading low income earners to outsource other means of improving their living standards. Formation of savings and credit co-operatives has been one successful avenue. Over time they have strived to mobilize funds and grant credit to their members but they have not been able to sufficiently grow. This study sought to assess prudent financial management practices on growth of Savings and Credit Cooperative Societies (SACCOs) in Nakuru County. Study objective was to establish the effects of prudent external borrowing practices on growth of SACCOs in Nakuru County. The study was conducted using descriptive survey research design. The study population comprised of all the financial and operations managers of 106 registered SACCOs in Nakuru County. The sampling frame was drawn from the Kenya Union of Savings and Credit Co-operatives list of registered SACCOs in Nakuru County. The sample size for the study composed of 84 managers of SACCOs in Nakuru County. Stratified random sampling technique was used to select the two strata in the study sample; 42 operation managers and 42 finance managers. Primary data was obtained from the managers of the SACCOs using a structured questionnaire. Data was analyzed using descriptive statistics such as frequency counts, percentages, means and standard deviation. Pearson correlation was used to analyze the relationship between variables. The study found out that prudent external borrowing had a positive impact on growth of Saccos therefore; the researcher recommended that Central Bank of Kenya, which has the mandate of overseeing the implementation of prudent financial management practices should design a strategy for ensuring adoption and implementation of prudent financial practices in Saccos.

Keywords: Prudent, external borrowing, growth, savings and credit cooperative societies

1. Introduction

1.1. Background Information

The SACCO industry has been growing at a very high rate to take the center stage in economic growth. In recognition of these roles, Kenyas Vision 2030 embraces the cooperative movement as a strategy for steering the country to an industrialized economy by the year 2030. This introduction of prudential regulation for Sacco societies is therefore a valuable initiative step in mainstreaming the Sacco industry into the formal financial system. Prudent financial management entails finance management above the minimum standards which are geared towards safeguarding members deposits, sustainability and growth of SACCOs (SASRA, 2013)

1.2. Statement of the Problem

The role played by SACCOs in economic empowerment especially among the poor is evident from the background literature (Ndung'u, 2010), especially through savings mobilization. However, disbursement of credit and ensuring SACCOs' long term sustainability through prudent financial practice have been under emphasized at the start up phase of the SACCOs. The introduction of prudential regulation framework for the SACCO industry in 2010 was a critical government initiative as a means to enhance transparency and accountability in the SACCO sub sector. However, little research attention has been given to the prudent finance management strategies by SACCOs in Kenya. The study therefore assessed how the use of prudent financial management practices affected Sacco's growth in Nakuru County by focusing on external borrowing practices.

1.3. Research Objectives

To establish the effects of prudent external borrowing practices on growth of SACCOs in Nakuru County

1.4. Research Hypothesis

- $H_{03}: \mu_1 = \mu_2$: External borrowing practices have no significant effects on growth of SACCOs in Nakuru County.

1.5. Justification of the Study

Findings of the study are of great significance to developing economies relying on the cooperative movement to grow their economies. This would enhance transparency, accountability and efficiency in the co-operative societies hence financial soundness of SACCO Societies. Further the findings are also of great assistance to SACCOs in identifying key factors that enhance growth. The findings also revealed the effects of prudent external borrowing practices in SACCOs in relation to growth which are of great assistance to the central bank in formulating financial management policies besides being a reference point for other related research or studies carried out in future.

2. Methodology

2.1. Research Design

The study was quantitative in nature in that it sought to quantify the prudential external borrowing practices practiced by SACCOs in relation to their growth. To achieve this, the study used descriptive research design where selected sacco managers rated their institutions on the basis on the study variables to capture information the way it is without manipulation. The research design was applicable in the study because it allows the researcher to study phenomena that do not allow for manipulation of variables.

2.2. Target Population

The target population for the study was comprised of all the operations and finance managers in the registered SACCOs within Nakuru County. The total of managers were 106 from the 53 Saccos according to the annual report of SASRA 2014 (KUSSCO, 2014).

2.3. Sampling Frame

The sampling frame for study was all the finance and operations managers of registered SACCOs operating under KUSCCO Nakuru County. The Sacco register by KUSSCO Nakuru was used in identifying them. In each Sacco the operations manager and finance manager was included in the study.

2.4. Sample and Sampling Techniques

The sample size was determined using the formular by Fisher et.al (1994) as shown below:

$$S = \frac{n}{1+n/N}$$

Where S = Sample Size

N = Target population

n = Target sample

$$S = \frac{106}{1+106/400}$$

Upon substitution, the appropriate sample size for the study was obtained as:

S= 84 comprising of both finance and operations managers. The study therefore considered that the 84 managers were drawn from 42 Saccos where from each sacco two managers were selected. Stratified random sampling technique was used to select the elements into the study sample. The population was therefore divided into two strata that is the operation managers and finance managers. This sampling technique was preferred for the study because it increased the sample's statistical efficiency.

2.5. Research Instruments

The study used the questionnaire as a tool in the collection of primary data. On set of questionnaire was designed by the researcher for the exercise. The questionnaire was based on two variables: prudent management of external borrowing and growth of SACCOs. These were measured using a five point lickert scale to establish the extent. The instruments were piloted to a population similar to the target population in Nakuru County. SACCOs selected for piloting were not part of the ultimate sample for the study. Face validity method was used to assess the validity of the research instruments. The researcher read through the instruments and compared them with the set objectives guided by lecturers from Jomo Kenyatta University of Agriculture and Technology. Pilot questionnaires were further analyzed for reliability using the cronbach coefficient to determine the extent of reliability. A Cronbach Alpha reliability coefficient of 0.77 was obtained therefore the instruments were found to be adequate for the study.

2.6. Data Processing and Analysis

Data collected was coded and analyzed using Statistical Package for Social Sciences (SPSS) Version 21.0 computer programme to facilitate addressing the research objectives and hypothesis. Quantitative data was summarized using descriptive statistics which include mean, mode, standard deviations, frequencies and percentages. Pearson correlation analysis was then used to determine the relationship between variables.

3. Findings and Discussions

3.1. Findings

The study which sought to establish the effects of external borrowing practices on growth of SACCOs in Nakuru County. The study sought to determine the external borrowing practices and their relationship with growth of Saccos. First managers sought to determine whether Saccos borrowed funds externally and the findings are shown on Table 1.

	Frequency	Percent
Yes	50	67.6
No	24	32.4
Total	74	100.0

Table 1: Sacco Borrowing From External Sources

According to the managers, 67.6% of the saccos borrowed funds from external sources compared to 32.4% who were yet to consider external borrowing. Further analysis on prudent practices in external borrowing were then confined to saccos with external borrowing mechanisms; saccos which never borrowed externally were left out hence $n = 50$.

Further, the frequency in which Saccos considered external borrowing was also determined as shown on Table 2.

	Frequency	Percent
Very often	8	16.0
Often	9	18.0
Sometimes	29	58.0
Rare	3	6.0
very rare	1	2.0
Total	50	100.0

Table 2: Frequency of External Borrowing
Mean = 2.60, SD = 0.904.

The findings show that overall the frequency of borrowing was rated average at a Mean = 2.60, $\sigma = 0.904$. 34.0% borrowed either often or very often while 58.0% borrowed sometimes. Analysis on the nature of borrowing is shown on Table 3

	Frequency	Percent
Short term	21	42.0
Long term	25	50.0
both	4	8.0
Total	50	100.0

Table 3: Duration of External borrowing

Majority of the Saccos borrowed 50.0% in the long term, 42.0% borrowed for short term, while 8.0% borrowed for both short term and long term. The sources of funds borrowed externally are presented on Table 4.

Source of funds	Frequency	Percent
Local commercial banks	47	94.0
Trade credit, bank credit	1	2.0
Loans and advances	1	2.0
Overdraft	1	2.0
Total	50	100.0

Table 4: Sources of Funds

Nearly all Saccos (94.0%) opted for external financing from commercial banks as opposed 2% who sought credit from Trade credit while 2% sought overdraft from banks. Interest charged on borrowed funds varied as shown on Table 5.

	N	Minimum	Maximum	Mean	Std. Deviation
Interest rate on borrowed capital	50	12.00	15.00	13.1600	.95533
Valid N (listwise)	50				

Table 5: Interest Charged On Borrowed Capital

On average, interest rates charged on loan varied between 12.0% and 15.0% per annum however the average interest charged was 13.16%. Table 6 shows how banks utilized funds borrowed from external sources.

Utilization of borrowed funds	Frequency	Percent
To boost loan reserves	14	28.0
For purchase of sacco assets	20	40.0
Development of new products	16	32.0
Total	50	100.0

Table 6: Utilization of Borrowed Capital

Borrowed funds were mostly used in the purchase of assets (40.0%), followed by new product development and also building cash reserves for the Sacco (28.0%). Finally in analyzing this objective, the practices related to, prudent management of external borrowing were analyzed as shown below.

	N	Minimum	Maximum	Mean	Std. Deviation
External borrowing decisions are passed by financial experts from sacco	50	2	5	4.20	0.891
Conduct proper analysis of external borrowing	50	1	5	4.36	1.041
External borrowing preceded by proper needs assessment	50	1	5	4.26	1.034
Decisions to borrow externally approved through AGM	50	1	5	4.00	1.085

Table 7: Prudential External Borrowing Practices

The findings on Table 7 shows that Saccos in Nakuru Town emphasized a lot on the prudent management of external borrowing as seen from the high level of rating on practices. Managers indicated that their Saccos conduct proper appraisal of external borrowing sourcing before engaging them (mean = 4.36). Decisions to go for external borrowing were preceded by proper needs assessment (mean = 4.26) and experts were engaged in passing external borrowing decisions in sacco (Mean = 4.20). External borrowing decisions were also subjected to AGMs for endorsements before the management implements (Mean = 4.00).

3.1.1. Testing Hypothesis III

The third hypothesis of the study was.

- $H_{03}:\mu_1=\mu_2$. External borrowing practices have no significant effect on growth of SACCOs in Nakuru County
- $H_{13}:\mu_1\neq\mu_2$. External borrowing practices have a significant effect on growth of SACCOs in Nakuru County

These hypotheses were tested using person correlation analysis between rating on external borrowing practices and growth of Saccos. The tests were performed at a significance level $p = 0.05$.

		External borrowing practices	Growth of saccos
External borrowing practices	Pearson Correlation	1	.669**
	Sig. (2-tailed)		.000
	N	50	50
Growth of saccos	Pearson Correlation	.669**	1
	Sig. (2-tailed)	.000	
	N	50	50

Table 8: Correlations between External Borrowing and Growth of Saccos

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

Results of Pearson correlation analysis on Table 8 revealed that a very strong correlation between prudent external borrowing practices and growth of Saccos ($r = 0.669$, $p < 0.05$). Therefore the study upheld the alternative hypothesis $H_{13}:\mu_1\neq\mu_2$: that prudent external borrowing practices have a significant effect on growth of SACCOs in Nakuru County.

3.2. Discussion of Findings

Concerning the prudence in external borrowing and its effects on growth of saccos, the study established that: Majority of saccos borrowed funds from external sources. The frequency of borrowing was moderate and that borrowed funds were majorly used to invest in long term projects. Nearly all Saccos opted for external financing from commercial banks as opposed a few who sought

credit from Trade credit and overdraft from banks. On average, interest rates charged on loan ranged between 12.0% and 15.0% per annum. Borrowed funds were mostly used in the purchase of assets, new product development and also building cash reserves for the Sacco.

On their financial practices, Saccos emphasized a lot on the prudent management of external borrowing as seen from the high level of rating on practices. Managers indicated that their Saccos conduct proper appraisal of external borrowing sourcing before engaging them, decisions to go for external borrowing were preceded by proper needs assessment, and experts were engaged in passing external borrowing. External borrowing decisions were then subjected to AGMs for endorsements before the management implemented. Finally, the findings revealed that there existed a very strong correlation between prudent external borrowing practices and growth of Saccos in Nakuru County which implied that Saccos with more prudent practices in external financing recorded higher growth rates. These findings were consistent with Alexandra (2006) who found that external borrowing would help ease cash flow management, generate more institutional income, increase membership size and promote training and capacity building. FSD (2009) cited that borrowed funds were useful in enhancing growth of membership.

4. Conclusions & Recommendation

Saccos emphasized a lot on the prudent management of external borrowing which was also found to have a very strong correlation with growth rate. The central bank of Kenya which is charged with the mandate to oversee the implementation of prudent finance management practices on borrowing should set limits of external borrowing and specific sources of loans for saccos. This will enable them access cheap funds critical for growth.

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