THE INTERNATIONAL JOURNAL OF BUSINESS & MANAGEMENT

Challenges Facing Cooperative Financial Institutions in Compliance to Corporate Governance Practices

Lucas Patrick
Assistant Lecturer, Moshi Cooperative University, Tanzania

Abstract:
This study examined the challenges facing cooperative financial institutions in conforming to corporate governance practices. The cross sectional study was conducted with sample size of seventy respondents, however responses were from sixty five respondents. Both primary and secondary data were collected. Primary data were collected through questionnaires, interview and secondary through documentary review. Data were analyzed using descriptive statistic. Findings revealed that fraud, low member's participation and insufficient board members knowledge and skills needed to make business judgments, weak internal control systems and low level of accountability were found to major challenges facing cooperative financial institution in complying with corporate governance practices. The study recommends for SACCOS to regularly organize business management skills training for the board members. This will improve the level of supervision and monitoring within the SACCOS. Furthermore cooperative laws and rules should stipulate heavy punishment for fraud practices since fraud has been regular practice in SACCOS. Regarding low level of member's participation, SACCOS should regularly provide training to its members to enhance their understanding of SACCOS operations and their position in decision making. Finally Supervisory committee members who are responsible for internal control must have accounting knowledge.

Keywords: *Cooperative financial institutions, corporate governance*

1. Introduction

1.1. Background of the Problem

Corporate governance is critical to any organization to achieve corporate goals. It is the process whereby persons entrusted with the future of an organization exercise oversight. Good corporate governance enhances compliance in adhering to policies, rules, and regulations. An organization gets into trouble when they fail to execute these duties properly (Anand 2007). If a company has a reputation of strong governance practices leads to greater confidence in the investors, which in turn leads to a good flow in capital. Corporate governance enhances more transparency of the business thus attaining the trust of its stakeholders. Raising capital also becomes easier because of the support the company gets from its stakeholders. The corporate value of the company is increased by adopting good corporate governance practices (Monks, 2011). Demand of good corporate governance came through shareholders of major corporate entities to guard their resources and assets from bankruptcies and more specifically guarding against fraud and mismanagement (Strenger 2006). In cooperative financial institutions fraud and mismanagement has also been revealed for example there is evidence of poor corporate governance which led to failure of cooperative financial institutions CFIs such as that which occurred in the 1970–80 in Latin America (Cuevas and Fischer, 2006).In Africa the same situation has occurred where by the member of cooperative financial institutions CFIs have suffered big financial loss resulting from non compliance to corporate governance. Taking Kenya as an example, the authority which is responsible for regulating saving and credit societies (SACCOS) reported financial losses suffered by members of SACCO due to poor corporate governance (Team BD, 2012). In Tanzania the situation is not different. In the study conducted by Akyoo (2011) at (KIFISACCOS) concludes serious financial problems faced by the SACCOS were internally caused that is lack of good governance rather than external. Furthermore Inspection report on Wazalendo SACCOS (2013) reported a number of problems resulted from poor governance. Among the problems reported because of poor governance include the following: The board chairman overriding the management to the extent of undertaking day to day operational activities of the SACCOS, external auditing was not conducted for four years indicating lack of transparency and insider dealings. Most of problems reported in cooperative financial institution stem from poor corporate governance. If cooperative financial institutions were managed properly have big contribution to economy. For example SACCOS which is member based financial institution play important role in the economy. They play important role on lending, mobilizing savings and management at local level. SACCOS appear to be a very promising mechanism for delivery of financial services to the rural poor throughout the country. In view of their nearness to their clients, the operating and transaction costs of SACCOS are relatively low (IFAD 2013).

1.2. Statement of the Problem

The achievement or collapse of entities is dependent on the level to which they are managed efficiently. Good corporate governance practices boost firm performance through better management and wise allocation of firms' resources. Consequently good corporate governance practices can increase the demand for shares as well as increase the share price of firm, on the other hand poor corporate governance can lead to collapse of the firm because demand for its share will fall and the price of its share will go down (Mobius, 2002). Many cooperative financial institutions have been registered but it is only very few grow to large cooperative financial institution, It has been argued that to large extent the situation has been influenced by the weak corporate governance in cooperatives financial institutions (Kyazee, 2010). For example in Tanzania the number of SACCOS registered by the year 2012 was 5424 out of which 1346 (25%) were dormant (URT 2012). It is a fruitless exercise to continue to register financial co-operatives that will end up small and redundant therefore there is a need to improve corporate governance practices in cooperative financial institution which will enhance operational performance. (Klapper and Love 2002) found that, better corporate governance is highly correlated with better operating performance and market valuation. They provide evidence showing that firm level corporate governance matter more in countries with weak legal environments. Bhagat and Bolton (2008) supported (Klapper and Love 2002) argument that there is positive relationship between corporate governance and firm performance. Patrick et,al (2014) in the study designed to examine corporate governance practices and performance of cooperative financial institutions in cooperative financial institutions in Tanzania, found that most of SACCOS visited were not full practicing corporate governance, lthough the extent of corporate governance practices were different among SACCOS. Despite the fact that the author managed to explore a range of corporate governance variables in cooperative financial institution but did not look at the challenges which faces cooperative financial institutions in complying with corporate covernance . This was the situation which motivated the researcher to undertake this study.

1.3. Objectives

The main purpose of this study was to examine the challenges facing cooperative financial institutions in compliance to corporate governance practices with the view of suggesting better way of overcoming the mentioned challenges.

1.4. Significance of the Study

The findings of this study add to the efforts of government regulators in coming up with regulations that will govern the operations of cooperative financial institutions. The study will facilitate better CFIs management by enhancing the knowledge of the board members in overseeing the management of cooperative financial institutions. Knowledge gained will be used to increase awareness of cooperative financial institutions on how to overcome different challenges related to the corporate governance.

2. Literature review

2.1. Corporate Governance

Rezaee (2009) defined as a process through which shareholders induce management to act in their interests, providing investors degree of confidence that is necessary for the capital markets to function effectively. It is concerned with the duties and responsibilities of a company's board of directors to successfully lead the company and their relationship with its shareholders and other stakeholder groups (Pass 2004). Cadbury (1992) defined corporate governance as the system by which companies are directed and controlled. Corporate governance is concerned mainly with the establishment of structures and processes with appropriate checks and balances that enable directors to discharge their legal responsibilities, and oversee compliance with legislation (King III Report 2009). King report on corporate governance has been issued three times King Report I in 1994, King Report II in 2002 and King Report III in 2009. To South Africa all companies listed in Johannesburg stock exchange are required to comply with all principles. King report has been cited as the best international practice in corporate governance (Banhegyi 2007). King believes that leaders should direct the company to achieve sustainable economic, social and environmental performance (King III report 2009).

2.2. Cooperative Financial Institutions (CFIs)

Cooperative financial institution means a society registered to render financial service (URT, 2003). It includes diverse member owned financial intermediaries which bear different name but in fact they are similar. CFI includes savings and credit cooperatives, credit unions, cooperative banks, and other that differ across regions of the world which member owned financial intermediaries. In Tanzania CFIs includes saving and credit cooperative society (SACCOS), financial cooperatives and cooperative bank. Their institutional structure and governance, legal and regulatory status, and scale and services portfolio also vary widely across regions and especially between developed countries and developing economies. A most basic common denominator is that they collect deposits and do business often solely with members. Most of CFIs serves poor people although middle-income people are also among their member (Cuevas and Fischer 2006).

2.3. Corporate Governance Challenges

Nair (2007) pointed out that SACCOs in developing countries are typically constrained by the lack of autonomy from government interference, outdated legal frameworks, and lack of an appropriate regulatory framework as well as poor supervisory capacity of the entity responsible for supervising them. Legal frameworks often prevent the adoption of better corporate governance practices. Regulatory frameworks often lack the prudential regulations that are critical for regulating financial institutions, and supervisory agencies often lack the skills and the financial resources to effectively supervise CFIs. According to Cuevas and Fischer (2006) governance challenges is reinforced by the fact that co-operatives have frequently faced weak external competition through subsidized financing from government which has also enabled inefficient managers to survive. If the competition were stiff weaker manager would have thrown away and strong manager gets in and therefore ensure good performance of cooperatives. The CGAP report (2005) also cited lack of adequate participation in decision-making by members as governance challenge facing credit unions in the developing world resulting in dominance of the co-operative by community elites who then use the funds to secure their own position. According to Staschan (2003) weak governance, transparency and management knowhow are widely known to affect many SACCOs as opposed to the relatively regulated institutions such as public companies. Shaw (2006) noted that good corporate governance practices for co-operatives were still insufficient in terms of their development and implementation, affirming that the few co-operative codes adopted so far have been modeled on the codes designed for investor-owned companies, only adding in further provisions concerning membership but not substantively modify them. Edger (1995), in his study 'Reinventing the cooperatives' concluded that the board needs to be fully aware of the most common reasons for business failure that they may readily spot signals of impending trouble and then take prompt corrective action. Directors should be able to identify the symptoms that normally precede such disastrous event so that the early warning signals may be spotted quickly and steps can be taken to avert such happening. The common reasons for financial cooperative failure given by the author include the following. Overtrading that is the desire to increase turnover at the expense of proper credit control, resulting in late payment and bad debts, Poor credit control that means the institutions need tough credit control procedures to be in place and regular checks with debtors is essential, uncontrolled capital expansion that is every new capital invested must be able to make financial contribution, Failure to control fixed cost especially those which are not directly associated with earning a return, Inaccurate or untimely management information, Long term fixed price contracts without renegotiation clause can result in cooperative facing heavy losses when their own cost increase and financial impropriety which can lead to disaster if there is no right kind of control in place.

2.4. Stakeholder Theory

The stakeholders' theory has been used by different researchers who have undertaken studies in corporate governance. A stakeholder is any group of individuals who can affect or is affected by the activities of the firm in achieving the objectives of the firm (Freeman 1984). The theory is also relevant to cooperative financial institutions because the stakeholders are also available in cooperatives. The stakeholders in cooperative financial institutions include severs, borrowers, suppliers, employees, indigenous people, government and non government organizations. The objectives of cooperative would be achieved through balancing the conflicting interests of these various stakeholders who will also help to reduce challenges in conforming to corporate governance (Ansoff 1965). Therefore an essential aspect of stakeholder theory is to identify the stakeholders an organization is responsible for. It can be seen that stakeholder theory is an extension of the agency viewpoint where responsibility of the board of directors is increased from shareholders to other stakeholders' interests (Smallman 2004). Therefore a narrow focus on shareholders has undergone a change and is expected to take into account a broader group of stakeholders such as those interest groups linked to social, environmental and ethical considerations (Donaldson and Preston 1995; Wicks and Parmar 2004). The stakeholder theory supports the implementation of corporate social responsibilities. Corporate governance practices are also viewed through corporate social responsibility which contribute good image to the business.

2.5. Empirical Literature Review

Cuevas and Fischer (2006) found that corporate governance challenges in developing countries are different from that of developed countries. They identified the following as main corporate governance challenges including extremely low levels of participation by members, lack of appropriate training and support for directors in the context of relatively low levels of literacy and related skills and conflict between members and their boards. They further argued that this has been fostered by long established practices of placing of government nominees on co-operative boards and related patterns of corruption. Their study was conducted in developing countries other than Tanzania. This study was conducted in Tanzania along with other objectives to examined challenges facing SACCOS in complying with corporate governance guidlines. The developing countries differ in terms of legal environment, political environment and cultural environment which may affect the extent of corporate governance. Patrick et,al (2014) in the study designed to examine corporate governance practices in cooperative financial institutions in Tanzania using crosss sectional survey , found that most of SACCOS visited were not full practicing corporate governance, although the extent of corporate governance practices were different among SACCOS. The autor managed to explore a range of corporate governance variables in cooperative financial institution but did not look at the challenges facing those institution in complying with corporate governance.

3. Methodology

This part addresses the way the study was carried out. It puts forward the design for the study, describing study population and sample size**,** data collection techniques and its analysis. Research design is general plan of how the researcher went about in answering the research questions (Saunders et al., 2009). The study employed cross sectional research design. Population of the study was 5,424 SACCOS which are total number of SACCOS in Tanzania (URT 2012). The sampling frame for this study was all SACCOS in Kilimanjaro region which were 220 where the choice of sample was made. Stratified sampling was used to obtain sample which includes urban and rural SACCOS from all seven districts. Stratified was used because the characteristics of urban and rural SACCOS differs. Sample size used by this study was sevent respondents. Both primary and secondary data were collected. Primary data were collected through questionnaires and interview and secondary through documentary review. Data were analyzed using Statistical package for social sciences specifically descriptive statistics.

4. The Result of the Study

This part presents the findings, analyses and discusses the findings basing on the objectives of the study.

4.1. Challenges Facing Cooperative Financial Institution in Complying with Corporate Governance Practices

The objective was examining the challenges facing cooperative financial institution in complying with corporate governance practices. Respondents were supposed to show their attitude on different factors including fraud, low members participation, government and political interference and insufficient board members knowledge and skills needed to make business judgments.

4.2. Low Member's Participation

Respondents were asked to offer their opinion whether low members participation hinder SACCOS to comply with corporate governance practices. The study findings in Table 1 below indicate their responses:

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly Disagree	2	3.1	3.1	3.1
Disagree	4	6.2	6.2	9.2
Neutral	6	9.2	9.2	18.5
Agree	6	9.2	9.2	27.7
Strongly Agree	47	72.3	72.3	100.0
Total	65	100.0	100.0	

Table 1: Low member participation
Source: Field data, (2014).

The study findings in Table 1 above shows that, 3.1%% of the respondents strongly disagreed, 6.2% of the respondent disagreed, 9.2% of the respondents were neutral, 9.2% of the respondent agreed and 72.3% strongly agreed that low members participation hinder SACCOS to comply with corporate governance. Cooperatives organization structure has left more power to member therefore participation of members is of great important. The findings regarding low participation of members influence poor corporate governance was as follows; 81% of the respondents accept that factor, indicating that most of cooperative members do not know their right that they are final decision maker in any cooperatives undertaking otherwise they would have been participating. Low level of member participation gives the room for managers to become more powerful since there is no internal pressure from members. The findings concur (Spear, 2004) who argued that the co-operative systems of governance contribute to the development of powerful and unshakable managers who have more control than in similar private-sector companies. He further argued that pressure on managers is weak because of low levels of member participation (Spear 2004). Respondents declared that many members are not self motivated to attend meeting and those who attend do not actively participate. The finding implies that cooperative members need to be educated that their participation is of great important. In cooperative settings it is members who accept or reject any request brought by the board. It is members who elect board and be elected as board member. Therefore if members do not participate will result to weak policies passed without be questioned and also weak board members to be elected.

4.3. Insufficient Board Members Knowledge and Skills Needed to Make Business Judgments

Respondents were asked to offer their opinion whether insufficient board members knowledge and skills needed to make business judgments hinder SACCOS to comply with corporate governance practices. The study findings in Table 2 below indicate their responses:

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly Disagree	1	1.5	1.5	1.5
Disagree	1	1.5	1.5	3.1
Neutral	6	9.2	9.2	12.3
Agree	33	50.8	50.8	63.1
Strongly Agree	24	36.9	36.9	100.0
Total	65	100.0	100.0	

Table 2: Insufficient board member qualification or skills and knowledge needed to make business judgments
Source: Field data, (2014)

The study findings in Table 2 above shows that, 1.5% of the respondents strongly disagreed, 1.5% of the respondent disagreed, 9.2% of the respondents were neutral, 50.8% of the respondent agreed and 36.9% strongly agreed that insufficient board members knowledge and skills needed to make business judgments hinder SACCOS to comply with corporate governance. Overall, 88% of the respondents at least agreed that lack of business knowledge affects corporate governance in cooperative financial institutions. Cooperative board is very important organ in management of cooperative because it is there to protect interests of members. The board has duties to define mission, vision, strategic objective and policies of cooperative and ensures plan conforms to them, appoints, appraises, and disciplines management. Review and approve business plan and budget before presenting to AGM, and supervises management in execution of approved plans. The board whose members lack business management skills and knowledge can not undertake such duties and responsibilities effectively and efficiently. The findings implies that there is need for cooperative to elect members with relevant skills if available or be read to train elected members to acquire business management skills.

4.4. Government and Political Interference in SACCOS Decision Making

Respondents were asked whether the government and political interference in their decisions had effects on effort corporate governance. Table 3 below provides responses:

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly Disagree	4	6.2	6.2	6.2
Disagree	12	18.5	18.5	24.6
Neutral	15	23.1	23.1	47.7
Agree	26	40.0	40.0	87.7
Strongly Agree	8	12.3	12.3	100.0
Total	65	100.0	100.0	

Table 3: Government interference in SACCOS decision making
Source: Field data, (2014)

The study findings in Table 3 above shows that, 6.2% of the respondents strongly disagreed, 18.5% of the respondent disagreed, 23.1% of the respondents were neutral, 40% of the respondent agreed and 12.3% strongly agreed that government and political interference had effect on the corporate governance in cooperative financial institutions. 52.3% of the respondents at least accept that government and political interference affect the corporate governance. Government influences SACCOS to make the decision which otherwise would not have make. This implies that SACCOS member need to be careful since some members contest for board membership or establish new SACCOS for their political interest. The finding of this study concurs with (Nair, 2007) findings that SACCOS in developing countries are typically constrained by the lack of autonomy from government interference.

4.5. Fraud

Respondents were asked to offer their opinion whether fraud affect the efforts to comply with corporate governance practices. The study findings in Table 4 below indicate their responses:

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly Disagree	1	1.5	1.5	1.5
Disagree	4	6.2	6.2	7.7
Neutral	6	9.2	9.2	16.9
Agree	20	30.8	30.8	47.7
Strongly Agree	34	52.3	52.3	100.0
Total	65	100.0	100.0	

Table 4: Frauds
Source: Field data, (2014)

Table 4 above reveals that, 1.5% of the respondents strongly disagreed, 6.2% of the respondent disagreed, 9.2% of the respondents were neutral, 30.8% of the respondent agreed and 52.3% strongly agreed that fraud affect the SACCOS effort to comply with good corporate governance. Overall 83% at least agreed and 8% at least disagreed. The results indicate that frauds were common in cooperative financial institutions. Most of the respondent interviewed by the researcher admit at least once in the life time of SACCOS fraud practice has been reported. Respondents further explained that the common fraud practice was collusion between board members and management of SACCOS to misappropriate SACCOS' funds. The finding implies that sustainability of performance of SACCOS is questionable if members will not be careful to elect faithful board members.

4.6. Weak Internal Controls System

Respondents were asked to offer their opinion whether weak internal control system influence poor corporate governance practices in SACCOS. The study findings in Table 5 below indicate their responses:

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly Disagree	5	7.7	7.7	7.7
Disagree	21	32.3	32.3	40
Neutral	3	4.6	4.6	44.6
Agree	26	40	40	84.6
Strongly Agree	10	15.4	15.4	100
Total	65	100	100	

Table 5: Weak internal control system
Source: Field data, (2014)

Table 5 portrays that, 7.7% of the respondents strongly disagreed, 32.2% of the respondent disagreed, 4.6% of the respondents were neutral, 40% of the respondent agreed and 15.4% strongly agreed that weak internal control influence poor corporate governance practices. In cooperative financial institutions specifically SACCOS supervisory committees are entrusted to ensure that internal control is working properly thus they work as internal auditors. Overall 55.4% at least disagreed and 40% at least agreed that supervisory committee ensure that the cooperative operating policies and procedures and expenditure control are followed. It implies that almost half of SACCOS operates without strict internal control therefore compliance with rules, regulation and procedures remains on the wishes of the management because of the weaknesses in internal control systems. This could be one among the reasons for failure of SACCOS.

4.7. Lack of Accountability
Respondents were asked to offer their opinion whether lack of accountability affect the efforts to comply with corporate governance practices. The study findings in Table 6 below indicate their responses:

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly Disagree	1	1.5	1.5	1.5
Disagree	4	6.2	6.2	7.7
Neutral	6	9.2	9.2	16.9
Agree	20	30.8	30.8	47.7
Strongly Agree	34	52.3	52.3	100.0
Total	65	100.0	100.0	

Table 6: Lack of accountability
Source: Field data, (2014)

Table 6 above reveals that, 1.5% of the respondents strongly disagreed, 6.2% of the respondent disagreed, 9.2% of the respondents were neutral, 30.8% of the respondent agreed and 52.3% strongly agreed that lack of accountability affect the SACCOS effort to comply with good corporate governance. Overall 83% at least agreed and 8% at least disagreed. The results indicate that the extent to which management is held responsible for their action by the board and the extent to which the board is held responsible by the members are questionable. This has been contributed by the dominant power the management have over the board. The dominant power is influenced by the expertise knowledge the management have over the board. That is why there is a need to empower the board members and members of SACCOS through training so that they can undertake their responsibility effectively.

5. Conclusions and Recommendations

5.1. Conclusion
The study depicted that challenges facing cooperative financial institutions in their effort to comply with corporate governance include fraud, where unethical board member and management who deliberately manipulate procedures to fulfill their personal interest. Low level of member's participation in cooperative activities also affects corporate governance since they are the ultimate decision makers in cooperative structure. It was observed that lack of understanding by member regarding the philosophy of cooperative contributed to low participation. Insufficient board members knowledge and skills needed to make business judgments and political and government interference to SACCOS also contribute.

5.2. Recommendations
Based on presented findings, implications, discussions and conclusions, several issues would need to be addressed in order to improve corporate governance in cooperative financial institutions. The following recommendations are among the issues that can be addressed to improve corporate governance in cooperative financial institutions in Tanzania.

i. In order to improve the competence of board members in managing SACCOS, there should be commitment to improve capacity of board members. SACCOS should regularly organize business management skills training for the board members especially to new elected board members. This improves the level of supervision and monitoring within the SACCOS. Some SACCOS had been found to have relevant policies and procedures in place but these policies and procedures were hardly followed or not strictly observed because of the lack of monitoring caused by incompetence of the board members. Incompetence leads to several inefficiencies in the running of the SACCO.

ii. Low members' involvement or participation seems to be influenced by the little understanding of members regarding cooperative operations. SACCOS should regularly provide training to its members to enhance their understanding of SACCOS' activities. In cooperative structure members participation is very important since they are ultimate in decision making.

iii. Deliberate misappropriation of fund had been regular practice in SACCOS. This has been influenced by the insufficient punishment offered to those people caught offensive. The existing cooperative laws also have been little strict on fraud incidences which influence repetitions. It is recommended that cooperative laws should be revised to stipulate heavy punishment for any fraud practice discovered also member can reduce fraud through ensuring that only ethical and moral people are elected to be members of the board

iv. In many SACCOS' internal control seems to be weak which influence embezzlement of members fund. Supervisory committees are needed to ensure that the cooperative operating policies and procedures and expenditure control are followed but the problem arise when the committee rarely meet and they don't know their duties and responsibilities. There is need for SACCOS to employ a person with accounting knowledge that will be responsible for internal control.

v. There is need for the government to establish clear corporate governance guidelines for SACCOS and ensures their implementation. Implementation of the guidelines can be well enforced through establishing SACCOS' regulatory authority.

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