THE INTERNATIONAL JOURNAL OF BUSINESS & MANAGEMENT

Factors Affecting the Financial Performance of Saccos in Kenya: A Case of Selected Sacco's

Stephen Muatha Maingi
Student, Master of Science, Department of Finance
Jomo Kenyatta University College of Agriculture and Technology
Kenya School of Monetary Studies, Kenya

Abstract:
The objective of this study was to provide an understanding of the factors affecting the financial performance of Sacco's in Kenya to bridge the knowledge gap that exists. The results indicated that there was a strong correlation between dividend policy and financial performance, while a correlation between increased surplus and performance showed that there was a strong negative correlation. Similarly a correlation between loan portfolio and performance showed that there was a weak positive correlation. The adjusted R^2 is 41% and the value of F statistics observed is 3.789 which are higher than critical value of F- distribution of 1.92 and hence the model is good. It was also concluded that of the three factors that affect the financial performance of Sacco's, dividend policy has the highest impact with a strong positive correlation of 0.697 while loan portfolio and increased surplus had correlations of 0.209 and -0.055 respectively.

Keywords*; Co-orporation, Dividends, Liquidity, Shareholder, Production*

1. Introduction

Agarwal and Mohtadi (2004) noted that the basis for a self sufficient or balanced financial position in Sacco's comes as a result of the simultaneous presence of savers and the borrowers of funds. However, the conflicts of interest are inherent in this balance as borrowers want low loan interest rates, low transaction costs and lax discipline while savers demand high deposit interest rates and strong prudential disciplines because savers have strong incentives to see the institutional viability strengthened by profitability yet the borrowers' short term incentives favour conditions like lax discipline, low loan rates, easy access to loans which adversely affect the financial stability of the credit union.

Amedeo, Espenlaub, Khurshed and Simkovic (2010*)* observed that some cooperatives in Kenya were finding it difficult to operate largely because of their poor financial state. According to Agarwal and Mohtadi (2004), profitability is not the primary concern for credit unions. It stated that credit unions sought to generate profits in order to directly benefit the owners as they (members) serve as both the owners of the credit union and the recipients of the cooperative services.

Ashton (1991) pointed out that low profitability in SACCOs was not only due to governance issues but also to poor costing in order to make the loans attractive to the members; partly due to lack of know how or relatively high operating costs. According to the IMF Report (2001), most SACCOs in Uganda had large loan portfolios in arrears, with overdue loan repayments stretching back into the distant past mainly because lending policies were usually poorly enforced and systems to track and manage arrears hardly existed. Many if not all SACCOs had experienced considerable difficulties in realizing collateral for loans.

Beck, Demirgu and Kunt, (2006) maintained that the loan evaluation system and ability of members to repay within a specified timeframe had not always been considered sufficiently in the loan application process and that the cooperative model of finance relied to a certain extent on the common bonds shared by members, which fostered a trust between members. The AMFIU report (2007) indicated that there had been problems of over indebtedness as well as poor management of the loan portfolio. Loan application appraisals and subsequent monitoring by SACCO were all poor leading to high default rates.

Brigham and Ehrhardt (2001) highlighted political interference as a possible threat to the quality of the loan portfolio pointing out that whereas politicians were very crucial at the mobilization and starting stages of the SACCOs, some were frustrating the program as they take loans from these SACCOs with the intention of not paying back.

1.1. Statement of the Problem

The savings and credit co-operative societies have been facing many problems and weaknesses; indeed, the sector has been inadequately prepared and ill equipped to effectively deal with the Sacco's problems like insufficient capital base, lack of or slow rate of Information Technology (IT) adoption, and inefficient loan pricing strategies among others (Munge, 2005).

With such challenges, the dividend policy of major Sacco's may be put into question, especially with low and middle income earners in developing countries where the average citizen live on less than a dollar a day. Equally, the rate of getting dividends

are generally lower than those in developed countries, therefore, better dividends policy should usually be a priority for Sacco's in developing countries (Mwangi, 2008).
Despite Sacco's effort to strengthen the dividend policy mechanisms, the services currently available to assist the customers are not adequate. Unless the level of the sector capacity and cooperation in the development of Sacco plan(s) and appropriate implementation action(s) improves, they will soon be unable to sustain their operations causing them to go against the principle of providing quality services. Member's contributions are a direct income to the Saccos and without adequate finances and facilities to recapitalize the income; Saccos will suffer the consequences (KUSCCO, 2000).
With the savings and credit co-operatives increasingly becoming an important tool in economic development, the instability and inadequacy of services provided by them may compromise the quality of life and life span of average income groups in Kenya. This in the long run will affect the country's income generation potential and the overall economic growth. This growth can only be realized when there is sufficient number of well trained co-operative officers, technical staff, professional and management manpower. Therefore the study will explore ways of addressing dividend policy disparity to members so as to maintain sustainability of savings and credit co-operatives with or without government support (Mwangi, 2008).
Consequently, it can therefore be argued that a good dividend policy, loan portfolio and increased surplus have a role to play in ensuring the efficient financial performance of Sacco's. Very little or no study has been done to evaluate the relationship between the factors affecting the financial performance of Sacco's in Kenya hence creating a research gap.

2.Materials and Methods

2.1. Conceptual framework

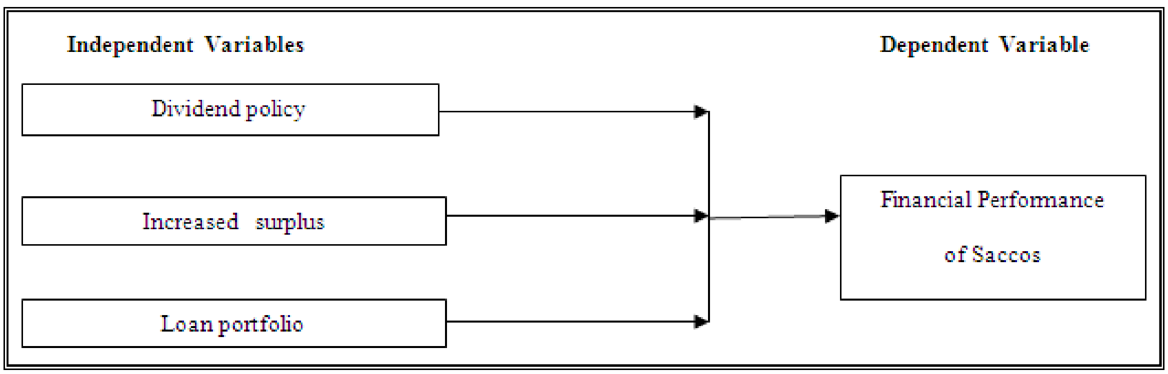

Figure 1
Source: Author (2013)

2.2. Dividend Policy

A policy of paying a low regular dividend plus a year-end extra in good years is a compromise between a stable dividend and a constant payout rate. Such a policy gives the firm flexibility, yet investors can count on receiving at least a minimum dividend. Therefore, it is supplemental dividend paid in good years and excess funds are available for distribution. Payment of dividend at usual rate is termed as regular dividend.
Stable dividend policy refers to payment of a specific amount of dividend each year or periodically increasing the dividends at a constant rate. In such a policy the annual dividend is relatively predicable by investors. The stability of dividend means consistency in the stream of dividend payments. It means payment of certain minimum amount of dividend regularly.
When the firm does not pay out fixed dividend regularly, it is irregular dividend policy. It changes from year to year according to changes in earnings level.
Residual dividend policy is one where the dividend paid is set equal to the actual earnings as reduced by the amount of retained earnings necessary to finance the firm's optimal capital budget. The basis of the policy is that the investors prefer to have the firm retain and reinvest earnings rather than paying them as dividends.

2.3. Increased Surplus

When employees like to do what they are assigned, they are completely involved in their job to perform their best and bring desired results. The survey conducted by Hay Group, a global management consulting firm, revealed that engaged workforce are 40 percent more productive than those who are not engaged. When engagement level among employees increases, it increases their productivity which in turn, improves the financial standing of the organization.
Increased surplus is believed to be a strong factor that affects the financial performance of Saccos in Kenya.

2.4. Loan Portfolio

Effective management of the loan portfolio and the credit function is fundamental to a Sacco's safety and soundness. Loan portfolio management (LPM) is the process by which risks that are inherent in the credit process are managed and controlled. Because review of the LPM process is so important, it is a primary supervisory activity. Assessing LPM involves evaluating the steps management takes to identify and control risk throughout the loan process. The assessment focuses on what management does to identify issues before they become problems (Munge 2005).

2.5. Research Design

The study employed descriptive research design for it portrayed an accurate profile of situations (Kibera 2006). This was designed to describe the characteristics of a particular phenomenon in a situation. It was used to obtain information concerning the current status of the industry and to survey what exists with respect to the conditions in a situation. The design helped the researcher to obtain information concerning the current status of the dividends policy being used by the sector, increased surplus and loan portfolio and thus relate them to the objectives of the research and therefore make them relevant to the research question as well as getting the correlation between financial performance and alternative dividend policy, increased surplus and loan portfolio (Saunders 2009).

2.6. Population

The study focused on 5 Sacco's in Nairobi County. The researcher focused on Sacco's which are well established in terms of equipment, capital base, national coverage and skilled human resources. These were important as they can justify the financial performance of the Sacco's. The study specifically focused on those Sacco's under the Kenya union of savings and credit co-operatives (KUSCCO). Since the study was a survey of five major Sacco's within Nairobi County, stratified sampling was used for the study. The researcher focused on five Sacco's which are well established in terms of capital base (Harambee Sacco), national coverage(Mwalimu Sacco), professionalism(Mhasibu Sacco), agriculture(Ukulima Sacco) and Government sector .(Wanaanga Sacco).

2.7. Research Instruments and Data Collection Methods

The study used Secondary data (financial statements) that had been collected and was readily available from other sources. With the help of secondary data, the researcher was able to address the research gaps. Secondary data is cheaper and more quickly obtainable than the primary data (Saunders, 2009). The researcher sought a letter of introduction from Jomo Kenyatta University of Agriculture and Technology to be presented to the selected Sacco's in Nairobi County. This helped the researcher to gather information more easily. Further, available information especially on financial performance was collected to form the basis of secondary data.

2.8. Data Processing and Analysis

The data was analyzed using qualitative and quantitative techniques. Qualitative method involved content analysis and evaluation of text material. Quantitative method involved the use of statistical tools of descriptive analysis such as Statistical package for social sciences (SPSS).

2.9. Measurement Model

The external environment (X) is the independent variable(s) and Y is Sacco's financial performance which is the dependent variable. The functional relationship was shown by using the multiple regression equation which takes the form:

$Y = ß_0 + ß_1 D + ß_2 I + ß_3 L$

Where:

- Y = Sacco's performance
- D = Dividends Policy
- I = Increased Surplus
- L = Loan portfolio

Two methods of data analysis were applied in this study. One method was correlation models specifically Pearson correlation to measure the degree of association between different variables under consideration. The other method was multiple regression analysis that estimates the causal relationships between stock beta and other chosen variables. Pearson correlation analysis was used for data analysis to see the relationship between variables such as dividends policy, increased surplus and loan portfolio.

2.10. Ethical Issues

The researcher observed some ethical issues and made sure that financial information obtained from the Cooperative Societies was kept confidential.The researcher also made sure the information was solely used for the research project and was not put to any other use at all.

3. Results

The results indicated that correlation between dividend policy and financial performance showed that there was a strong positive correlation, while a correlation between increased surplus and financial performance showed that there was a strong negative correlation. Similarly a correlation between loan portfolio and performance show that there was a weak positive correlation and is significant at a= 5% and implies that an increase or decrease in independent variables would not significantly affect the beta of the firm. The increase in dividends has a positive impact on the beta. The adjusted R^2 is 41% and the value of F statistics observed is 3.789 which are higher than critical value of F- distribution of 1.92 which means that the model is good.

Secondary data obtained shows that there is a significant negative variance between dividend policy and performance of selected Saccos and there is a projected constant increase in customer base which means that the dividend policy would continue to grow as customers population grows.
The results also show that selected Sacco's still faces a lot of challenges in the management of dividends and its relationship with financial performance. The finding showed that the selected Sacco's still rely heavily on dividend policy for its financial performance and therefore needs to expand their sources of funds beyond the share contributions. Although there are loans for Sacco's operations, the study showed that the surplus was still low and therefore the loans portfolio is still underutilized.

4. Discussion

The findings showed that there was a weak positive correlation of 0.209 between loan portfolio and financial performance. Effective loan portfolio management begins with oversight of the risk in individual loans. Prudent risk selection is vital to maintaining favourable loan quality. Therefore, the historical emphasis on controlling the quality of individual loan approvals and managing the performance of loans is essential.
A correlation between dividend policy and financial performance showed that there was a strong positive correlation of 0.697. The regular dividend can be maintained only by the company of long standing and stable earnings. A company should establish the regular dividend at a lower rate as compared to average earnings of the company
A correlation between increased surplus and performance shows that there was a strong negative correlation of -0.055. The need satisfaction increases when the quality price ratio of the commodities improves and more satisfaction is achieved at less cost. When engagement level among employees increases, it increases the surplus which in turn improves the financial performance of the organization. Although the financial performance is not directly related to the employee engagement levels but it is believed to be a major contributor.

5. Conclusion

Because of the increase in demand for dividends from the increasing number of customers, there is need for the selected Sacco's to actively open up new avenues for funding its activities.
Regular dividend policy is maintained by Sacco's of long standing and stable earnings. Residual dividend policy is used by Sacco's which finance new projects through equity that is internally generated thus affecting Sacco's performance.
It was concluded that lending is the principal business activity for most credit institutions. The loan portfolio is typically the largest asset and the predominate source of revenue.Loan portfolio is also the greatest source of risk to a Saccos's financial safety and soundness and that it should be well controlled and managed.
It was also concluded that of all the three factors ;dividend policy, increased surplus and loan portfolio that affect the financial performance of Sacco's , dividend policy has the greatest impact and therefore more emphasis should placed on it in gauging the financial performance of Saccos.

6. References

1. Agarwal S. & Mohtadi H. (2004). Financial markets and the financing choice of firms. Evidence from developing countries. Global Fin J 15(1)
2. Amedeo De Cesari, Susanne Espenlaub, Arif Khurshed & Michael Simkovic. (2010) The effects of Ownership and Stock Liquidity on the Timing of Repurchase Transactions. Prentice hall
3. Anderson W,. (2009). Alternative Event Study Methodology for Detecting Dividend Signals in the context of Joint Dividend and Earnings Announcements. Acc and Fin: 49.
4. Ashton, D.J, (1991) "Corporate financial policy: American analytics and UK taxation," journal of Business Finance and Accounting, 18.
5. Beck T., & Demirgu. c-Kunt, (2006). Small and medium-size enterprises. Access to finance as a growth constraint. Journal Banking and Fin: 30(11).
6. Browers, J. and J. wood, (1992) International portfolio investment with dividend imputation Taxes Australian Graduate School of Management.
7. Butt B Z, Hunjra AI & Rehman KU (2010). Financial Management Practices and their Impact on Organization Performance. World App Science J: 9 (9).
8. Carol Taylor Fitz-Gibbon (1990), "Performance indicators", BERA Dialogues (2) Cliffe, C. and A. Marsden, (1992) The effect of dividend imputation on company financing decisions and cost of capital in New Zealand, Pacific Accounting Review, 4.
9. Hanson, D. and P. Ziegler, (1990) The impact of dividend imputation on firms' financial decisions, Accounting and Finance, 30.
10. Howard, P.F. and R.L. Brown, (1992) Dividend policy and capital structure under the imputation tax system: some clarifying comments, Accounting and Finance, 32.
11. Fama, E.F.; French, K.R. (2001). Disappearing Dividends: Changing Firm Characteristics or Lower Propensity to Pay. Journal of Financial Economics 60
12. Gustavo Grullon, Roni Michaely and Bhaskaran Swaminathan (2002) Dividend Changes a Sign of Firm Maturity? The Journal of Business Vol. 75, No. 3.
13. Julio, B. and D. Ikenberry, (2005), Reappearing dividends, Journal of Applied Corporate Finance.

14. KUSCCO, (2000). SACCO star No. 27. Nairobi
15. Michael Simkovic, (2009) the Effect of Enhanced Disclosure on Open Market Stock Repurchases, 6 Berkeley Bus. L.J.
16. Miller, R.W. and F. Modigliani, (1958) Dividend policy, growth, and the valuation of shares, Journal of Business, 34.
17. Munge (2005) conducted a study on the influence of dividend policy in dairy industry, Unpublished MBA Research project.
18. Mwangi (2008) carried a study on factors affecting dividend practices in coffee industry Unpublished MBA Research project.
19. Saunders, Lewis and Thornhill (2009) Research methods for business students, 5th edition, prentice hall.
20. Shleifer A, and R. Vishny, (2000), Agency Problems and Dividend Policies around the world,Journal of Finance 55.
21. Sullivan, Arthur, Steven M. Sheffrin (2003). Economics. Principles in action. Upper Saddle River, New Jersey 07458: Pearson Prentice Hall.
22. Titman S (2002). The Modigliani and Miller Theorem and the Integration of Financial Markets. Financial. Management. 31