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Extent of adoption of corporate governance principles by Deposit- Taking SACCOs in Kenya and the effect on financial performance.

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**Extent of Adoption of Corporate Governance Principles by Deposit- Taking Saccos in  
Kenya and the Effect on Financial Performance**

**Linda Chelangat Yegon**

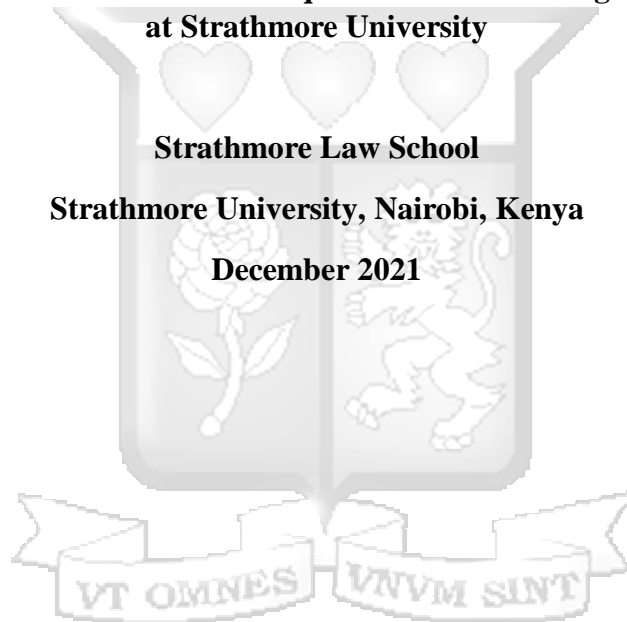
**Reg. No. 111181**

**Submitted in Partial Fulfillment of the Requirements for the Degree of Master of Laws  
at Strathmore University**

**Strathmore Law School**

**Strathmore University, Nairobi, Kenya**

**December 2021**



**Declaration**

I declare that this is my original work and has not been presented in any other University or institution of higher learning for examination/academic purposes.

Linda Chelangat Yegon

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Date: .....

**Approval**

The thesis of **Linda Chelangat Yegon** was reviewed and approved by the following:

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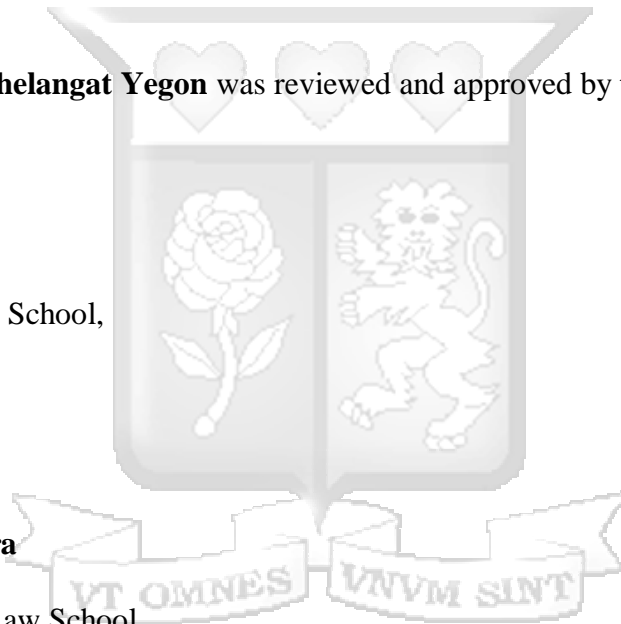
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## **Abstract**

This research sought to determine extent of adoption of corporate governance principles by deposit-taking Savings and Credit Cooperative Societies in Kenya, and the effect on financial performance. Reference was made to the corporate governance principles of accountability, disclosure and transparency, and risk management as envisaged by the Organisation for Economic Co-operation and Development (OECD), and their incorporation into the legal and regulatory framework governing deposit-taking SACCOs in Kenya. The general objective of the study was to establish the correlation between extent of adoption of corporate governance principles and the financial performance of deposit-taking SACCOs in Kenya, and to identify weaknesses in the legal and regulatory framework, as well as to examine the impact of corporate culture of DT-SACCOs on their financial performance.

The thesis considered the background of corporate governance and its development to combat governance shortcomings that saw financial institutions with systemic significance collapse, causing disruption globally. Considering the rise of deposit-taking SACCOs in Kenya, and their significance in the Kenyan financial eco-system, the research examined the incorporation of corporate governance principles in the legal and regulatory framework governing SACCOs as well as in the internal systems of the SACCOs, and the resultant effect it has had in the financial performance of deposit-taking SACCOs in Kenya.

Desk-based research methodology was adopted, relying on primary data and secondary sources. The research also considered the stewardship and stakeholder theories of corporate governance.

This research found that there indeed is a correlation between the financial performance of DT-SACCOs in Kenya and the extent to which they have adopted the corporate governance principles of accountability, disclosure and transparency, and risk management. The recommendation of the research was to strengthen the legal and regulatory framework governing DT-SACCOs in Kenya, specifically regarding corporate governance principles. It was also recommended by this research that boards of directors of DT-SACCOs strengthen the corporate culture of their organizations so as to enhance compliance to corporate governance requirements in order to achieve sustained financial performance.

## Table of Contents

Declaration .....	ii
Abstract .....	iii
Table of Contents .....	iv
List of Acronyms .....	vii
List of Statues and Legal Instruments .....	viii
Acknowledgment .....	ix
Dedication .....	x
<b>CHAPTER ONE: INTRODUCTION</b> .....	<b>1</b>
1.1. Background .....	1
1.2. Deposit-taking SACCOs (DT-SACCOs) in Kenya and their significance .....	3
1.3. Corporate Governance and the Organisation for Economic Co-operation and Development (OECD).....	8
1.4. Problem Statement.....	8
1.5. Research Objectives .....	9
1.6. Research Questions .....	10
1.7. Hypothesis .....	10
1.8. Significance of the Study .....	11
1.9. Research Methodology .....	12
1.10. Literature Review .....	12
1.11. Limitations of the Study .....	17
1.12. Chapter Breakdown.....	17
<b>CHAPTER TWO: THEORETICAL FRAMEWORK AND THE DEVELOPMENT OF CORPORATE GOVERNANCE</b> .....	<b>18</b>
2.1. Introduction .....	18
2.2. The Concept of Corporate Governance.....	19
2.3. Concept of financial performance .....	20
2.3. Stakeholder theory and corporate governance .....	21
2.4. Stewardship theory and corporate governance.....	21
2.5. History of Corporate Governance .....	23

2.6.	Corporate scandals and the evolution of corporate governance .....	27
2.7.	Corporate Governance and Financial Institutions .....	29
2.8.	Development of Corporate Governance in Africa .....	29
2.9.	Corporate Governance in Kenya .....	30
2.10.	OECD Principles of Corporate Governance .....	31
2.10.1.	The principle of accountability .....	32
2.10.2.	The principle of disclosure and transparency .....	33
2.10.3.	The principle of risk management .....	35
2.11.	Corporate Culture .....	36
2.12.	Conclusion .....	38
<b>CHAPTER THREE: CORPORATE GOVERNANCE AND THE LEGAL AND REGULATORY FRAMEWORK GOVERNING DT-SACCOS IN KENYA.....</b>		<b>39</b>
3.1.	Introduction .....	39
3.2.	Regulation of DT-SACCOS .....	39
3.3.	Incorporation of corporate governance principles in the legal and regulatory framework governing DT-SACCOS in Kenya .....	43
3.3.1.	The principle of accountability .....	46
3.3.2.	The principle of disclosure and transparency .....	47
3.3.3.	The principle of risk management .....	48
3.4.	Corporate Culture in DT-SACCOS .....	50
3.5.	Conclusion .....	51
<b>CHAPTER FOUR: EXTENT OF ADOPTION OF CORPORATE GOVERNANCE PRINCIPLES BY DT-SACCOS IN KENYA.....</b>		<b>53</b>
4.1.	Introduction .....	53
4.2.	Adoption of corporate governance principles in the SASRA regulations, and effect on financial performance of DT-SACCOS in Kenya .....	54
4.2.1.	Adoption of the principle of accountability .....	56
4.2.2.	Adoption of the principle of disclosure and transparency .....	58
4.2.3.	Adoption of the principle of risk management .....	61
4.3.	Significance of corporate culture in DT-SACCOS .....	64
4.4.	Conclusion .....	67
<b>CHAPTER FIVE: CONCLUSION AND RECOMMENDATIONS.....</b>		<b>68</b>
5.1.	Introduction .....	68
5.2.	Conclusion on corporate governance and financial performance .....	68
5.3.	Extent of adoption of the SASRA guidelines on corporate governance principles, and the influence of corporate culture .....	70

5.4. Recommendations ..... 70

5.5. Conclusion ..... 75

BIBLIOGRAPHY ..... 76

APPENDICES ..... 89

Appendix A- SU-IERC Ethical Approval Report ..... 89

Appendix B- Plagiarism report ..... 90



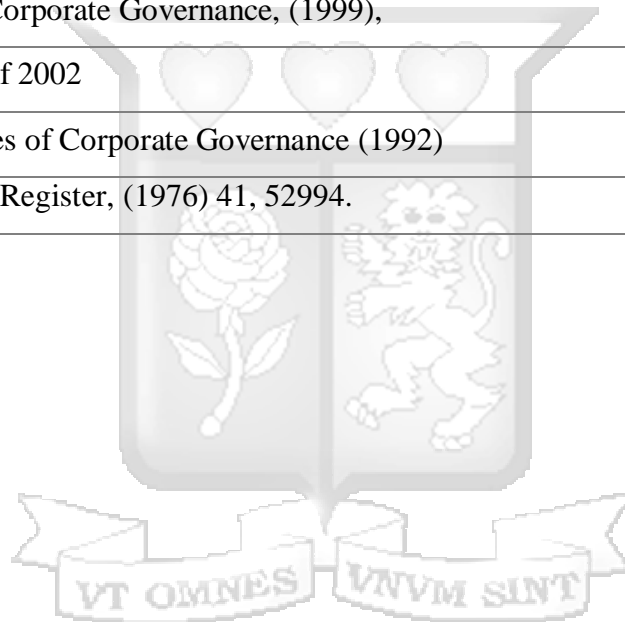
## List of Acronyms

Acronym	Definition
BOD	Board of Directors
DT-SACCO	Deposit-taking SACCO
KCC	Kenya Cooperative Creameries
OECD	Organisation for Economic Co-operation and Development
SACCOs	Savings and Credit Cooperative Organisations
SASRA	SACCO Societies Regulatory Authority



## List of Statues and Legal Instruments

<b>i. Kenyan legislations and policies</b>
Constitution of Kenya (2010)
Co-operative Societies Act of Kenya ( Act No. 2 of 2004)
SACCO Societies Act (Act No. 14 of 2008)
SASRA Guidelines on Good Corporate Governance Practices
The Banking ( Amendment) Act, ( Act No. 25 of 2016)
<b>ii. Non-Kenyan Legislations</b>
Kings Commission Reports in South Africa (1992).
OECD Principles of Corporate Governance, (1999),
Sarbanes-Oxley Act of 2002
UK Cadbury Principles of Corporate Governance (1992)
United States Federal Register, (1976) 41, 52994.



## **Acknowledgment**

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I am very grateful to my supervisor, Dr. Peter Kwenjera, for his invaluable guidance during the process of writing my thesis. I am also thankful to my friends, my classmates, and the Strathmore Law School administration.



## Dedication

This thesis is dedicated to God and to my family.



## CHAPTER ONE: INTRODUCTION

### 1.1. Background

Savings and Credit Cooperative Organisations (SACCOs) are organizations that provide members with savings and credit facilities. SACCOs are founded on voluntary membership and are run and managed by their members. The surplus generated from activities is shared as dividends amongst members. SACCOs are basically for members, by members. SACCOs originated from South Germany in the mid-1800s<sup>1</sup> to mitigate the agricultural crisis in Germany, where farmers in rural areas were threatened by takeovers because of shortage of capital. SACCOs were formed to raise capital and provide loans to farmers.

In Kenya, cooperatives were formed by the white settlers in the early 1900s.<sup>2</sup> Membership was however restricted to Europeans only, until the 1950s, when Africans were allowed to form and be part of cooperatives.<sup>3</sup> The first registered cooperatives were the Kenya Cooperative Creameries and the Kenya Farmers Association. The legislation regulating the cooperatives at that time was the Cooperative Societies Ordinance, which was enacted in 1931. By the time Kenya attained independence, the country had about 1000 registered cooperatives.<sup>4</sup> Notable cooperatives in the 1960s and the 1970s include the Kenya National Federation of Co-operatives, which is now the Co-operative Alliance of Kenya Limited, the Cooperative Bank of Kenya, registered in 1968, the Cooperative Insurance Company (CIC), which was registered in 1978, along with the National Cooperative Housing Union (NACHU).<sup>5</sup> The Kenya Union of Savings and Credit Cooperatives (KUSCCO) was also among the notable cooperatives registered in the 70s.<sup>6</sup>

Initially, the main objective of cooperatives in Kenya was to get likeminded people together to form a membership that would facilitate them doing business together in order to place them

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<sup>1</sup> Ajai Nair/Renate Kloppinger TAN, "Reaching rural areas with financial services: lessons from financial cooperatives in Brazil, Burkina Faso, Kenya, and Sri Lanka" Agriculture and Rural Development Discussion Paper 35 (2007).

<sup>2</sup> Republic of Kenya, Ministry of Industrialization and Enterprise Development, *History and organization of cooperative development and marketing sub sector in Kenya*, 14 January 2014.

<sup>3</sup> Otieno S, 'The role of cooperatives in social and economic development of Kenya and actions required to accelerate growth and development of the sector in Africa' Co-operative Alliance of Kenya Limited, 2019, 3.

<sup>4</sup> Otieno S, 'The role of cooperatives in social and economic development of Kenya and actions required to accelerate growth and development of the sector in Africa', 3.

<sup>5</sup> Otieno S, 'The role of cooperatives in social and economic development of Kenya and actions required to accelerate growth and development of the sector in Africa', 3.

<sup>6</sup> Otieno S, 'The role of cooperatives in social and economic development of Kenya and actions required to accelerate growth and development of the sector in Africa', 3.

at an advantage by enabling them to increase levels of production and save on costs.<sup>7</sup> Furthermore, through these cooperatives, members sought to have their economic, cultural, and social needs enhanced for the advancement and strengthening of the local communities within which the cooperatives operated.<sup>8</sup> Cooperatives also encouraged and instilled a savings culture and facilitated investment activities amongst the members.<sup>9</sup> As registered institutions, the cooperatives were at a better position to utilize financial, technical, and resource support that were made available to them from the government, non-governmental organizations, as well as from key stakeholders of the cooperatives.<sup>10</sup> Currently, cooperative societies in Kenya are regulated by the Co-operative Societies Act, Cap. 490.

SACCOs, a sector in the cooperatives, were then introduced in 1964 and have continued to grow in number, particularly in segments where commercial banks were reluctant or unwilling to provide credit facilities.<sup>11</sup> Kenya currently has over 5000 registered SACCOs.<sup>12</sup> One of the reasons for their exponential growth over the years has been that they have made access to credit easier and more accessible to more people as compared to commercial banks, which have much more stringent terms. The SACCO movement in Kenya has been recognized as among the largest in Africa.<sup>13</sup>

SACCOs are an important part of the Kenyan economy; as of 2019, it was reported that they hold domestic savings of over Kshs. 500 billion and have an asset base of over Kshs. 600 billion.<sup>14</sup> Furthermore, as per the report, they have provided employment opportunities to over five hundred thousand people and given opportunities to women and the vulnerable in society.<sup>15</sup> The cooperatives movement has also been entrusted with providing housing solutions by 2020, playing a key role in achieving Kenya's Vision 2030 goals.<sup>16</sup>

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<sup>7</sup> Otieno S, 'The role of cooperatives in social and economic development of Kenya and actions required to accelerate growth and development of the sector in Africa', 3.

<sup>8</sup> Otieno S, 'The role of cooperatives in social and economic development of Kenya and actions required to accelerate growth and development of the sector in Africa', 6.

<sup>9</sup> Otieno S, 'The role of cooperatives in social and economic development of Kenya and actions required to accelerate growth and development of the sector in Africa', 6.

<sup>10</sup> Otieno S, 'The role of cooperatives in social and economic development of Kenya and actions required to accelerate growth and development of the sector in Africa', 6.

<sup>11</sup> Co-operative Alliance of Kenya Limited, *The role of cooperatives in social and economic development of Kenya and actions required to accelerate growth and development of the sector in Africa*, 21 May 2019.

<sup>12</sup> [www.kuscco.com](http://www.kuscco.com) on 30 January 2020

<sup>13</sup> Wanyama FO, 'Surviving liberalization: the cooperative movement in Kenya' Working Paper Number 10, Coop Africa (2009).

<sup>14</sup> Kiruga M, 'Kenyan savers hit by stumbling Sacco' *The African report* (18 March 2019).

<sup>15</sup> Kiruga M, 'Kenyan savers hit by stumbling Sacco'

<sup>16</sup> Kiruga M, 'Kenyan savers hit by stumbling Sacco'

## 1.2. Deposit-taking SACCOs (DT-SACCOs) in Kenya and their significance

DT-SACCOs are a part of the cooperatives movement in Kenya. The cooperatives movement was key in Kenya as it had the capacity to help alleviate poverty, promote financial inclusion that commercial banks at the time could not, as well as play a role in addressing the housing problem in the country through housing schemes such as the National Housing Cooperation (NHC).<sup>17</sup> In 2005, through the International Labour Organization (ILO), the United Nations (UN) recognized the important role that cooperatives play in poverty reduction. In a partnership with the International Cooperative Alliance (ICA), an initiative was formed known as ‘The Global Co-operative against Poverty’, whose theme was “Co-operating out of poverty”.<sup>18</sup> A report by the World Bank also revealed that by the year 2019, SACCOs provided approximately 90% of housing finance.<sup>19</sup> This plays an important role in realizing Kenya’s Vision 2030 goal of providing housing solutions.<sup>20</sup> DT-SACCOs have loan facilities accessible to their members through which they can be used to finance house purchasing.<sup>21</sup> These SACCOs therefore not only play a significant role for their members, but are an integral part of Kenya’s economy and the country’s developmental goals.

Cooperatives have also played a key role in providing financial inclusivity in the communities they operate in, and the country at large. Whereas commercial banks did not have enough reach to the community, SACCOs stood in the gap by allowing their members to have a platform where they could save, as well as enable the members to access affordable loan facilities. This facilitated financial deepening within the communities, which plays a significant role in improving Kenya’s economic position as a whole.<sup>22</sup> Financial deepening through SACCOs has also been recognized in Kenya’s Vision 2030 blueprint.<sup>23</sup> From being community based and focusing mostly on agricultural businesses and farming, SACCOs have extended their

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<sup>17</sup> Otieno S, ‘The role of cooperatives in social and economic development of Kenya and actions required to accelerate growth and development of the sector in Africa’, 6.

<sup>18</sup> Kuria NC, ‘Co-operatives in social development’ CIC Insurance Group Ltd, 2019, 1.

<sup>19</sup> ‘Mortgage vs SACCO loans- the best house financing options in Kenya 2021’ <https://nellions.co.ke/2020/12/30/own-house-financing-kenya-mortgage-sacco-harambee-construction-loan/> on 2 May 2021.

<sup>20</sup> Kenya Ministry of Planning and National Development, *Kenya: vision 2030*, National Government Publication, Nairobi, 2007, 19.

<sup>21</sup> Wood D, ‘The role of savings and credit cooperative organisations in Kenya’s housing finance sector’ *Urbanet* (2019).

<sup>22</sup> Otieno S, ‘The role of cooperatives in social and economic development of Kenya and actions required to accelerate growth and development of the sector in Africa’, 7.

<sup>23</sup> ‘Saccos play a significant role in Kenya’ 22 November 2017 <https://www.mhasibusacco.com/saccos-play-a-significant-role-in-kenya/> 2 May 2021.

reach into other sectors, such as the transportation industry, with many public service vehicles being registered and operating under SACCOs.

SACCOs are different from other cooperatives as their objective and purpose are specifically for the mobilization of savings as well as providing credit services to their members.<sup>24</sup> They provide financial services and thus also form part of the financial sector; they are known as financial cooperatives.<sup>25</sup> SACCOs are further categorized into two; deposit-taking SACCOs, and non- deposit taking SACCOs. The non-deposit-taking SACCOs provide services limited to utilizing their members' savings as collateral for any loan facilities advanced to them.<sup>26</sup> These savings that are used as collateral cannot be withdrawn by members and can only be given back to members upon leaving the SACCOs.<sup>27</sup> Because members do not hold accounts for depositing or withdrawing money, these SACCOs typically do not provide front office services for their members.<sup>28</sup> In Kenya, SACCOs constitute approximately 50% of the cooperatives sector.<sup>29</sup> Among all SACCOs, DT-SACCOs also make up about 75% of the assets and deposits held by the sub-sector.<sup>30</sup>

DT-SACCOs were the focus of this research. In Kenya, DT-SACCOs are governed by the SACCO Societies Act of 2008, which regulates and supervises SACCOs. The Act also establishes the SACCO Societies Regulatory Authority (SASRA), which is a semi-autonomous body under the Ministry of Industrialization and Enterprise Development. SASRA is tasked with ensuring that the interests of members of various DT-SACCOs are protected, and also provides an avenue where aggrieved members can lodge complaints. SASRA also promotes

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<sup>24</sup> ' How to know if your sacco is a deposit taking sacco or not' *WebSacco* 29 October 2019 <https://blog.websacco.com/2019/10/29/how-to-know-if-your-sacco-is-a-deposit-taking-sacco-or-not/> 2 May 2021.

<sup>25</sup> ' How to know if your sacco is a deposit taking sacco or not' *WebSacco* 29 October 2019 <https://blog.websacco.com/2019/10/29/how-to-know-if-your-sacco-is-a-deposit-taking-sacco-or-not/> 2 May 2021.

<sup>26</sup> ' How to know if your sacco is a deposit taking sacco or not' *WebSacco* 29 October 2019 <https://blog.websacco.com/2019/10/29/how-to-know-if-your-sacco-is-a-deposit-taking-sacco-or-not/> 2 May 2021.

<sup>27</sup> ' How to know if your sacco is a deposit taking sacco or not' *WebSacco* 29 October 2019 <https://blog.websacco.com/2019/10/29/how-to-know-if-your-sacco-is-a-deposit-taking-sacco-or-not/> 2 May 2021.

<sup>28</sup> ' How to know if your sacco is a deposit taking sacco or not' *WebSacco* 29 October 2019 <https://blog.websacco.com/2019/10/29/how-to-know-if-your-sacco-is-a-deposit-taking-sacco-or-not/> 2 May 2021.

<sup>29</sup> Onyim,C, Oluoch M, Wanjare M, ' Corporate governance practices and financial performance of deposit taking saccos in western Kenya' 4 *Scholars Journal of Economics, Business and Management* ( 2017), 198.

<sup>30</sup> Wanyoike S, ' Effect of compliance to sasra regulations on financial performance of savings and credit co-operatives in Kenya: a survey of deposit taking saccos in Nairobi County" Published, Kabarak University, Nakuru, 2013, 5.

confidence in SACCOs and encourages people to sign up as members of SACCOs, which in turn will contribute to the growth of the Kenyan economy through the mobilization of domestic savings.

DT-SACCOs receive deposits from their members, and these members can make withdrawals from their savings accounts, a service that is similar to that offered by commercial banks.<sup>31</sup> Because they offer these services, DT-SACCOs have front office services whereby they cater to members who want to deposit money into their accounts or withdraw money from their accounts.<sup>32</sup> For this reason, they play a significant role in providing employment opportunities as they provide front-office services, which requires persons to be employed in various capacities to serve members. The main difference between non-DT-SACCOs and DT-SACCOs is the demand for deposits; where the former requires for their members to buy shares into the organization, the latter requires their members to open savings accounts in the SACCO, and periodically, often monthly, deposit funds into it.<sup>33</sup> Members can also withdraw from these savings accounts.<sup>34</sup> Another key difference is in the regulation and supervision of the different types of SACCOs. DT-SACCOs are supervised and regulated by SASRA, while non-DT-SACCOs are supervised and regulated by the Department of Co-operatives and Development.<sup>35</sup>

In an empirical study conducted by the World Council of Credit Unions in 2009, it was revealed that the SACCO movement in Kenya is the largest in Africa, and its rapid growth drew necessity for its regulation, thus giving rise to the enactment of the SACCO Societies Act of 2008.<sup>36</sup> In addition to having the largest movement in Africa, it has also been lauded for having the most vibrant SACCO movement in Africa.<sup>37</sup> For this reason, it can be considered a

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<sup>31</sup> ‘ How to know if your sacco is a deposit taking sacco or not’ *WebSacco* 29 October 2019 <https://blog.websacco.com/2019/10/29/how-to-know-if-your-sacco-is-a-deposit-taking-sacco-or-not/> 2 May 2021.

<sup>32</sup> ‘ How to know if your sacco is a deposit taking sacco or not’ *WebSacco* 29 October 2019 <https://blog.websacco.com/2019/10/29/how-to-know-if-your-sacco-is-a-deposit-taking-sacco-or-not/> 2 May 2021.

<sup>33</sup> ‘ How to know if your sacco is a deposit taking sacco or not’ *WebSacco* 29 October 2019 <https://blog.websacco.com/2019/10/29/how-to-know-if-your-sacco-is-a-deposit-taking-sacco-or-not/> 2 May 2021.

<sup>34</sup> ‘ How to know if your sacco is a deposit taking sacco or not’ *WebSacco* 29 October 2019 <https://blog.websacco.com/2019/10/29/how-to-know-if-your-sacco-is-a-deposit-taking-sacco-or-not/> 2 May 2021.

<sup>35</sup> ‘ How to know if your sacco is a deposit taking sacco or not’ *WebSacco* 29 October 2019 <https://blog.websacco.com/2019/10/29/how-to-know-if-your-sacco-is-a-deposit-taking-sacco-or-not/> 2 May 2021.

<sup>36</sup> Kuria NC, ‘ Co-operatives in social development’ CIC Insurance Group Ltd, 2019, 3.

<sup>37</sup> <https://journals.ijcab.org/journals/index.php/jbmed/article/view/118/112> page 66

trendsetter whose systems can be mimicked for the advancement of the cooperatives movement in Africa and other developing nations.

DT-SACCOs have been embraced by Kenyans and have become more popular over the years for the reason that they offer high interest on members' savings, putting them in a better light as compared to commercial banks.<sup>38</sup> They have shown significant growth in terms of their asset base, the revenue generated from their membership, and the dividends they remit to their members.<sup>39</sup> Members have been positively impacted economically, and this has had a domino effect in the general economy of the country.<sup>40</sup> The savings aspect of DT-SACCOs is significant as savings can be mobilized for investment into local enterprises, as well as allow for personal development of members of these institutions.<sup>41</sup>

DT-SACCOs in their operations have a business model that is similar to that of commercial banks, and they offer similar products too.<sup>42</sup> However, a distinct difference between DT-SACCOs and commercial banks is that while in commercial banks one's deposits does not translate into shareholding, in DT-SACCOs, members who open accounts with the organization become shareholders and are thus entitled to participate in the decision making function through having voting rights.<sup>43</sup> Furthermore, while in commercial banks where savings and borrowing is open to members of the public, in these SACCOs, only registered members can open deposit accounts and borrow from the SACCOs.<sup>44</sup>

DT-SACCOs in Kenya are member based. Initially, DT-SACCOs had their membership made up from mainly low-income households and like-minded individuals, but their membership has since extended to the wider population, though many are still restricted to members of certain

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<sup>38</sup> 'How to know if your sacco is a deposit taking sacco or not' *WebSacco* 29 October 2019 <https://blog.websacco.com/2019/10/29/how-to-know-if-your-sacco-is-a-deposit-taking-sacco-or-not/> 2 May 2021.

<sup>39</sup> 'How to know if your sacco is a deposit taking sacco or not' *WebSacco* 29 October 2019 <https://blog.websacco.com/2019/10/29/how-to-know-if-your-sacco-is-a-deposit-taking-sacco-or-not/> 2 May 2021.

<sup>40</sup> 'How to know if your sacco is a deposit taking sacco or not' *WebSacco* 29 October 2019 <https://blog.websacco.com/2019/10/29/how-to-know-if-your-sacco-is-a-deposit-taking-sacco-or-not/> 2 May 2021.

<sup>41</sup> 'Saccos play a significant role in Kenya' 22 November 2017 <https://www.mhasibusacco.com/saccos-play-a-significant-role-in-kenya/> 2 May 2021.

<sup>42</sup> Kibanga JK, 'Effect of financial empowerment on member advancement of licensed deposit taking saccos in Nairobi city county, Kenya' Unpublished, Jomo Kenyatta University of Agriculture and Technology, 2019, 29.

<sup>43</sup> Munene C, Muturi W, 'The challenges facing deposit-taking savings and credit cooperative societies' regulatory compliance in Kenya: a case of the Gusii region' 4 *Interdisciplinary Journal of Contemporary Research in Business* (2013), 1016.

<sup>44</sup> Munene C, Muturi W, 'The challenges facing deposit-taking savings and credit cooperative societies' regulatory compliance in Kenya: a case of the Gusii region', 1016.

communities or certain professions, such as the Mwalimu SACCO for teachers, and the Law Society of Kenya SACCO, whose membership is restricted to members of the Law Society of Kenya and those that work in law firms. A report by SASRA revealed that the grouping of DT-SACCOs based on membership is changing due to the competitive environment that inspired these organizations to open up to non-traditional ideas regarding membership in order to grow.<sup>45</sup> This has seen DT-SACCOs welcome membership from persons other than those from their immediate communities or the communities within which they operate, for the purpose of getting more funds from member deposits, with which they can be able to sustain business operations. SACCOs that were initially strictly based on farming have now expanded from only serving farmers, to extending their services to the entire community.<sup>46</sup>

With the rapid growth of DT-SACCOs in Kenya, the need for regulation became apparent.<sup>47</sup> These SACCOs have developed from having their operations limited to the rural areas and communities to fully fledged organizations that are operated by professionals.<sup>48</sup> Their growth in Kenya has even seen their membership extend to persons living in the diaspora being members and investing in these organizations.<sup>49</sup>

One of the objectives of DT-SACCOs is to uplift the living conditions of the communities within which they operate. They have however seemingly failed to achieve this objective over the years. They have also failed to satisfy the expectations of their membership, such as the SACCOs in the Kiambu region of Kenya, where an empirical study revealed that despite governmental support to achieve this, there seemed to have been some failure.<sup>50</sup>

Over the years, despite the growth in numbers and popularity, there have been reports of mismanagement and non-compliance resulting in the instability, and sometimes closure, of

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<sup>45</sup> Wanyoike S, ‘Effect of compliance to sasra regulations on financial performance of savings and credit co-operatives in Kenya: a survey of deposit taking saccos in Nairobi County’ Published, Kabarak University, Nakuru, 2013, 5.

<sup>46</sup> Wanyoike S, ‘Effect of compliance to sasra regulations on financial performance of savings and credit co-operatives in Kenya: a survey of deposit taking saccos in Nairobi County’ Published, Kabarak University, Nakuru, 2013, 5.

<sup>47</sup> Miringu S, Namusonge GS, ‘Effect of innovation adoption on financial performance of deposit taking saving and credit co-operative societies in Kenya’ 5 *International Journal of Social Sciences and Information Technology* (2019), 54.

<sup>48</sup> ‘Saccos play a significant role in Kenya’ 22 November 2017 <https://www.mhasibusacco.com/saccos-play-a-significant-role-in-kenya/> 2 May 2021.

<sup>49</sup> ‘Saccos play a significant role in Kenya’ 22 November 2017 <https://www.mhasibusacco.com/saccos-play-a-significant-role-in-kenya/> 2 May 2021.

<sup>50</sup> Gitonga E, Miano, ‘The effect of corporate governance practices on performance of deposit taking savings and credit cooperative societies in Kiambu county, Kenya’ 2 *International Journal of Business Management, Entrepreneurship, and Innovation* (2020), 67.

DT-SACCOs.<sup>51</sup> Ekeza SACCO is an example of one such SACCO that was eventually deregistered for failure to comply to the regulations set by SASRA, jeopardizing members' deposits which amounted to Kshs. 2.4 billion.<sup>52</sup> Other notable DT-SACCOs that have been deregistered due to failures resulting from non-compliance and mismanagement include the Nitunze SACCO Society Limited, Moi University SACCO, and the Good Life SACCO.<sup>53</sup>

### **1.3. Corporate Governance and the Organisation for Economic Co-operation and Development (OECD)**

The OECD defines corporate governance as 'the systems by which business corporations are directed and controlled'.<sup>54</sup> In addition to having a system indicating each person's rules and responsibilities, having a proper structure provides a means through which an organization can set its objectives, a strategy on how to achieve the objectives, as well as mechanisms to monitor performance in achieving the set objectives.<sup>55</sup>

Some of the key challenges corporate governance seeks to address in organizations are, *inter alia*, fraud, lack of transparency, accountability issues, unethical practices, and conflict of interest. The OECD Corporate Governance Principles are based on the notion that adherence to key principles will have a direct effect on the management, supervision, and control of a corporation, and ultimately, its financial performance.<sup>56</sup> A proper corporate governance framework should promote financial markets that are transparent and fair, and where resources are allocated efficiently. Furthermore, they should be consistent with the domestic laws, and be able to facilitate satisfactory enforcement of the laws, and supervision as well.<sup>57</sup>

### **1.4. Problem Statement**

This research focused on the corporate governance principles of accountability, disclosure and transparency, and risk management as envisaged by the OECD. Noting the importance of corporate governance and its impact on the performance of organizations, the SACCO

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<sup>51</sup> <https://www.businessdailyafrica.com/bd/news/why-sh1trn-kenya-saccos-are-a-ticking-time-bomb-video-2242054>

<sup>52</sup> <https://www.businessdailyafrica.com/bd/news/troubled-ekeza-sacco-begins-refunding-members-deposit-2276306>

<sup>53</sup> <https://sokodirectory.com/2019/02/scandalous-saccos-kenyans-avoid/>

<sup>54</sup> Organisation for Economic Co-operation and Development, *G20/ OECD Principles of corporate governance*, OECD Publishing, Paris, 2015, 9.

<sup>55</sup> [https://ijbssnet.com/journals/Vol\\_7\\_No\\_5\\_May\\_2016/14.pdf](https://ijbssnet.com/journals/Vol_7_No_5_May_2016/14.pdf)

<sup>56</sup> Maher M, Andersson T, 'Corporate governance: effects on firm performance and economic growth' *Organisation for Economic Co-operation and Development* (1999), 4.

<sup>57</sup> Organisation for Economic Co-operation and Development, *G20/ OECD Principles of corporate governance*, 15.

Societies Regulatory Authority (SASRA), which is established by the SACCO Societies Act of Kenya, developed the SASRA Guidelines on Good Governance Practices for Deposit-taking SACCOs.

Despite these principles being provided for in the legal and regulatory framework governing deposit-taking SACCOs in Kenya, there have continued to be reports of mismanagement of DT-SACCOs, and these institutions being under financial distress, which has led to some of them collapsing or having their licenses revoked.<sup>58</sup> There have been several instances of DT-SACCOs failing and underperforming hence exposing members to financial losses, and risking the Kenyan economy, in which SACCOs control over Kshs. 500 billion in domestic savings.<sup>59</sup> These challenges facing DT-SACCOs in Kenya have been attributed to corporate governance lapses and non-compliance by these institutions to corporate governance regulations, which has had an impact on their financial performance, thus directly affecting key stakeholders.<sup>60</sup> This is an indication that there may be weaknesses and gaps in the legal and regulatory provisions guiding the adoption of these principles by DT-SACCOs in Kenya. Furthermore, the SASRA Guidelines on Good Governance Practices and the SASRA Guidelines on Risk Management Practices for Deposit-taking SACCO Societies have yet to be gazetted, making them more of advisory documents, rather than binding ones.

Corporate governance lapses in DT-SACCOs in Kenya may also be an indication that there is weak corporate culture in these institutions. There may thus be laxity in fully embracing corporate governance principles by key players, specifically the boards of directors of deposit-taking SACCOs, their members, and the regulator, which may have hindered SACCOs from realizing the benefits of a sound and compliant corporation- one of the important benefits being the assurance of financial stability and prosperity.

## **1.5. Research Objectives**

The general objective of this research was to establish the extent to which DT-SACCOs in Kenya have adopted the corporate governance principles of accountability, disclosure and

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<sup>58</sup> Kiaritha HW, 'Determinants of the financial performance of savings and credit co-operatives in the banking sector in Kenya' Unpublished, Jomo Kenyatta University of Agriculture and Technology, Nairobi, 2015, 7.(2015).

<sup>59</sup> 'How weak controls and mismanagement have left Saccos bleeding' *Nairobi Business Monthly* (2016).

<sup>60</sup> Kiaritha HW, 'Determinants of the financial performance of savings and credit co-operatives in the banking sector in Kenya' Unpublished, Jomo Kenyatta University of Agriculture and Technology, Nairobi, 2015, 7.(2015).

transparency, and risk management as envisaged by the OECD, and the effect this has had on the financial performance of these organizations.

The specific research objectives were:

- i. To identify gaps in the legal and regulatory framework governing DT-SACCOs in Kenya and to establish the shortcomings with regard to corporate governance principles, and the monitoring and supervision of these institutions, with the aim of providing suggestions to strengthen the framework.
- ii. To identify shortcomings in the corporate culture of DT-SACCOs and provide recommendations for improvements so as to enhance the adoption of corporate governance principles for the realization of better and sustained financial performance.

#### **1.6. Research Questions**

- i. To what extent have DT-SACCOs in Kenya adopted the corporate governance principles of accountability, disclosure and transparency, and risk management as envisaged by the OECD, and what effect has this had on financial performance?
- ii. Has the current legal and regulatory framework governing DT-SACCOs in Kenya sufficiently provided for the corporate governance principles of accountability, disclosure and transparency, and risk management?
- iii. What is the relationship between the corporate culture of DT-SACCOs and their financial performance?

#### **1.7. Hypothesis**

- i. The corporate governance structures and corporate culture of deposit-taking SACCOs affects the adherence to and implementation of corporate governance principles by these SACCOs, and directly impacts financial performance.
- ii. Inadequate legal and regulatory provisions under the SACCO Societies Act of Kenya and the SASRA Guidelines on Corporate Governance Practices have had a negative effect on the adoption of corporate governance principles.

## 1.8. Significance of the Study

DT-SACCOs have shown tremendous growth over the past couple of decades. There was clearly a need for them despite the existence of commercial banks.<sup>61</sup> They have provided a savings platform, as well as affordable and accessible credit to members, filling in a gap left by the mainstream/ commercial banks. DT-SACCOs need to embrace best corporate governance practices to increase public confidence, attract more members, thus increasing the capital base, and in turn, improving the economy of Kenya, and ultimately the livelihood of Kenyans. Furthermore, by creating employment opportunities, and providing housing solutions, they would be playing their part in achieving the Kenya 2030 vision goals for the cooperatives sector.

This research was set to benefit the key stakeholders of DT-SACCOs. The boards of directors and management of DT-SACCOs, in being cognizant of the effect of corporate governance on the performance of SACCOs, will be better equipped to ensure they comply with the relevant requirements and avoid pitfalls that could threaten the success of the organization.

Members of DT-SACCOs will benefit from a sound organization that they can trust to hold their savings, protect their interests and to be able to offer financial assistance when they need it. They will also benefit from sound policies that affect the interests of members, such as interest rates, loan guarantor policies, and general practices affecting all stakeholders.

Considering that SACCOs play a significant role in the economy of Kenya, it is in the best interest of the country that SACCOs thrive in their operations and play their part in achieving Kenya's developmental goals such as increasing domestic savings, creating employment, and providing housing solutions.

Most studies in this area have focused on the effect of corporate governance principles on the financial performance of DT-SACCOs. This research goes further to analyze the extent to which DT-SACCOs have adopted the corporate governance principles in question, and the resultant effect on financial performance.

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<sup>61</sup> Jefwa B, ' Saccos in Kenya are ripe for disruption' *CIO East Africa* ( 2019).

## **1.9. Research Methodology**

This was a desk-based research that was reliant on primary data and secondary sources of information. Primary data entailed the examination of legislations, regulations, policies, and institutional guidelines to establish whether the current laws relating to DT-SACCOs are effective and sufficient in ensuring that corporate governance principles as envisaged by the OECD are adopted by these institutions. The research examined how the level of compliance to corporate governance principles by DT-SACCOs has impacted their operations, and the effect it has had on their financial performance. Study of the anchoring regulatory documents also gave insight into gaps in the current legal and regulatory framework as regards the adoption of corporate governance principles, as well as the role that SASRA plays in guiding and ensuring compliance.

The secondary sources of information included reviews of various published and unpublished sources of information. The thesis was also informed by empirical data relevant to the research contained in peer-reviewed journals and articles. The studies reviewed established the correlation between the adoption of corporate governance principles and the financial performance of DT-SACCOs.

Government reports were also analyzed in answering the question of the extent to which corporate governance principles have been adopted by deposit-taking SACCOs. Published data from the US was also used in this research for the purpose of demystifying the concept of corporate governance as well as examining the effect of corporate governance on the financial performance of institutions. Reference was made to the US as it is in this country that one of the biggest corporate scandals, the Enron scandal, occurred, igniting corporate governance reforms, more-so in financial institutions.

This thesis was anchored on the stakeholder and stewardship theories of corporate governance, which were considered in giving insight into the concept of corporate governance, the role of various stakeholders of DT-SACCOs, as well as in examining the effect of corporate culture in the financial performance of these institutions.

## **1.10. Literature Review**

Corporate governance reforms were introduced to address gaps in institutional practices that left major corporations vulnerable to failure, case in point being the Enron scandal. The

collapse of the Enron Corporation resulted in shareholders making huge losses in their investments, employees losing their jobs, and even contributed to the collapse of the United States stock market.<sup>62</sup> Scandals such as these give an indication of how lapses in corporate governance practices can have far reaching effects beyond affecting just the entity. According to Rezard Dibra, corporate governance provides measures that can guide in identifying unethical practices, but not cure them.<sup>63</sup> We believe that identification of corporate governance lapses is a preventative measure; as the adage goes, prevention is better than cure.

A study by Acharya and Misangyi intimated that there is little evidence to support the hypothesis that the performance of a corporation is linked to its adoption of corporate governance principles.<sup>64</sup> However, Stanwick and Stanwick in their research confirmed that there is a direct correlation between good corporate governance practices and a firm's financial performance, and that higher rate of returns can be attributed to a firm's risk mitigation.<sup>65</sup> The main aim of a business organization is profit maximization. In DT-SACCOs, the aim is to maximize profits and protect member's savings and deposits. Being that one of the fundamentals of corporate governance is risk mitigation, risk management in SACCOs is key to profit generation and wealth maximization of their members. As established by the OECD, risk management is fundamental to good corporate governance; financial and non- financial risk management ultimately impacts the financial performance of an institution.<sup>66</sup> This hypothesis is supported by Newell and Wilson's research, which found that market value of firms increased when their corporate governance structures improved.<sup>67</sup> In the Kenyan scenario, with regard to SACCOs, it has been reported within the last couple of years that poor corporate governance practices have been the cause of failure and loss of finances by SACCOs. Mismanagement and fraud have constantly been cited as the cause of the demise of several SACCOs.<sup>68</sup> Additionally, non- compliance to legislation and other regulatory requirements has exposed SACCOs to financial vulnerabilities, jeopardizing the members' savings and on a larger scale, the Kenyan economy.

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<sup>62</sup> Bartby Research, *Enron scandal and its impact on the economy*, 1

<sup>63</sup> Dibra R, 'Corporate governance failure: the case of Enron and Parmalat' 12 *European Scientific Journal* ( June 2016), 286.

<sup>64</sup> A G Acharya, V F Misangyi, 'Substitutes or Complements? A Configurational Examination of Corporate Governance Mechanisms' 57 *Academy of Management Journal*, (2014) 1681.

<sup>65</sup> Stanwick P A, Stanwick S D, 'The relationship between corporate governance and financial performance' 8 *Journal of Corporate Citizenship*, (2002), 35–48.

<sup>66</sup> OECD, *Risk management and corporate governance*, 2014, 14.

<sup>67</sup> Newell R, Wilson G, 'A premium for good governance' *The McKinsey Quarterly* (2002), 22.

<sup>68</sup> Muchira N, 'How saccos in Kenya are addressing non-remittance of funds' *The East African* (19 August 2019)

SACCOs are part of the financial eco-system and offer financial services to their members. David Lewellyn noted that there are complexities that go with the regulation of financial products.<sup>69</sup> A report by the Toronto Centre revealed that weaknesses in internal monitoring may arise from board members not adequately exerting their oversight authority, lack of capacity in risk mitigation matters among the board members, and weak independent directors.<sup>70</sup> From these studies, it is consistent that a certain level of capacity is required for effective internal monitoring of financial institutions such as DT-SACCOs. Aside from internal monitoring mechanisms, external regulation is equally important in ensuring compliance to legal and regulatory provisions. Abd Elrahman Elzahi Saaid Ali found that supervision in the micro- finance sector yielded positive results in terms of improved service delivery of financial products.<sup>71</sup> This is supported by Muriuki and Ragui, who iterated that stringent corporate governance regulation led to enhanced performance.<sup>72</sup>

A weak legal and regulatory framework overseeing the adoption of corporate governance by corporations is precisely what led to the failure of major business entities. Anat R. Admati credited laws and regulations for their role in preventing governance issues and averting resultant financial instability of a firm by helping ease engagements with stakeholders through guidelines.<sup>73</sup> DT-SACCOs hold a significant amount of domestic savings in Kenya. This makes the government of Kenya an important stakeholder. The government's intervention, through laws and regulations, in the regulation of corporate governance is thus necessary. The effectiveness and application of these laws will determine the financial success of these SACCOs.

Supervision and monitoring are key elements that determine the success of an organization. The OECD CODE 2015 calls for the effective monitoring of organizations by management. This is in relation to internal monitoring and supervision, which calls for the boards of directors to monitor the actions and functions of the management of a company and ensure that decisions are made in the best interests of the stakeholders.<sup>74</sup> Internal controls are important in monitoring

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<sup>69</sup> Lewellyn D, 'The economic rationale for financial regulation' 1 *FSA Occasional Papers in Financial Regulation* (1999) 1, 23-25.

<sup>70</sup> Toronto Centre, *Governance in regulated firms*, 2016, 5.

<sup>71</sup> Ali A E S, 'The Challenges of Islamic Trade Finance in promoting SMEs in IDB member countries' *Journal of European Science* (2013).

<sup>72</sup> Muriuki K, Ragui M, 'Impact of the Sacco Societies Regulatory Authority ( SASRA) legislation on corporate governance in co-operatives in Kenya' 3 *International Knowledge Sharing Platform*, 6.

<sup>73</sup> Admati A R, 'A skeptical view of financialized corporate governance' 31 *The Journal of Economic Perspectives* (2017), 131-150.

<sup>74</sup> OECD, *G20/OECD principles of corporate governance*, 2015, 44.

compliance to corporate governance principles. Anthonia Ugowe stated that having the appropriate monitoring mechanisms in place aids in reducing instances of corruption and misappropriation that may occur due to lack of transparency and accountability.<sup>75</sup> The accuracy of results derived from monitoring exercises require full disclosure of information. Ugowe goes on to emphasize on the importance of non- executive directors being proactive in seeking out this information.<sup>76</sup> There is empirical evidence gathered by this author that revealed that lack of or poor stakeholder participation leads to weak executive monitoring and accountability. In the case of Parmalat, an Italian company that sensationally collapsed, it was established that the lack of a monitoring system within its governance framework exposed it to fraudulent activity and abuse of power.<sup>77</sup> From these studies, it is notable that the role played by stakeholders of DT-SACCOs with regard to supervision and monitoring will have an impact on financial performance.

Corporate culture includes the norms and values that define the behavior of employees and managers in a business environment. With regard to this research, focus was to analyze to what extent corporate governance principles have influenced the corporate practices of DT-SACCOs, and whether they informed the structures of these organizations. Weak corporate governance culture influences the adoption of corporate governance principles by those in the relevant positions in firms, and consequently affects the financial performance.<sup>78</sup> According to William Craig, the leadership of a firm has the responsibility of developing, guiding and encouraging a good corporate culture.<sup>79</sup> In order to influence the corporate culture of an organization, the board of directors and management have to be aware of good corporate governance and it should reflect in their mission statement and consequently, the work culture. A research conducted by Nick Bontis revealed that boards of organizations that are aware of their company's mission and are committed to it are more likely to influence the rest of the organization to be committed.<sup>80</sup> He stated that board members must always refer to the mission

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<sup>75</sup> Ugowe AO, 'Monitoring good corporate governance in developing countries: evidence from Nigeria' 7 *Nnamdi Azikiwe University Journal of International Law and Jurisprudence* (2016).

<sup>76</sup> Acharya AG, Misangyi V F, 'Substitutes or Complements? A Configurational Examination of Corporate Governance Mechanisms' (2014) 57 *Academy of Management Journal*, 1681.

<sup>77</sup> Dibra R, 'Corporate governance failure: the case of Enron and Parmalat' 12 *European Scientific Journal* ( June 2016), 288.

<sup>78</sup> 'Understanding and developing organizational culture' <https://www.shrm.org/resourcesandtools/tools-and-samples/toolkits/pages/understandinganddevelopingorganizationalculture.aspx> on 2 September 2020.

<sup>79</sup> Craig W, 'The role leadership has in company culture' *Forbes* (2018).

<sup>80</sup> Bontis N, 'Distinguishing between the board and management in company mission implications for corporate governance' *Journal of Intellectual Capital* (2003), 9.

statement in all their engagement with the rest of the organization and should develop measures to track its implementation.<sup>81</sup>

Nguyen and Mohammed's study established that the corporate culture of an organization influences the organizational structures that will be put in place.<sup>82</sup> Corporate culture is thus important as it influences the organizational structure of an institution, which defines the rights and responsibilities of various stakeholders, as well as the decision-making procedures. A good organizational structure ensures accountability and aids in increasing productivity, thus improving the financial performance of a firm.<sup>83</sup> Lack of proper structures in place create room for unethical practices such as corruption and can expose SACCOs to financial risk where there are no mitigation measures in place. Aside from board members and the management of DT-SACCOs having good corporate culture, it is important for members to have awareness of corporate governance matters. Members are the foundation of SACCOs, and a weak membership cannot sustain the organization.<sup>84</sup>

SACCOs are part of society, and operate within the society, affecting its members, whether directly or indirectly. Organizations should therefore be cognizant of the fact that their environmental, social and governance practices, which form part of their corporate governance operations, have an impact on financial performance.<sup>85</sup> Justin O'Brien notes that more than following legislative and regulatory provisions, an organization should also do right by society, and comply to moral and ethical expectations of the society within which it operates.<sup>86</sup> Corporate character is also important as it guides the interactions between stakeholders and the employees. Carmichael and Rubin, in their book, stated that corporate character is important in maintaining stakeholder confidence.<sup>87</sup> They go on to note that with the technological advancements and the age of social media, negative interactions may be exposed to a wide audience, and may cause an immediate impact on the company, leading to financial losses occasioned by members pulling out or investors withdrawing their investments. DT-SACCOs

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<sup>81</sup> Bontis N, 'Distinguishing between the board and management in company mission implications for corporate governance', 9.

<sup>82</sup> Mohamed S, Nguyen H N, 'Leadership and behaviors, organizational culture and knowledge management practices: An empirical investigation' 30 *Journal of Management Development* (2011), 206-221.

<sup>83</sup> Price N J, 'The importance of corporate culture for good governance' *Diligent Insights* (2018).

<sup>84</sup> 'How weak controls and mismanagement have left Saccos bleeding' *Nairobi Business Monthly* (1 July 2016)

<sup>85</sup> O'Brien, 'Corporate culture and the search for authenticity' 13 *Law and Financial Markets Review* (2019), 77-80.

<sup>86</sup> O'Brien, 'Corporate culture and the search for authenticity', 77-80.

<sup>87</sup> Carmichael B, Rubin J, *Reset: business and society in the new social landscape*, Columbia University Press, New York, 2018, 69- 106.

thus ought to be aware of how their interaction with various stakeholders impacts financial performance.

### **1.11. Limitations of the Study**

It is worth noting that this was a desk-based research. This research was done during a period when there was a lock-down due to the Covid-19 pandemic. Movement was restricted, thus collecting data from SACCOs in various parts of the country would have been a challenge. There were also instances where some authors of published data refused or delayed access to such material.

### **1.12. Chapter Breakdown**

Chapter one gave the background to the study, stating the research problem, hypothesis, research objectives, and research questions that were answered in the subsequent chapters. Chapter two expounded on the concept of corporate governance principles, considering the stakeholder and stewardship theories of corporate governance. It also looked into the development of corporate governance principles globally, focusing on the OECD principles, and thereafter the development corporate governance in Kenya. The chapter examined the OECD corporate governance principles of accountability, disclosure and transparency, and risk management. Corporate culture was also addressed in this chapter.

Chapter three looked into the inclusion of corporate governance principles of accountability, disclosure and transparency, and risk management as envisaged by the OECD in the legal and regulatory framework governing DT-SACCOs in Kenya. Chapter four focused on the extent to which DT-SACCOs have adopted corporate governance principles in terms of compliance to legal and regulatory requirements. The chapter also considered the extent to which corporate governance affects the corporate culture of the SACCOs, and the resultant effect on financial performance. Chapter five gave a summary of findings made from the research and suggested solutions to enhance adoption of corporate governance principles by DT-SACCOs so as to realize improved and sustained financial performance.

## **CHAPTER TWO: THEORETICAL FRAMEWORK AND THE DEVELOPMENT OF CORPORATE GOVERNANCE**

### **2.1. Introduction**

This chapter set out to discuss the concept of corporate governance. It looked into the evolution of corporate governance in the western world, sub-Saharan Africa, and in Kenya. The research highlighted failures in the corporate world that exposed weaknesses in organizational systems, thus calling for corporate governance reforms. The concept of financial performance was also discussed in this chapter.

This research was focused on the Organisation for Economic Co-operation and Development (OECD) corporate governance principles, specifically regarding accountability, disclosure and transparency, and risk management. This chapter considered the influence of corporate culture of an organization on the implementation of corporate governance principles. The chapter further discussed the significance of incorporating the corporate governance principles in financial institutions.

This chapter also analyzed the stakeholder theory and stewardship theories in relation to corporate governance. The stakeholder theory was considered by this research as it accounts for all parties, beyond the members of DT-SACCOs, who are directly or indirectly affected by these institutions. Aside from members of DT-SACCOs, other stakeholders include, *inter alia*, government regulators, employees working for DT-SACCOs, creditors, and the communities within which they operate.

This research also considered the stewardship theory, which ties in with the stakeholder theory, whereby it is upon stewards to guide the organization, whose operations and performance ultimately affects stakeholders beyond just the institution. The stewards, in the case of DT-SACCOs, are the board of directors, and the management team, who are entrusted by the principals, being the members of the SACCOs, to ensure optimum performance, which should then translate to positive financial performance.

## 2.2. The Concept of Corporate Governance

The word governance comes from the Latin word ‘gubernare’, which essentially means to steer or to rule.<sup>88</sup> Governance was initially concerned with administration of authority over a geographical area such as a kingdom or town, whereby those in authority were held accountable for their actions while exercising their authority.<sup>89</sup> The corporate world then began embracing governance over the following decades.<sup>90</sup>

Corporate governance has various definitions ranging from simple definitions to complex definitions. The definitions vary depending on the perception of stakeholders, the legal and regulatory policies of a place, institutional, political, and financial frameworks, among other factors that would determine what corporate governance is to each institution.<sup>91</sup> The definition can also be pegged on the definition of a corporation, whereby if a corporation is seen to be a culmination of implied or explicit contractual associations, then corporate governance can be viewed as a social construct created for the purpose of formulating a institution’s strategy to drive it and prevent adverse actions.<sup>92</sup>

Corporate governance has been defined as a system of policies, rules, and practices that inform the operations of an organization’s board of directors in their oversight and management functions.<sup>93</sup> According to Melvin Ayogu, corporate governance is the system design adopted by institutions that guides the management of an institution in carrying out their duties, while being cognizant of the effect their actions have on the welfare of stakeholders such as shareholders, employees, investors, creditors, and the community at large.<sup>94</sup> One of the key stakeholders in corporate governance are the shareholders.<sup>95</sup> The essence of good corporate governance is thus to protect all the stakeholders of a corporation, which could extend to the

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<sup>88</sup> Hunt J, Smith D, Garling S, Sanders W, Contested governance culture, power and institutions in indigenous Australia Australian National University Press, Canberra, 2008, 78.

<sup>89</sup> Njuguna A, ‘ The evolution of corporate governance and consequent domestication in Kenya’ 7 *International Journal of Business and Social Science* (2016), 153.

<sup>90</sup> Panchsara BM, ‘ An empirical study on corporate governance in Indian banking sector’ 3 *Finance India* ( 2017), 949-956.

<sup>91</sup> Njuguna A, ‘ The evolution of corporate governance and consequent domestication in Kenya’, 153.

<sup>92</sup> Carney M, Gedajlovi E, ‘ Corporate governance and firm capabilities: a comparison of managerial, alliance and personal capitalisms’ 18 *Asia Pacific Journal of Management* ( 2001), 335.&

<sup>93</sup> ‘Corporate governance’<https://corporatefinanceinstitute.com/resources/knowledge/other/corporate-governance/> on 26 February 2021.

<sup>94</sup> Ayogu Melvin D, ‘ Corporate governance in Africa: the record and policies for good governance’ 66 The African Development Bank (2001), 5.

<sup>95</sup> ‘Corporate governance’<https://corporatefinanceinstitute.com/resources/knowledge/other/corporate-governance/> on 26 February 2021.

community within which a corporation operates, or even over a large geographical area, thus having national or even international impact.

According to Cadbury, corporate governance is defined as a system for the control and direction of companies for the ultimate purpose of protecting stakeholders,<sup>96</sup> as well as ensuring return on investment.<sup>97</sup> Corporate governance has also been defined by Shleifer and Vishny as a means by which the suppliers of finance to a firm may ensure that they get a return of investment through ensuring that the firm has the proper systems, controls, and monitoring mechanisms in place to guarantee this.<sup>98</sup> From this definition, key aspects of corporate governance are authority to direct, corporate control, and organization of a firm.<sup>99</sup> An organization must thus have the proper structures in place informing members and participants of an organization of their rights and responsibilities.<sup>100</sup> Similarly, according to Donaldson, corporate governance is a structure through which the actions of managers are controlled by the board of directors of a corporation, who do this by incentivizing them as well as setting up monitoring mechanisms to assess performance.<sup>101</sup>

### **2.3. Concept of financial performance**

The financial performance of an organization refers to an assessment of its position regarding its asset base, equity, expenses, revenue generated, liability portfolio, and the overall profitability of the organization.<sup>102</sup> In evaluating financial performance, these factors are considered and analyzed over a certain period of time. Information on financial performance is necessary to reveal whether an organization is able to control and utilize its resources to the benefit of its shareholders and stakeholder.<sup>103</sup> Financial performance reveals the general health of an organization.

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<sup>96</sup> Adrian Cadbury, *Report of the committee on the financial aspects of corporate governance*, 1 December 1992, 14.

<sup>97</sup> Sullivan JD, 'The moral compass of companies: business ethics and corporate governance as anti-corruption tools' *International Finance Corporation* (2009), 14.

<sup>98</sup> La Porta R, Florencio L, Shleifer A, Vishny R, 'The quality of government' 15 *Journal of Law, Economics and Organization* (1999), 222-279.

<sup>99</sup> Njuguna A, 'The evolution of corporate governance and consequent domestication in Kenya', 153.

<sup>100</sup> Njuguna A, 'The evolution of corporate governance and consequent domestication in Kenya', 153.

<sup>101</sup> Donaldson L, 'Ethics problems and problems with ethics: towards a pro-management theory' 78 *Journal of Business Ethics* (2008), 308.

<sup>102</sup> 'Financial performance' <https://corporatefinanceinstitute.com/resources/knowledge/finance/financial-performance/> on 5 July 2021.

<sup>103</sup> Fatihudin D, Jusni, Mochklas M, 'How measuring financial performance' 9 *International Journal of Civil Engineering and Technology* (2018), 553.

### 2.3. Stakeholder theory and corporate governance

The stakeholder theory was developed by Edward Freeman, building the theory on the foundation of the relationship that is created between a firm, and the various stakeholders that interact with the business in one way or the other.<sup>104</sup> It is a corporate governance theory that emphasizes on the value of an organization's accountability to its stakeholders.

Freeman describes a stakeholder as a party who is affected by or may affect the operations of a corporation in meeting its objectives. Contrary to the agency theory, the stakeholder theory does not just focus on the interests of shareholders, who form part of the stakeholders, but also on the rest of the stakeholders, such as, *inter alia*, suppliers, regulators, government, the community, and employees.

The theory is premised on a firm's impact on the society and environment within which it operates, and the accountability that is demanded of a corporation. Thomas Clarke stated that by an organization integrating social and environmental responsibilities into their structure, greater value is likely to be realized by stakeholders.<sup>105</sup> In the American Law Institute Report (1992), it was established that a corporation cannot subsist on its own; an interdependent relationship is created between an organization and its stakeholders.<sup>106</sup> The report went further to state that though there may be no legal obligation compelling corporate officials to make decisions based on ethical considerations, they are to abide to the same ethical expectations as the rest of society is subject to.

With regard to DT-SACCOs, there are various stakeholders; members, employees, creditors, government regulators, the boards of directors, among others. The extent of adoption of corporate governance principles by DT-SACCOs has an effect on financial performance, and this ultimately affects the stakeholders.

### 2.4. Stewardship theory and corporate governance

The relationship created under this theory is that between a steward and a principal bound under contract. Donaldson and Davis introduced the stewardship theory, which is premised on the idea that a steward who is entrusted with assets will act responsibly and make decisions in the best interests of the owner, foregoing their personal interests if they conflict with the owner's

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<sup>104</sup> Freeman R, *Strategic management: A stakeholder approach*, Pitman, 1984.

<sup>105</sup> Clarke T, 'Ethics, Values and Corporate Governance' in *Value and Ethics for the 21<sup>st</sup> Century* (2013), 418.

<sup>106</sup> American Law Institute, *Principles of corporate governance: Analysis and recommendations*, 1992.

interests.<sup>107</sup> In the event that the objectives of the principal and the steward are not aligned, the steward will give priority to the objectives of the principal.<sup>108</sup>

The style that informs this theory is psychology and sociology, focus being what guides human interaction, and consequently human behavior at the workplace. Davis, Schoorman and Donaldson state transparency, trust, and performance as some of the key elements of the theory. Davis, Schoorman and Donaldson go on to further suggest that the behavioral aspect of the theory is a means to achieving the main objective of a corporation; profit maximization.<sup>109</sup> Greater value is also placed on the collective goals of the organization rather than individual goals.<sup>110</sup> The rationalization is that when stewards work towards the collective goal of an organization, their individual needs will be met through job security, salaries, and other performance-based incentives.<sup>111</sup> However, according to the theory, intrinsic rewards such as the satisfaction of achieving the organization's goals are more important to the steward, over extrinsic rewards such as monetary gains.<sup>112</sup>

Being that the theory posits that a 'moral contract' is created from the principal- steward relationship, there is no fear that the principal will take advantage of the steward, hence why the steward does not hesitate to oblige by the stakeholders' expectations; there is a moral obligation on the principals to ensure the stewards are duly rewarded. The theory also puts emphasis on continuous training of management to build their capacity to push the organization to greater heights using their expertise.<sup>113</sup>

This theory is also based on the assumption that not constraining the actions of those in management is a motivating factor that will push them towards achieving the goals of the company such as profit maximization.<sup>114</sup>

With regard to DT-SACCOs, the management acts as stewards of the monies of members, with the aim of maximizing the value of their deposits. The theory is useful in determining whether

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<sup>107</sup> Davis JH, Donaldson L, Schoorman D, 'Toward a stewardship theory of management' 22 *The Academy of Management Review* (1997), 24.

<sup>108</sup> Davis JH, Donaldson L, Schoorman D, 'Toward a stewardship theory of management', 24.

<sup>109</sup> Davis JH, Donaldson L, Schoorman D, 'Toward a stewardship theory of management', 24.

<sup>110</sup> Arino M, Pastoriza D, "When Agents Become Stewards: Introducing Learning in the Stewardship Theory" 1st IESE Conference on "Humanizing The Firm And The Management Profession", Barcelona, July 2008.

<sup>111</sup> Davis JH, Donaldson L, Schoorman D, 'Toward a stewardship theory of management', 25.

<sup>112</sup> Davis JH, Donaldson L, Schoorman D, 'Toward a stewardship theory of management', 5.

<sup>113</sup> Caldwell C, Okpala C, 'Humility, forgiveness, and love- the heart of ethical stewardship' 12 (2019), 2.

<sup>114</sup> Scherer AG, Schneider A, 'Corporate governance in a risk society' 126 *Journal of Business Ethics* (2015), 315.

the boards of directors, management, and employees are effective custodians of members' deposits. It considers effectiveness in terms of internal controls, performance measures, continuous professional development, and the general ethical soundness of the corporate governance structure. Ultimately, the adoption of corporate governance principles by DT-SACCOs is primarily dependent on the leadership of these institutions, whose influence is paramount in ensuring the rest of the organization observes and adheres to the principles

## **2.5. History of Corporate Governance**

At the start of the twenty-first century, there were various economic systems, one of them being capitalism.<sup>115</sup> Under capitalism in the twenty-first century, corporations would compete with each other for the attention of consumers. In corporations under capitalism, the Chief Executive Officer (CEO) was the head of the organization and was responsible for formulating the company's policies and strategies, which were then presented to a passive Board of Directors (BOD) for approval.<sup>116</sup> Shareholders in this case were very many, and were majorly from the middle-class, each having hundreds or thousands of shares thus making the shareholding individual power relatively diluted, disorganized, and therefore, powerless.<sup>117</sup> With a passive BOD, and a shareholding group that was not powerful, most of the power in corporations was held by the CEO. This then made corporations susceptible to abuse of power by the CEO, who would make decisions based on their personal, political, economic, or social beliefs.<sup>118</sup>

In capitalistic systems, many corporations are owned by a select elite group of people, many of whom may hail from wealthy families and from political families as well.<sup>119</sup> In such corporations, even professional employees do not have significant input into the running of the organization, and are merely subservient to the CEO, management, and dynasties, who are hesitant to give up their power and are not willing to provide accountability for their actions and decisions regarding the running of the organizations.<sup>120</sup>

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<sup>115</sup> Morck RK, 'A history of corporate governance around the world: family business groups to professional managers' *National Bureau of Economic Research* (2005), 1.

<sup>116</sup> Morck RK, 'A history of corporate governance around the world: family business groups to professional managers', 1.

<sup>117</sup> Morck RK, 'A history of corporate governance around the world: family business groups to professional managers', 1.

<sup>118</sup> Morck RK, 'A history of corporate governance around the world: family business groups to professional managers', 9.

<sup>119</sup> Morck RK, 'A history of corporate governance around the world: family business groups to professional managers', 4.

<sup>120</sup> Morck RK, 'A history of corporate governance around the world: family business groups to professional managers', 2.

Prior to the 1900s, aspects of corporate governance can first be traced to when the Joint Stock Companies Act of 1844, UK was enacted, providing for the incorporation of companies, and in it, providing for the separation of ownership and control in modern corporations.<sup>121</sup> In this legislation, the separation of ownership from control, an aspect of corporate governance, was firmed up in law, and thus this piece of legislation can be noted as the origin of corporate governance. As a result of wars and catastrophes in the 1920s and the 1930s, many countries around the world faced financial distress.<sup>122</sup> As a consequence of these financial catastrophes, ideas around corporate control evolved, with different countries adopting different ideologies.<sup>123</sup>

In the U.S., the term ‘corporate governance’ was first acknowledged and indicated in policy documents in 1976, where it featured in the Federal Register.<sup>124</sup> By its acknowledgment in policy, an opportunity was presented to corporations and their regulators to start defining best practices with regard to board structures of companies, hence establishing a standard benchmark to guide corporations and regulators.<sup>125</sup> Following the inclusion of corporate governance in the U.S. Federal Register, compliance and acceptance by the corporate world was then first evidenced by the New York Stock Exchange making it a requirement for all listed companies to have an audit committee in their boards, and additionally, that the committee include Independent Non- Executive Directors( INEDS).<sup>126</sup> Corporate governance was also highlighted in the 1980s, and the 1990s as a result of stock market crashes around the world, which brought to light the need for effective oversight by boards of directors on managers’ responsibility to steer corporations in the right direction.<sup>127</sup>

In the 1990s, corporations around the world adopted various corporate governance structures; civil law countries such as France and Germany adopted structures whose focus was on the stakeholders of corporations,<sup>128</sup> whereas commonwealth countries such as the U.S., the U.K. and New Zealand developed frameworks that were centered on the shareholder return/

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<sup>121</sup> Njuguna A, ‘ The evolution of corporate governance and consequent domestication in Kenya’, 155.

<sup>122</sup> Morck RK, ‘ A history of corporate governance around the world: family business groups to professional managers’, 30.

<sup>123</sup> Morck RK, ‘ A history of corporate governance around the world: family business groups to professional managers’, 30.

<sup>124</sup> Chapter II, *United States Federal Register*, (1976) 41, 52994.

<sup>125</sup> Moon C, ‘ The evolution of corporate governance’ *Praxonomy Blog* (2019).

<sup>126</sup> Moon C, ‘ The evolution of corporate governance’ *Praxonomy Blog* (2019).

<sup>127</sup> Njuguna A, ‘ The evolution of corporate governance and consequent domestication in Kenya’, 154.

<sup>128</sup> Anderson T, Maher M, ‘ Corporate governance: effects on firm performance and economic growth’ *Organisation for Economic Co-operation and Development* (1999), 35.

interests.<sup>129</sup> In 2002, one of the most notable corporate governance instruments, the Sarbanes Oxley Act, was passed by the United States Congress to address incidences of corporate scandals and fraud in the public sector that were highly publicized in the United States.<sup>130</sup> These incidences exposed how organizational issues such as conflicts of interest and poor compensation practices affected seemingly sound corporations. Over the years, corporate governance has continued to be acknowledged as an important component necessary in the running of organizations. Another evidence of this is that as of the year 2004, 70% of listed companies in Japan did not have INEDs, but by the year 2019, the number dramatically reduced, leaving only 0.01% of listed companies in Japan without INEDs.<sup>131</sup>

Governance predominantly involves establishment of strategy by those entrusted with that function, as well as overseeing the implementation of the set strategies.<sup>132</sup> In establishing strategies, the future of the corporation and the resultant effect of these strategies on the operations of the institutions must be taken into account.<sup>133</sup> For this reason, the involvement of INEDs is imperative in giving professional insight into the operations of an organization as well as overseeing the function of the board in ensuring that sound strategies are put in place, and sufficient risk-mitigation measures established in order to safeguard the interests of the corporation, its shareholders, as well as key stakeholders such as regulators, creditors, and the community.<sup>134</sup>

In 1997, the Heads of Government of Commonwealth nations developed the International Corporate Governance Network whose mandate was to promote corporate governance as well as conduct research on corporate governance to aid in its development. In 1999, the Commonwealth Association for Corporate Governance (CACG) was then established, which came up with the CACG Guidelines: Principles for Corporate Governance in the Commonwealth.<sup>135</sup> Over the decades, theoretical as well as practical aspects of corporate

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<sup>129</sup> Njuguna A, 'The evolution of corporate governance and consequent domestication in Kenya', 155.

<sup>130</sup> Weidner DJ, 'New FASB rules on accounting for leases' 72 *The Business Lawyer* (2017), 367.

<sup>131</sup> Konishi M, Niwa M, Sato Y, 'Annual shareholders' meetings mirror how executive compensation is changing in Japan' Executive Pay Memo Asia Pacific (2019).

<sup>132</sup> 'Corporate governance' <https://corporatefinanceinstitute.com/resources/knowledge/other/corporate-governance/> on 26 February 2021.

<sup>133</sup> Moon C, 'The evolution of corporate governance' *Praxonomy Blog* (2019).

<sup>134</sup> Moon C, 'The evolution of corporate governance' *Praxonomy Blog* (2019).

<sup>135</sup> Njuguna A, 'The evolution of corporate governance and consequent domestication in Kenya', 155.

governance has for the most part been developed by the Western world, and this has influenced its development in the rest of the world.<sup>136</sup>

One of the notable documents on corporate governance is the Cadbury report of 1992, which was a culmination of deliberations by a committee established comprising of representatives from the Financial Reporting Council, the London Stock Exchange, and various accounting institutions, who's mandate was to look into key aspects that affected corporate governance in the financial sector.<sup>137</sup> The committee was chaired by Sir Adrian Cadbury. One of the main objectives of the committee was to look into the functions of INEDS in a board, the various board committees a corporation should have, and what role auditors played in an organization as agents of the board and of shareholders.<sup>138</sup> In their report, the committee recommended that listed companies in the London stock exchange be required to adopt and adhere to the code of best practices, and that all listed companies keep and disclose a statement of compliance or non-compliance in its annual financial statements.<sup>139</sup> Listed companies were thus expected to have the proper structures in place to facilitate sound practices. The oversight function of the BOD was also emphasized, the recommendation being that they were required to have the proper mechanisms in place to allow monitoring of the operations of the organization. Additionally, it was proposed that there be different committees within the board with the relevant capacities to carry out their duties in overseeing and monitoring the functions of management.<sup>140</sup>

Another significant recommendation of the Cadbury Report was the separation of the office of the CEO from that of the chairman of the board, making the holders of such offices and their responsibilities in the organizations separate and distinct.<sup>141</sup> The findings of the committee and their recommendation ultimately advocated for sound governance structures and practices within listed companies. Subsequent reports in corporate governance included the Greenbury Report (1995), the Hampel Report in 1998, and the Higgins Report of 2003. All these reports focused on establishing the principles of corporate governance, the role of board of directors,

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<sup>136</sup> Njuguna A, 'The evolution of corporate governance and consequent domestication in Kenya', 155.

<sup>137</sup> Njuguna A, 'The evolution of corporate governance and consequent domestication in Kenya', 156.

<sup>138</sup> Njuguna A, 'The evolution of corporate governance and consequent domestication in Kenya', 156.

<sup>139</sup> Njuguna A, 'The evolution of corporate governance and consequent domestication in Kenya', 156.

<sup>140</sup> Adrian Cadbury, *Report of the committee on the financial aspects of corporate governance*, 1 December 1992, 29.

<sup>141</sup> Adrian Cadbury, *Report of the committee on the financial aspects of corporate governance*, 1 December 1992, 52.

functions of the chairperson and CEO, the committees within the board, the role of the INEDS, and professional development.<sup>142</sup>

## 2.6. Corporate scandals and the evolution of corporate governance

Enron Corporation was an American energy company that was formed in 1985 through a merger between two companies, Internorth, and Houston.<sup>143</sup> This merger resulted in a successful company that became listed in the top 500 companies in the U.S.<sup>144</sup>, and one of the largest companies in the world.<sup>145</sup> In 2001, the corporation filed for bankruptcy. In October 2001, the company was reported to have been facing financial difficulties, and by December 2001, the company had filed for bankruptcy.<sup>146</sup> The collapse was attributed to violations of Generally Accepted Accounting Principles.<sup>147</sup> Up until the company was about to collapse, investors of the company had been unaware of the violations and financial manipulation that had been going on.<sup>148</sup>

The sinister accounting methods used by Enron facilitated stealing and misappropriation of funds from the company by its financial personnel, who presented ‘cooked’ financial figures to the BOD.<sup>149</sup> When the company collapsed, stockholders, creditors and investors lost billions of dollars. The BOD of Enron had a fiduciary duty to protect the company’s shareholders, which they failed to do as they allowed the company to engage in high-risk accounting and transactions where there was conflict of interest.<sup>150</sup> Ultimately, despite being aware of the questionable practices that were being carried out by the management of the company, the BOD of Enron failed to address them in a timely manner, and took no action, nor informed the shareholders, which worked to the detriment of the business and its stakeholder.<sup>151</sup>

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<sup>142</sup> NJuguna A, ‘ The evolution of corporate governance and consequent domestication in Kenya’, 156.

<sup>143</sup> ‘ Enron files for bankruptcy’ *A & E Television Networks*, <https://www.history.com/this-day-in-history/enron-files-for-bankruptcy> on 26 March 2021.

<sup>144</sup> ‘ Enron files for bankruptcy’ *A & E Television Networks*, <https://www.history.com/this-day-in-history/enron-files-for-bankruptcy> on 26 March 2021.

<sup>145</sup> Enron, ‘ Enron: why corporate governance matters’ *SRI News* ( 2019).

<sup>146</sup> Lemus E, ‘ The financial collapse of the Enron corporation and its impact in the United States capital market’ *14 Global Journal of Management and Business Research* ( 2014), 41.

<sup>147</sup> Lemus E, ‘ The financial collapse of the Enron corporation and its impact in the United States capital market’,41.

<sup>148</sup> Lemus E, ‘ The financial collapse of the Enron corporation and its impact in the United States capital market’,41.

<sup>149</sup> ‘Corporate governance’<https://corporatefinanceinstitute.com/resources/knowledge/other/corporate-governance/> on 26 February 2021.

<sup>150</sup> U.S. Government Printing Office, *The role of the board of directors in Enron’s collapse*, 2002, 3.

<sup>151</sup> U.S. Government Printing Office, *The role of the board of directors in Enron’s collapse*, 2002, 3.

According to Candriam, Enron's corporate governance failures included a lack of an independent and qualified board, lack of diversity in the board composition, no separation between the post of CEO and chairman of the board, and conflict of interest whereby some board members who were politicians would put their interests before the interests of the company.<sup>152</sup>

The Enron Scandal triggered the drafting of the Sarbanes-Oxley Act, which the U.S. Congress passed in 2002, and which gave emphasis to the importance of having financial reports of all companies assessed, and that these reports be accurate.<sup>153</sup> The Act also provided that corporations ensure that they comply with all laws and regulations relevant to them.<sup>154</sup> The collapse of Enron had global ramifications that affected banks and insurance companies that were exposed to losses amounting to billions of dollars as they had engaged banking and insurance services from institutions in various countries.<sup>155</sup>

The Enron case is an example of how far-reaching the consequences of lapses in corporate governance in firms can go. Furthermore, that all stakeholders are affected where there is no accountability by those entrusted with a fiduciary duty, such as the BOD, whose failures leave them vulnerable to financial loss. As evidenced by the Enron scandal, financial institutions have systemic significance, and instability of one could negatively impact the global financial system.

In the recent years, we have seen the failure of Lehman Brothers Holdings, which happened during the financial crisis of 2008-2009, and whose collapse highlighted the vulnerability of even large corporations that may seem sound and stable. Upon further investigations into the Lehman Brothers Holdings scandal, it was revealed that financial fraud, abuse, and corporate incompetence were among the corporate governance issues that led to the collapse.<sup>156</sup> Though some of these unfortunate events in the corporate world triggered systemic failure of a global magnitude, they also initiated discussions that saw an opportunity for reform as regards corporate governance, as well as reforms and revolution in policies, legislations, regulations

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<sup>152</sup> Enron, 'Enron: why corporate governance matters' *SRI News* (2019).

<sup>153</sup> Lemus E, 'The financial collapse of the Enron corporation and its impact in the United States capital market', 42.

<sup>154</sup> Lemus E, 'The financial collapse of the Enron corporation and its impact in the United States capital market', 42.

<sup>155</sup> 'Enron bankruptcy has global consequences' *Insurance Journal* (2001).

<sup>156</sup> Organisation for Economic Co-operation and Development, *Corporate governance, and the financial crisis*, 2009, 46.

and practices.<sup>157</sup> Other notable corporate failures in the finance sector in the recent years include, *inter alia*, the Bank of Credit and Commerce International collapse, WorldCom, and the Parmalat failure.

## **2.7. Corporate Governance and Financial Institutions**

Following the Great Depression, the Global Financial Crisis of 2008 was the next extreme economic crisis that led to the failure of financial institutions that had systemic significance, and this in turn affected the global economy. Lapses in corporate governance have been cited as the cause of the collapse of the economy in the 2008 GFC. Among the failures in corporate governance that were cited include poor risk mitigation, questionable remuneration practices, and overstepping by CEOs who would make decisions that would benefit them in short term, such as in terms of incentives, rather than looking at the long-term sustainability of their decisions, which would affect the company, its shareholders, and stakeholders.<sup>158</sup>

Prior to the 2008 GFC, there have been various legislations around corporate governance put in place for the purpose of addressing lapses that led to the crisis. However, a question remains regarding the extent of enforcement of these laws, and furthermore, whether they were enforceable, or whether BODs of corporations were aware of the implications of not complying to the regulations and that it would have impacted the global economy to the extent that it did.<sup>159</sup>

The BOD plays an important role in corporations and in the corporate culture of an organization. As stated in the Walker Report, it is critical for a safe environment to be created in which the executive's decisions can be challenged, and where dissenting opinions welcomed and considered in the making of resolutions on matters involving strategy and significant risk that the organization may be exposed to.<sup>160</sup>

## **2.8. Development of Corporate Governance in Africa**

In Sub-Saharan Africa, some of the most significant instruments on corporate governance have been the King's Committee Report, and the Code of Practice for Corporate Governance in

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<sup>157</sup> NJuguna A, 'The evolution of corporate governance and consequent domestication in Kenya', 155.

<sup>158</sup> Moon C, 'The evolution of corporate governance' *Praxonomy Blog* (2019).

<sup>159</sup> Moon C, 'The evolution of corporate governance' *Praxonomy Blog* (2019).

<sup>160</sup> Walker D, Stanley M, A review of corporate governance in UK Banks and other financial industry entities, 2009.

South Africa( 1994), which was published for the purpose of encouraging the development of corporate governance in Africa.<sup>161</sup>

Among the first nations in Africa to embrace corporate governance in their institutional mechanisms were Zimbabwe, South Africa, and Ghana.<sup>162</sup> Various conferences were then held between the years of 1998 and 2000 to discuss the way forward in creating awareness around corporate governance in the region.

African countries borrowed best practices from developed countries in adopting concepts such as having the requirement of non-executive directors as part of the BOD, separating the office of the CEO from the chairperson of the board, and including independent persons as part of the audit committee.<sup>163</sup>

Corporate governance involves compliance to laws, regulations, and codes of conduct and policies. As Transparency International reported, most countries in Africa rank highly in the corruption index.<sup>164</sup> This has been one of the pertinent issues that has affected the compliance to laws and regulations, as well as enforcement of corporate governance practices in the continent.

## **2.9. Corporate Governance in Kenya**

In Kenya, consultative talks by the Consultative Corporate Sector held seminars between 1998 and 2000, from which it was resolved that a Private Sector Initiative for Corporate Governance be established for the purpose of formulating a code for the best practices on corporate governance in Kenya , as well as discussions on the establishment of a corporate governance national body and the coordination of corporate governance in collaboration with other initiative in East Africa and the wider African region as well as globally. This initiative culminated in the adoption of a code of best practices in October 1999, and in 2002, the Guidelines on the Principles of Corporate Governance for Public Listed Companies, which was promulgated by Capital Markets Authority as a response to the desire and call for the institutionalization of the principles.<sup>165</sup>

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<sup>161</sup> Njuguna A, ‘ The evolution of corporate governance and consequent domestication in Kenya’, 155.

<sup>162</sup> Njuguna A, ‘ The evolution of corporate governance and consequent domestication in Kenya’, 154.

<sup>163</sup> Ayandele IA, Isichei EE, ‘ Corporate governance practices and challenges in Africa’ *5 European Journal of Business and Management* ( 2013), 158.

<sup>164</sup> Ayandele IA, Isichei EE, ‘ Corporate governance practices and challenges in Africa’, 158.

<sup>165</sup> Ayandele IA, Isichei EE, ‘ Corporate governance practices and challenges in Africa’, 158.

## 2.10. OECD Principles of Corporate Governance

The definition of corporate governance as per the OECD is the most widely adopted by various countries and international organizations such as, *inter alia*, the World Bank Group, the United Nations, the International Organization of Securities Commissions (IOSCO), Islamic Financial Services, and the Basel Committee for Banking Supervision (BCSB).<sup>166</sup> The reason for this is that the definition has been found to be comprehensive in basically providing that corporate governance is the ‘systems, practices and procedures that govern institutions.’<sup>167</sup> Furthermore, it involves collective responsibility in the resolution of problems, as well as conflict resolutions among stakeholders.<sup>168</sup>

The OECD committed to work with the G20 international organizations, as well as domestic institutions in order to assess the efficacy of the systems that were in place at the time, and to support and facilitate the implementation of the principles, which are ultimately meant to guide policymakers to improve domestic legal, regulatory and institutional frameworks.<sup>169</sup> Though these principles were developed for public listed companies in and out of the financial sector, they have also been formulated to be a useful guiding tool for corporations in the private sector.<sup>170</sup>

The OECD principles acknowledge key players in corporate governance as a company’s board of directors, its management, shareholders, and various stakeholders. As corporate governance has been evolving over many decades, the OECD acknowledges that as different trends emerge and the business and economic climates change, the principles may from time to time be reviewed to reflect the current state of things; they are thus evolutionary in nature.<sup>171</sup> In the past, corporate governance focused more on the protection of shareholders and ensuring maximum return for shareholders.<sup>172</sup> Corporate governance has since evolved to include stakeholder returns as part of their focus.<sup>173</sup>

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<sup>166</sup> Njuguna A, ‘ The evolution of corporate governance and consequent domestication in Kenya’, 154.

<sup>167</sup> Njuguna A, ‘ The evolution of corporate governance and consequent domestication in Kenya’, 154.

<sup>168</sup> Njuguna A, ‘ The evolution of corporate governance and consequent domestication in Kenya’, 154.

<sup>169</sup> Organisation for Economic Co-operation and Development, *G20/ OECD Principles of corporate governance*, 9.

<sup>170</sup> Organisation for Economic Co-operation and Development, *G20/ OECD Principles of corporate governance*, 9.

<sup>171</sup> Organisation for Economic Co-operation and Development, *G20/ OECD Principles of corporate governance*, 13.

<sup>172</sup> Moon C, ‘ The evolution of corporate governance’ *Praxonomy Blog* (2019).

<sup>173</sup> Moon C, ‘ The evolution of corporate governance’ *Praxonomy Blog* (2019).

According to the OECD, corporate governance serves the purpose of creating enabling conditions where a corporation can create an environment where there is transparency, accountability, and trust, which will foster long-term sustainable investment, integrity in the conduct of business, and financial stability, all the while facilitating the growth of a stronger and more inclusive society.<sup>174</sup> Emphasis is placed on the adoption and implementation of the principles into the governance rules and regulations.

In establishing the updated rules and regulations, the OECD carried out extensive research and empirical studies to assess corporate governance gaps and needs based on emerging trends around the world in the corporate sectors as well as the financial sector.<sup>175</sup> Lessons were derived from the global financial crises, feedback from interactions resulting from cross-border exchanges, which have increased more and more, as well as the changing spheres in the stock markets functions, and the complexities that accompany investments, from household investment savings, to investments in the corporate world.<sup>176</sup>

### **2.10.1. The principle of accountability**

Accountability is a key aspect in corporate governance. One of the objectives of corporate governance is to ensure that those in relevant positions are held accountable for their actions which may directly or indirectly affect the organizations that they work for, and in turn, the stakeholders.<sup>177</sup>

Corporate accountability can be defined as the obligation placed on members of a firm to explain their conduct or their actions and/ or decisions. This obligation is mainly placed on the BOD, its committees, and the management of the organization.<sup>178</sup> The aspect of accountability as a principle of corporate governance focuses on the board and management of an institution,

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<sup>174</sup> Organisation for Economic Co-operation and Development, *G20/ OECD Principles of corporate governance*, 7.

<sup>175</sup> Organisation for Economic Co-operation and Development, *G20/ OECD Principles of corporate governance*, 7.

<sup>176</sup> Organisation for Economic Co-operation and Development, *G20/ OECD Principles of corporate governance*, 7.

<sup>177</sup> 'Corporate governance' <https://corporatefinanceinstitute.com/resources/knowledge/other/corporate-governance/> on 26 February 2021.

<sup>178</sup> 'The core principles of good corporate governance' *Pearse Trust* 19 February 2014 <https://www.pearse-trust.ie/blog/bid/108866/the-core-principles-of-good-corporate-governance> on 16 April 2021.

and their accountability to the shareholders of the institutions, as well as to the stakeholders, and examining the boards intention to act in the best interest of these key stakeholders.<sup>179</sup>

The BOD should be accountable to the shareholders of the company, and similarly, board committees are to be accountable in their actions in terms of ensuring there is professionalism as they carry out their duties, and that they are consistently exhibiting integrity, independence, and competency.<sup>180</sup> Similarly, the management team must be accountable to the BOD, who have the oversight authority over them.

Accountability has also been emphasized through the separation of the CEO and chairman of the board roles, as the board can now make the management accountable without risking an instance of conflict of interest that may result due to having the CEO, who is part of the management, as also the chairman of the board, thus affecting independence of the board in exercising its oversight role.

### **2.10.2. The principle of disclosure and transparency**

Disclosure and transparency are key aspects of good corporate governance. According to the OECD, disclosure and transparency with regard to timeliness and accuracy on disclosures made on all material matters forms part of an effective corporate governance framework.<sup>181</sup> Timely and accurate disclosures on all material matters are key in assessing the financial position of an institution, its financial performance, shareholding, and the governance structures in place.<sup>182</sup>

Disclosures are also necessary for investors, from which current and potential investors may make informed decisions. It is also important for any information presented to be accurate so that users of this information may be able to use it to predict trends in the industry, identify changes in the financial position of an organization, and the performance of the organization.<sup>183</sup> Accurate financial information also allows for internal users of this information to ascertain the financial position of the organization in comparison to other similar institutions in the same

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<sup>179</sup> Jesover F, Kirkpatrick G, ‘ The revised OECD principles of corporate governance and their relevance to non-OECD countries’ 19.

<sup>180</sup> Organisation for Economic Co-operation and Development, *G20/ OECD Principles of corporate governance*, 43.

<sup>181</sup> Jesover F, Kirkpatrick G, ‘ The revised OECD principles of corporate governance and their relevance to non-OECD countries’ *Corporate Governance: An International Review*, 2005,7.

<sup>182</sup> Organisation for Economic Co-operation and Development, *G20/ OECD Principles of corporate governance*, 37.

<sup>183</sup> Nezhad MB, Mohammadi, ‘ The role of disclosure and transparency in financial reporting’, 61.

industry.<sup>184</sup> According to Mensah, the level, accuracy, and extent of disclosures is dependent upon the level of independence the board of an organization has.<sup>185</sup>

In addition to prompt presentation of financial reports, the information contained therein should be presented in a way that is easily understandable to users of the information in order to increase the usefulness of the information.<sup>186</sup> This may call for authors of the information to provide interpretations and explanations regarding how certain figures were calculated.<sup>187</sup> The information must also be free from bias.

In assessing what forms part of disclosures, the concept of materiality has been used by many countries, whereby material information has been defined as the information which if failed to be disclosed, omitted, or misstated, is likely to influence economic decisions of those to whom the information is targeting, such as investors. It is therefore information that a reasonable investor would consider useful in making investment decisions or voting decisions.<sup>188</sup> The information should thus be accurate in order to not mislead investors into making misinformed decisions.

Though disclosures may be an annual requirement, it is imperative for disclosures to be made whenever there are material developments prior to the annual reporting.<sup>189</sup> Additionally, despite being a necessity, disclosures should not impose unreasonable financial burden on the company, and furthermore, the disclosure requirement should not reveal sensitive information that may put a company at a competitive disadvantage against similar companies.<sup>190</sup>

Disclosures are also very important in promoting transparency and as a tool to support monitoring, and also gives shareholders the ability to exercise their rights based on accurate information and from an informed perspective. Transparency requires that accurate accounting methods be adopted by corporations, and that accurate accounting information is promptly

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<sup>184</sup> Nezhad MB, Mohammadi, ‘ The role of disclosure and transparency in financial reporting’, 61.

<sup>185</sup> Mensah, BK, ‘Internal control information disclosure and corporate governance: evidence from an emerging market’ 16 *The International Journal of Business in Society*,(2016), 79-95,

<sup>186</sup> Nezhad MB, Mohammadi, ‘ The role of disclosure and transparency in financial reporting’3 *International Journal of Accounting and Economic Studies* ( 2015), 61.

<sup>187</sup> Nezhad MB, Mohammadi, ‘ The role of disclosure and transparency in financial reporting’, 61.

<sup>188</sup> Organisation for Economic Co-operation and Development, *G20/ OECD Principles of corporate governance*, 37.

<sup>189</sup> Organisation for Economic Co-operation and Development, *G20/ OECD Principles of corporate governance*, 37.

<sup>190</sup> Organisation for Economic Co-operation and Development, *G20/ OECD Principles of corporate governance*, 37.

presented to the BOD, relevant stakeholders, and the relevant regulatory authorities.<sup>191</sup> Reports must also be transparent in revealing conflicts of interest that any of the board members may have. Information regarding board structures, management structure, as well as ownership information of an organization must also be made apparent.<sup>192</sup>

### **2.10.3. The principle of risk management**

One of the key functions of the BOD is risk management. The BOD is required to have in place sufficient policies and procedures to guide risk management. As part of their oversight role, the BOD must be accountable for risk mitigation and management, specifying types of risks in the organization's policy documents, the degree of risks the organization may be able to withstand according to its goals, and what measure the company has in place to safeguard itself from risks arising from its operations and interactions internally and externally.

An organization should have a risk profile, and the management of the organization is expected to meet this desired risk profile through its risk management.<sup>193</sup> Boards should not only focus on risks that may be potentially catastrophic externally, but should place more emphasis on risks that may have negative impacts on the shareholders, investors, and key stakeholders.<sup>194</sup>

After the Enron scandal, corporate governance was seen as a necessity to minimize risks well enough to foster investor and public confidence in the financial markets.<sup>195</sup> Corporations were thus called upon to have the necessary risk mitigation and management structures in place, with the management required to have the necessary competence in risk mitigation techniques, which were seen as necessary in order to improve financial performance.<sup>196</sup> Since then, the quality of risk governance in financial institutions has been found to have a direct impact on the performance of the organization.<sup>197</sup>

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<sup>191</sup> Oino I, *Corporate governance*, Emerald Publishing Limited, 2019, 1347.

<sup>192</sup> Oino I, *Corporate governance*, 1347.

<sup>193</sup> Organisation for Economic Co-operation and Development, *G20/ OECD Principles of corporate governance*, 47.

<sup>194</sup> Organisation for Economic Co-operation and Development, *G20/ OECD Principles of corporate governance*, 47

<sup>195</sup> Njuguna A, ' The evolution of corporate governance and consequent domestication in Kenya', 154.

<sup>196</sup> Organisation for Economic Co-operation and Development, *Corporate governance, and the financial crisis*, 2009, 32.

<sup>197</sup> Organisation for Economic Co-operation and Development (OECD), *Risk management and corporate governance*, 2014, 20.

## 2.11. Corporate Culture

Pre-historically, governance was an individual responsibility, whereby persons were expected to conduct themselves in an ethical manner.<sup>198</sup> Currently, in a corporate environment, it is the duty of those place in positions of authority to ensure that the corporation meets its ethical responsibilities, and that ethical principles and practices are enforced throughout the organization.<sup>199</sup> According to Alison Taylor, understanding unethical behavior is difficult to quantify and understand, as human beings can easily justify why they behave the way they do.<sup>200</sup> It should thus not be left to individuals to choose to conduct themselves as they wish.

Factors that affect ethical behavior in corporations include, among others, time pressure, work stress, and lack of adequate incentives.<sup>201</sup> At the OECD conference in 2016, companies were called to diversify and broaden ways in which they approach to corporate governance beyond just compliance, and to reconsider the purpose, values, and ethics of a corporation.<sup>202</sup> This was echoed in 2018 when Laurence D. Fink, the CEO of Blackrock, one of the largest and influential public companies in the U.S.A, wrote a letter to various business leaders in the corporate world, urging them to not only focus on profit-making, but to also make significant positive contributions to the society.<sup>203</sup>

BODs have a responsibility to lead an organization in embracing good corporate governance. It is thus the mandate of the BOD to be proactive in creating a strong corporate culture for the organization.<sup>204</sup> According to Nicholas J. Price, in creating a healthy corporate culture, the BOD members must be aware of corporate governance matters.<sup>205</sup> This means that members of the board have to have the necessary competencies to be able to understand the concept of corporate governance. With the necessary understanding, the BOD would be able to identify

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<sup>198</sup> Colley JL, Doyle JL, Logan GW, Stettinus W, *What is corporate governance*, McGraw Hill Professional, New York, 2004, 4.

<sup>199</sup> Clancy RF, Luegenbiehl HC, *Global Engineering Ethics*, Butterworth-Heinemann, Oxford, (2017), 99.

<sup>200</sup> Sorkin AR, 'BlackRock's message: contribute to society, or risk losing our support' *The New York Times*, 15 January 2018,1.

<sup>201</sup> Sorkin AR, 'BlackRock's message: contribute to society, or risk losing our support' *The New York Times*, 15 January 2018,1.

<sup>202</sup> Taylor A, 'Culture, behaviour, and contemporary integrity 2.0' 21 March 2018 <https://www.bsr.org/en/our-insights/blog-view/culture-behavior-and-corporate-integrity-2.0> on 16 April 2021.

<sup>203</sup> Sorkin AR, 'BlackRock's message: contribute to society, or risk losing our support' *The New York Times*, 15 January 2018,1.

<sup>204</sup> Taylor A, 'Culture, behaviour, and contemporary integrity 2.0' 21 March 2018 <https://www.bsr.org/en/our-insights/blog-view/culture-behavior-and-corporate-integrity-2.0> on 16 April 2021.

<sup>205</sup> Price NJ, 'The importance of corporate culture for good governance' *Diligent Insights* (2018).

the desired corporate culture and behavior for the organization, and thereafter lead the whole organization to embrace them through their actions and words.<sup>206</sup>

BODs ought to consider certain issues in vetting prospective board members. One question that should be posed to candidates to ascertain suitability is; why they would wish to be a board member in the organization, and what important contribution their membership would bring to the organization. These questions would help in establishing whether they have the necessary competencies to be board members.<sup>207</sup> Members of the board, save for the CEO, are not usually hands-on in the day-to day running of the organization. It is therefore important for board members to understand the extent of their mandate when it comes to the daily operations. They can be curious enough to question issues regarding day-to-day management but need to be careful not to overstep.<sup>208</sup>

The lack of institutional capacity by members of the BOD in implementing corporate governance policies within their organizations was cited by Ayandele and Isichei as one of the factors that led to failure of corporate governance.<sup>209</sup> They further noted that corruption and lack of checks and balances to monitor corporate executives created a difficult environment to allow for compliance to, and success of corporate governance. According to Neil Waters and Ego Zehnder, skill development in directorship, though difficult, is of utmost importance. They go on to state that there is usually no training for directorship, and from the moment they are appointed, they are entrusted with the decision- making function. They are expected to respond and make decisions on some issues that need to be addressed upon being raised, and thus they are expected to be sufficiently prepared to answer questions, some of which may come from their peers who would expect satisfactory answers from them. They are thus expected to keep abreast with matters that affect the industry they are in, e.g., SACCOs and the finance industry, as well as take any trainings that may enhance their skills as board members.<sup>210</sup> Despite being experienced, board members need to enhance their training as a matter of self-awareness; it is important for them to embrace learning in order for them to provide effective service while on the board.<sup>211</sup>

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<sup>206</sup> Price NJ, ‘ The importance of corporate culture for good governance’ *Diligent Insights* (2018).

<sup>207</sup> <https://www.praxonomy.com/blog/the-evolution-of-corporate-governance/>

<sup>208</sup> Moon C, ‘ The evolution of corporate governance’ *Praxonomy Blog* (2019).

<sup>209</sup> Ayandele IA, Isichei EE, ‘ Corporate governance practices and challenges in Africa’, 56.

CHAPTER TWO<sup>210</sup> Moon C, ‘ The evolution of corporate governance’ *Praxonomy Blog* (2019).

<sup>211</sup> Moon C, ‘ The evolution of corporate governance’ *Praxonomy Blog* (2019).

Diversity is one of the key factors that plays an important role in improving the corporate culture of an organization. One indication of a strong board is the diversity in its composition. Over the years, corporations around the world have embraced diversity in their BOD; the number of female board members in listed companies in the UK rose from 9.5% to 30% over the years.<sup>212</sup> According to an S&P Global Market intelligence research, it was found that diversity in the BOD of an organization is fundamental, and it was found that boards that had more female representation had seen a significant decrease in how often they were fined for misconduct.<sup>213</sup>

## 2.12. Conclusion

Corporate governance has evolved over the years from initially being advisory principles, to being mandatory inclusions in various legislations and regulations. Compliance with corporate governance regulations and best practices are key in ensuring the success and longevity of both the private and public sectors. Overall, corporate governance is a key aspect in facilitating sustainable development and thriving economies.<sup>214</sup>

DT- SACCOs are an essential part of the Kenyan economy and have systemic significance. It is thus important that corporate governance is factored in their operations so as to ensure the success of the institutions, as well as protect members of these SACCOs, their shareholders, various stakeholders, and the Kenyan economy at large. As stated by Lindell Edgell, in order to ensure global economic sustainability, financial systems need to change in order to accommodate challenges that arise with the current financial climate.<sup>215</sup>

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<sup>212</sup> Moon C, 'The evolution of corporate governance' *Praxonomy Blog* (2019).

<sup>213</sup> Moon C, 'The evolution of corporate governance' *Praxonomy Blog* (2019).

<sup>214</sup> International Finance Corporation, *What we learned about corporate governance and code development in Sub-Saharan Africa*, 2018, 7.

<sup>215</sup> Moon C, 'The evolution of corporate governance' *Praxonomy Blog* (2019).

## **CHAPTER THREE: CORPORATE GOVERNANCE AND THE LEGAL AND REGULATORY FRAMEWORK GOVERNING DT-SACCOS IN KENYA**

### **3.1. Introduction**

The focus of the chapter is on the legal and regulatory framework that guides the operations of DT-SACCOS, their development, and their incorporation of the corporate governance principles of accountability, disclosure and transparency, and risk management as envisaged by the OECD. The OECD principles, though not binding, are used as a reference point, as they have been widely adopted by various jurisdictions in the world, and have also been used as a stability indicator for sound financial systems by various organizations, *inter alia*, the World Bank, and the Financial Stability Board.<sup>216</sup> The chapter also looks into the corporate culture of DT-SACCOS in Kenya.

### **3.2. Regulation of DT-SACCOS**

With the evolution of the microfinance institutions, there has been more focus on regulation and policy regarding these institutions as they deviated away from the mainstream commercial banks that were already somewhat well regulated.<sup>217</sup>

DT-SACCOS are financial institutions, and it is of utmost importance that financial institutions be regulated. Regulation of financial institutions is imperative for the enhancement of the economy as well as for the protection of consumers and stakeholders of these institutions as a whole.<sup>218</sup> The regulation of financial institutions involves instilling and institution of laws and procedures to guide operations.<sup>219</sup> More importantly, financial regulation involves continuous oversight of such institutions, and monitoring and supervising them in order to ensure that they consistently enforce the rules and regulations that are applicable to them.<sup>220</sup> According to the

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<sup>216</sup> OECD, *G20/OECD principles of corporate governance*, 2015, 11.

<sup>217</sup> Miringu S, Namusonge GS, ‘Effect of innovation adoption on financial performance of deposit taking saving and credit co-operative societies in Kenya’ 56.

<sup>218</sup> ‘Explainer- what is financial regulation and why does it matter?’ *Central Bank of Ireland*  
<https://www.centralbank.ie/consumer-hub/explainers/what-is-financial-regulation-and-why-does-it-matter> 2 May 2021.

<sup>219</sup> ‘Explainer- what is financial regulation and why does it matter?’ *Central Bank of Ireland*  
<https://www.centralbank.ie/consumer-hub/explainers/what-is-financial-regulation-and-why-does-it-matter> 2 May 2021.

<sup>220</sup> ‘Explainer- what is financial regulation and why does it matter?’ *Central Bank of Ireland*  
<https://www.centralbank.ie/consumer-hub/explainers/what-is-financial-regulation-and-why-does-it-matter> 2 May 2021.

Financial Sector Deepening Kenya (FSD Kenya), the regulation of SACCOs is not a one-time event but rather a long-term process.<sup>221</sup>

Regulation is key in ensuring the soundness of a financial institution. For financial institutions such as DT-SACCOs, regulation may involve ensuring that they adhere to capital adequacy requirements, have provisions in place in case of loan losses, regularize loan documentations, and have regulations guiding what should be in their reserves, among others.<sup>222</sup> Additionally, a well-regulated institution is necessary in ensuring that borrowers are protected by preventing the institution from capitalizing at the expense of borrowers and seeking profit maximization at the expense of clients; it is imperative for deposit-taking institutions to protect the savings of its clients.<sup>223</sup> Regulation is key in helping to prevent failure of these institutions.

Ultimately, there are two facets to financial regulation; regulation to ensure the safety and soundness of the institution, and regulation to ensure the compliance to the set regulations and rules.<sup>224</sup> As already established in chapter one of this research, DT-SACCOs have billions in assets and deposits from their membership. Due the control they have in asset base and deposits, DT-SACCOs have systemic significance, and should they fail, it will result into a causal sequence that could potentially affect the country's financial system as a whole.

In the regulation of financial institutions, there is prudential and non-prudential regulation. The aim of prudential regulation is specific to ensure the protection of the financial system as a whole in addition to protecting the deposits that individual institutions hold.<sup>225</sup> It is also aimed at building and maintaining confidence in the financial system.<sup>226</sup> Prudential regulation is often expensive, difficult and intrusive to institutions, as it involves regulators having to understand the operations of individual institutions, and monitor them with the aim of protecting their health and the overall health of the financial system.<sup>227</sup> Prudential regulation involves keeping

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<sup>221</sup> The Financial Sector Deepening Kenya, *Government and regulators*, 2017.

<sup>222</sup> 'Explainer- what is financial regulation and why does it matter?' *Central Bank of Ireland*  
<https://www.centralbank.ie/consumer-hub/explainers/what-is-financial-regulation-and-why-does-it-matter> 2  
May 2021.

<sup>223</sup> 'Explainer- what is financial regulation and why does it matter?' *Central Bank of Ireland*  
<https://www.centralbank.ie/consumer-hub/explainers/what-is-financial-regulation-and-why-does-it-matter> 2  
May 2021.

<sup>224</sup> Abor JY, Agbloyo EK, Amidu M, Gyeke-Dako A, Fiador VO, Mensah L, *Money and banking in Africa*, Springer, New York, 2019, 28.

<sup>225</sup> Miringu S, Namusonge GS, 'Effect of innovation adoption on financial performance of deposit taking saving and credit co-operative societies in Kenya' 54.

<sup>226</sup> Mahajan V, 'Microfinance 101 regulation and supervision: what works' MicroCapital, 2006, 3.

<sup>227</sup> Mahajan V, 'Microfinance 101 regulation and supervision: what works' MicroCapital, 2006, 3.

track of liquidity and capital reserve requirements, and loan loss reserve requirements.<sup>228</sup> It is applied more so in institutions that take retail deposits from its customers, or institutions that are big enough that they would destabilize other financial institutions in the event that they should fail.

Non-prudential regulation focuses on the regulation of the operations of a business institution.<sup>229</sup> It typically does not involve the invoking of sanctions to non-compliant institutions, but it rather offers the institution guidelines on how to operate the institution by following set standards and best practices.<sup>230</sup> The focus of non-prudential regulation is the transparency and disclosure practices of financial institutions, which often involves the regulators expelling owners that are not suitable for the organization, and requiring the management to be transparent in their operations. Non-prudential regulation is however more common in MFIs that are credit-only and that do not take retail-deposits from its members.

The anchoring legislation for the co-operatives sector in Kenya is the Co-operatives Societies Act, Cap 490. DT-SACCOs are guided by the SACCOs Societies Act, No. 14 of 2008, which provides for the regulation, licensing, supervision, and regulation of SACCOs. The regulatory authority for DT-SACCOs, is also established under the SACCO Societies Act. The SACCO Societies Act is mainly concerned with prudential regulation. In this statute, there is provision for legal mechanisms for prudential regulation, borrowing from international best practices in the field of regulation and supervision of deposit taking financial institutions.<sup>231</sup> In addition to the anchoring legislation, which is the SACCO Societies Act, we also have the Cooperative Alliance of Kenya under which the DT-SACCOs fall, established in 2009 to steer the cooperatives movement.<sup>232</sup> With the growth of numbers in DT-SACCOs and the increase in the membership, there has been significant increase in the complexity of their operations attributable to the increase in size.<sup>233</sup> Any failure, as small as it may be deemed to be is difficult to mitigate before news of the failure gains traction and members start losing confidence in the

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<sup>228</sup> Mahajan V, 'Microfinance 101 regulation and supervision: what works' MicroCapital, 2006, 3.

<sup>229</sup> 'Harris A: Regulation in microfinance: advantages and drawbacks' <https://pages.kiva.org/blog/regulation-in-microfinance-advantages-and-drawbacks> 4 May 2021.

<sup>230</sup> 'Harris A: Regulation in microfinance: advantages and drawbacks' <https://pages.kiva.org/blog/regulation-in-microfinance-advantages-and-drawbacks> 4 May 2021.

<sup>231</sup> Kibanga JK, 'Effect of financial empowerment on member advancement of licensed deposit taking saccos in Nairobi city county, Kenya' Unpublished, Jomo Kenyatta University of Agriculture and Technology, 2019, 33.

<sup>232</sup> Gitonga E, Miano, 'The effect of corporate governance practices on performance of deposit taking savings and credit cooperative societies in Kiambu county, Kenya', 64.

<sup>233</sup> Kibanga JK, 'Effect of financial empowerment on member advancement of licensed deposit taking saccos in Nairobi city county, Kenya' Unpublished, Jomo Kenyatta University of Agriculture and Technology, 2019, 33.

institution. The regulation and oversight of DT-SACCOs is an important role that the official government regulatory body plays.

After years of DT-SACCOs being in existence, the legislation in which the regulation of these institutions is anchored was only enacted in 2008, and the regulatory authority, SASRA, established two years later. The introduction of new rules regarding the operations of DT-SACCOs was challenging to enforce as the changes were difficult for these institutions to accept and adhere to.<sup>234</sup>

The regulatory body for DT-SACCOs in Kenya is SASRA, which is a statutory state corporation that was established by the SACCO Societies Act of Kenya, Cap. 490 B.<sup>235</sup> SASRA came into operation once the SACCO Societies ( Deposit-taking SACCO Business) Regulations, 2010 were gazetted on the 18<sup>th</sup> of June 2010. The Authority is mandated under the Act to license DT-SACCOs, which are widely known as Front Office Service Activity (FOSA).<sup>236</sup> In addition to licensing, the Authority is also mandated to conduct monitoring and supervision of these institutions.<sup>237</sup> SASRA was established as part of the Kenya's financial sector reforms which aimed to protect the members of DT-SACCOs and build confidence of the public in SACCOs so as to tap in the economic development that can be achieved and facilitated by these institutions, from which domestic savings can be mobilized.<sup>238</sup> Ultimately, the key roles of SASRA are to regulate, license, and supervise DT-SACCOs in Kenya.<sup>239</sup> SASRA also achieves its objectives through progressive and continuous improvement of policies and the framework on supervision.<sup>240</sup> Additionally, the regulatory body also conducts on-site and off-site surveillance to monitor the compliance of DT-SACCOs to regulatory requirements.<sup>241</sup> Reports of violations against regulatory requirements by DT-SACCOs are investigated by the regulatory authority, and the necessary action enforced in accordance with

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<sup>234</sup> The Financial Sector Deepening Kenya, *Government and regulators*, 2017.

<sup>235</sup> Section 4, *Sacco Societies Act*, ( Act No, 14 of 2008)

<sup>236</sup> [https://www.sasra.go.ke/index.php?option=com\\_content&view=article&id=59:welcome-to-sasra&catid=2&Itemid=193#.Ylu\\_vaGEY2w](https://www.sasra.go.ke/index.php?option=com_content&view=article&id=59:welcome-to-sasra&catid=2&Itemid=193#.Ylu_vaGEY2w) 4 May 2021.

<sup>237</sup> Section 5, *Sacco Societies Act*, ( Act No, 14 of 2008)

<sup>238</sup> [https://www.sasra.go.ke/index.php?option=com\\_content&view=article&id=59:welcome-to-sasra&catid=2&Itemid=193#.Ylu\\_vaGEY2w](https://www.sasra.go.ke/index.php?option=com_content&view=article&id=59:welcome-to-sasra&catid=2&Itemid=193#.Ylu_vaGEY2w) 4 May 2021.

<sup>239</sup> Section 5, *Sacco Societies Act*, ( Act No, 14 of 2008)

<sup>240</sup> ' Sacco Societies Regulatory Authority and Vision 2030'

[https://www.sasra.go.ke/index.php?option=com\\_content&view=article&id=59:welcome-to-sasra&catid=2&Itemid=193#.Ylu\\_vaGEY2w](https://www.sasra.go.ke/index.php?option=com_content&view=article&id=59:welcome-to-sasra&catid=2&Itemid=193#.Ylu_vaGEY2w) 4 May 2021.

<sup>241</sup> ' Sacco Societies Regulatory Authority and Vision 2030'

[https://www.sasra.go.ke/index.php?option=com\\_content&view=article&id=59:welcome-to-sasra&catid=2&Itemid=193#.Ylu\\_vaGEY2w](https://www.sasra.go.ke/index.php?option=com_content&view=article&id=59:welcome-to-sasra&catid=2&Itemid=193#.Ylu_vaGEY2w) 4 May 2021.

the provisions of the SACCO Societies Act of 2008 and other applicable legislations. Information regarding the performance of DT-SACCOs is also collected, the data analyzed, and information disseminated to the various stakeholders of the organizations.<sup>242</sup>

Since its inception, SASRA has positively influenced the performance of DT-SACCOs in terms of increasing outreach and improving sustainable performance; there were reports of improved performance in the membership of the DT-SACCOs, their efficiency in performance, and their portfolio and loan cycles.<sup>243</sup>

SASRA acknowledged the fact that regulation of DT-SACCOs needs to be developed further in regulation and legislation, and identified that there needs to be tougher standards regarding governance enforced in the operations of the institutions.<sup>244</sup> This would allow for the strengthening of these financial institutions, and the financial system as a whole considering the systemic significance of DT-SACCOs based on number, size, asset base, and deposits held. It would also allow for the sustainability of the DT-SACCOs sector that would grow to meet the needs of Kenyans as well as the social and economic developmental needs of Kenya.

### **3.3. Incorporation of corporate governance principles in the legal and regulatory framework governing DT-SACCOs in Kenya**

The Kenya Co-operative Societies Act, Cap 490 states that a cooperative society, of which DT-SACCOs are a part of, that has its own by-laws in place, should incorporate the following corporate governance principles in their policies; open and voluntary membership, democracy in member control, independence and autonomy, member participation, community concern, capacity building and access to information, and cooperation among cooperatives.<sup>245</sup> In emphasizing the importance of corporate governance in the cooperatives movement, the Kenya Cooperatives Societies Act stresses that each society that is seeking to be registered must have the aforementioned seven core principles espoused in their policy documents and by-laws that govern them, proof of which is required prior to registration being approved.

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<sup>242</sup> ‘ Sacco Societies Regulatory Authority and Vision 2030’  
[https://www.sasra.go.ke/index.php?option=com\\_content&view=article&id=59:welcome-to-sasra&catid=2&Itemid=193#.Ylu\\_vaGEY2w](https://www.sasra.go.ke/index.php?option=com_content&view=article&id=59:welcome-to-sasra&catid=2&Itemid=193#.Ylu_vaGEY2w) 4 May 2021.

<sup>243</sup> Ngaira L, ‘ The impact of Sacco regulatory authority guidelines on Sacco operations in Kenya-the case of Nairobi deposit taking Saccos’ Unpublished, University of Nairobi, Nairobi, 2011, 5.

<sup>244</sup> The Financial Sector Deepening Kenya, *Government and regulators*, 2017.

<sup>245</sup> Section 4, *Co-operative Societies Act of Kenya* ( Act No. 2 of 2004)

In DT- SACCOs, there is a separation between the owners, who are the members with accounts, and the persons who control the management of the corporation. Separation between ownership and corporate control was viewed to have caused a problem as it was the executives, rather than the members, who had a say regarding the development of the firms, thus creating corporate governance issues.<sup>246</sup>

As previously stated in this research, corporate governance has also been defined as a mechanism through which those who finance corporations are able to get assurance that they will get a return on their investments.<sup>247</sup> This would be through addressing issues regarding the monitoring of the corporations, their management and accountability failures.<sup>248</sup> Without these, corporations are vulnerable to financial distress. The belief was that good corporate governance practices would protect a corporation from financial failures and financial investors would get a good return on their investments.<sup>249</sup>

The purpose of the OECD in developing the corporate governance principles was to help its members states as well as non-member states in developing good practices that would help improve legislation governing institutions, as well as regulation of institutions through their frameworks by adopting the principles in their guiding policies.<sup>250</sup>

The SACCO Societies Act is categorized into eight parts covering the following; licensing, governance of the SACCO societies, regulation and supervision, the deposit guarantee fund, miscellaneous provisions regarding SACCOs, and a schedule guiding how the board should conduct their operations.<sup>251</sup>

SASRA proposed a set of measures to be adopted and implemented by DT-SACCOs so as to strengthen the institutions through enforcement of sound financial policies.<sup>252</sup> These new

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<sup>246</sup> Onyim,C, Oluoch M, Wanjare M, ‘ Corporate governance practices and financial performance of deposit taking saccos in western Kenya’, 200.

<sup>247</sup> Onyim,C, Oluoch M, Wanjare M, ‘ Corporate governance practices and financial performance of deposit taking saccos in western Kenya’, 200.

<sup>248</sup> Onyim,C, Oluoch M, Wanjare M, ‘ Corporate governance practices and financial performance of deposit taking saccos in western Kenya’, 200.

<sup>249</sup> Onyim,C, Oluoch M, Wanjare M, ‘ Corporate governance practices and financial performance of deposit taking saccos in western Kenya’, 200.

<sup>250</sup> Gitonga E, Miano, ‘ The effect of corporate governance practices on performance of deposit taking savings and credit cooperative societies in Kiambu county, Kenya’, 64.

<sup>251</sup> Muriuki K, Ragui M, ‘ Impact of the Sacco Societies Regulatory Authority ( SASRA) legislation on corporate governance in co-operatives in Kenya’ 3 *Public Policy and Administration Research* ( 2013), 66.

<sup>252</sup> Muriuki K, Ragui M, ‘ Impact of the Sacco Societies Regulatory Authority ( SASRA) legislation on corporate governance in co-operatives in Kenya’ ,68.

measures include policies on capital adequacy requirements, property investment, and equity investment.<sup>253</sup>

According to Onyim, Wanjare, Ooko and Oluoch, studies that have been done about corporate governance have revealed that organizations that have embraced good corporate governance practices excel in performance as compared to organizations that don't.<sup>254</sup> Recognizing the need for corporate governance in the legislation and regulation of SACCOs, and in going with their mandate to ensure that members' deposits are safe in SACCO Societies, SASRA developed the SASRA Guidelines on Good Governance Practices for Deposit- Taking SACCO Societies. In these guidelines, governance is defined to be a system that involves a relationship created between members of the SACCO Society, the management of the society, its BOD, and other relevant stakeholders.<sup>255</sup> The guidelines are to be read with the Cooperative Societies Act, Cap 490. In collaboration with other relevant governance institutions, the guidelines were developed to guide the formulation of a governance structure that is tailored for DT-SACCOs.<sup>256</sup>

SASRA acknowledged the fact that these guidelines are not all encompassing, and provided that where there is a shortfall, international best practices in corporate governance should be applied.<sup>257</sup> The supremacy of members is recognized and they exert their authority in annual meetings or special general meetings to appoint a board they deem suitable, and to whom they will delegate the governance of the society, as per the Constitution of the society.<sup>258</sup>

In the SACCO Supervision Annual Report of 2019, the cooperative model is outlined, and the cooperatives ethical beliefs and core values defined. This is unlike the structure in other corporate legal entities. In corporate societies, in the spirit of promoting the values of equity and equality, the organizations are operated in a democratic manner, where all members are equal and have a say in decision-making.<sup>259</sup> They follow the rule whereby one member has one

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<sup>253</sup> The Sacco Societies Regulatory Authority, *The sacco supervision annual report 2019, 2020*, 15.

<sup>254</sup> Onyim, C, Oluoch M, Wanjare M, 'Corporate governance practices and financial performance of deposit taking saccos in western Kenya', 198.

<sup>255</sup> Sacco Societies Regulatory Authority, *Guidelines on good governance practices for deposit-taking sacco societies*, 2015, 4.

<sup>256</sup> Sacco Societies Regulatory Authority, *Guidelines on good governance practices for deposit-taking sacco societies*, 2015, 4.

<sup>257</sup> Sacco Societies Regulatory Authority, *Guidelines on good governance practices for deposit-taking sacco societies*, 2015, 4.

<sup>258</sup> Sacco Societies Regulatory Authority, *Guidelines on good governance practices for deposit-taking sacco societies*, 2015, 4.

<sup>259</sup> The Sacco Societies Regulatory Authority, *The sacco supervision annual report 2019, 2020*, 20.

vote, and not as per their shareholding as other corporations may have, distinguishing them from other legal entities such as companies formed under the Companies Act of Kenya.<sup>260</sup>

The SASRA guidelines are intended to improve and enhance accountability, in going with the provision of Section 50 of the SACCO Societies Act which states that SASRA is responsible for guiding, advising, and directing DT-SACCOs in order to ensure that the SACCO industry maintains stability and carries out its operations efficiently as part of the financial system.<sup>261</sup>

### **3.3.1. The principle of accountability**

A report by SASRA in 2015 stated that it is the responsibility of the audit committee to ensure that there are sufficient internal control checks in place to facilitate the realization of the goals and aims of financial reporting.<sup>262</sup> Markers of good corporate governance in an institution is effectiveness in the operations of the corporation, fair competitiveness, and ability to influence sustainability in the society.<sup>263</sup> These aid in ensuring that the organization's objectives are met, and fosters innovation and improvement in the quality of service provision, and ultimately improves the credibility of the institution and thus likely to attract more investment.<sup>264</sup> Good corporate governance also advocates for proper and effective utilization of resources, and corporate social responsibility by being alive to and prioritizing the needs of the communities and societies that the organizations operate within.<sup>265</sup>

The SACCO Societies Act requires that directors, in their oversight function, hold the management accountable in ensuring that proper and accurate records are maintained, and that these records show a true reflection of the organization's financial position.<sup>266</sup> Likewise, the BOD is to ensure that there is an effective internal control system, and institutional policies that ensure the assets of the society within which they operate and its membership is safeguarded, and above all, create internal systems that would detect and in turn prevent financial fraud, among other irregularities.<sup>267</sup> The SACCOs Societies Act is also in accordance

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<sup>260</sup> The Sacco Societies Regulatory Authority, *The sacco supervision annual report 2019, 2020*, 20.

<sup>261</sup> Section 50, *Sacco Societies Act*, ( Act No, 14 of 2008)

<sup>262</sup> Munene HN, ' Influence of internal controls on financial distress of Sasra regulated saccos' 2 *International Journal of Business Management and Economic Review* ( 2019), 29.

<sup>263</sup> Munene HN, ' Influence of internal controls on financial distress of Sasra regulated saccos', 67.

<sup>264</sup> Munene HN, ' Influence of internal controls on financial distress of Sasra regulated saccos', 67.

<sup>265</sup> Munene HN, ' Influence of internal controls on financial distress of Sasra regulated saccos', 67.

<sup>266</sup> Provision in the Act

<sup>267</sup> Sheria Sacco Society Ltd, *Annual report and financial statements for the year ended 31<sup>st</sup> December 2020, 2021*, 25.

with the provision of the International Financial Reporting Standards in requiring the directors of SACCOs to give a fair presentation of the financial health of their organization.<sup>268</sup>

As has been established, DT-SACCOs are governed by a BOD who are appointed by the membership of the corporation through voting. The BOD is accountable to SASRA as the regulator, as well as the membership of the organization, regarding all the internal controls that go into running the corporation. It had been assumed for a long time that this was enough to ensure stability of DT-SACCOs. However, this has been proved to be a false narrative, as evidenced by the various reports regarding SACCOs in distress collapsing and facing closure, risking the loss of members' deposits and investments.<sup>269</sup> With good corporate governance, which affects management of organizations, institutions are bound to have better management and control.<sup>270</sup>

### **3.3.2. The principle of disclosure and transparency**

As envisaged by the OECD principle of disclosure and transparency, it is important for an organization's financial reports to be accurate, reliable, and relevant. Additionally, any such information should be promptly presented to board members, shareholders, members, relevant regulatory agencies, and other key stakeholders.

Section 42 of the SACCOs Societies Act of Kenya provides for disclosure requirements. The sections states that a SACCO society should include in their financial statements disclosures on members who have over twenty percent shareholding in the society, any credit facilities advanced to a member exceeding limits set by each institution, and any credit advanced to insiders. Disclosure requirements for DT-SACCOs are also outlined in the SASRA Guidelines on Good Governance Practices for Deposit-taking SACCO Societies.

In addition to mandatory disclosures, DT-SACCOs may opt to make voluntary disclosures. Voluntary disclosure involves the presentation of financial and non-financial information to users of this information beyond legal and statutory requirements. According to Shaban Mohammadi and Behrad Nezhad, in the past, corporations have been wary of making voluntary

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<sup>268</sup> Sheria Sacco Society Ltd, *Annual report and financial statements for the year ended 31<sup>st</sup> December 2020*, 2021, 26.

<sup>269</sup> Fayo G, ' Why Sh1trn Kenya saccos are a ticking time bomb' *Business Daily Africa*, 11 March 2019.

<sup>270</sup> Gitonga E, Miano, ' The effect of corporate governance practices on performance of deposit taking savings and credit cooperative societies in Kiambu county, Kenya', 65.

disclosures as they believed that making this information public would reveal sensitive information that ideally gives them a competitive edge amongst industry players.<sup>271</sup>

Incomplete disclosure leads to lack of certainty in the financial affairs and position of an organization. This is likely to cause anxiety amongst investors and shareholders, and in the case of DT-SACCOs, to their members. Non-compliance to disclosure requirements may ultimately lead to sanctions by the regulator, and may also result in expenses channeled to high legal costs for paid-for representation of DT-SACCOs involved in lawsuits relating to non-disclosure or inadequate disclosures. These will ultimately affect members' deposits, investors' funds, key stakeholders of the institutions, and the financial position of the organization.

### **3.3.3. The principle of risk management**

According to the OECD, risk management is defined as the process through which alternative responses to regulatory and non-regulatory responses to risk are evaluated and suitable methods selected and adopted.<sup>272</sup> In this process, economic, legal, and social factors are considered.<sup>273</sup>

Section 50(1) of the SACCO Societies Act of Kenya empowers the regulatory authority, being SASRA, to impose on licensed DT- SACCOs minimum standards of operations necessary to ensure that stability of these institutions is maintained, and that they carry out their activities effectively and efficiently.<sup>274</sup> It is based on this provision that SASRA developed the SASRA Guidelines on Risk Management Practices for Deposit-Taking SACCOs. The main objective of these guidelines is to improve and maintain financial soundness through enforcement of risk management of policies and practices.<sup>275</sup> SASRA thus seeks to ensure that Boards of Directors and senior management teams of DT-SACCOs are well equipped with what the guidelines provides so that they can implement the necessary strategies and structures in their DT-SACCOs.<sup>276</sup>

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<sup>271</sup> Nezhad MB, Mohammadi, ' The role of disclosure and transparency in financial reporting', 61.

<sup>272</sup> Organisation for Economic Co-operation and Development, ' Risk management' 67 *Glossary of Environmental Statistics* ( 1997).

<sup>273</sup> Organisation for Economic Co-operation and Development, ' Risk management' 67 *Glossary of Environmental Statistics* ( 1997).

<sup>274</sup> Sacco Societies Regulatory Authority, *Guideline on risk management practices deposit-taking sacco societies*, 2015, 4, page 6

<sup>275</sup> Sacco Societies Regulatory Authority, *Guideline on risk management practices deposit-taking sacco societies*, 2015, 4, page 6

<sup>276</sup> Sacco Societies Regulatory Authority, *Guideline on risk management practices deposit-taking sacco societies*, 2015, 4, page 6

The SASRA Guidelines on risk-management are concerned with the following risks; liquidity risk, credit risk, operational risk, strategic risk, compliance risk, and interest rate risk. The guidelines basically focus on risks that could potentially have undesirable impact on the capital, viability, or earnings of a DT-SACCO.<sup>277</sup> Lack of risk management structures and policies could lead to the DT-SACCO losing members' earnings, misappropriation of capital, and place the institution in a position where it is unable to meet its obligations as they fall due.

It is imperative for the BOD and senior management team to be proactive in ensuring that the appropriate policies are in place, and that they are being implemented throughout all levels of the SACCO. They must take steps to ensure that the SACCO adheres to the risk limits as established by the BOD, that the persons meant to ensure implementation of risk management policies understand them.<sup>278</sup> The procedure for decision making regarding risks must be in line with the strategy and objective of the institution, and the decisions made by those responsible must be clear and explicit.<sup>279</sup> The compensation schedule for risks taken must also be clear, and the SACCO must ensure that the institution has sufficient capital at all times to cushion the organization from risk.<sup>280</sup>

Important elements of a risk management policy should have a statement on risk tolerance, which outlines the level of risk that the BOD has established that the organization is willing to undertake for the purpose of being able to achieve the goals and objectives of the organization.<sup>281</sup>

Another key element in risk management is risk identification, where certain risks peculiar to portfolios, individual and other transactions are highlighted and understood by the management of the SACCO.<sup>282</sup> Procedure and criteria for risk identification must be made clear to the

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<sup>277</sup> Sacco Societies Regulatory Authority, *Guideline on risk management practices deposit-taking sacco societies*, 2015, 8.

<sup>278</sup> Sacco Societies Regulatory Authority, *Guideline on risk management practices deposit-taking sacco societies*, 2015, 9.

<sup>279</sup> Sacco Societies Regulatory Authority, *Guideline on risk management practices deposit-taking sacco societies*, 2015, 9.

<sup>280</sup> Sacco Societies Regulatory Authority, *Guideline on risk management practices deposit-taking sacco societies*, 2015, 9.

<sup>281</sup> Sacco Societies Regulatory Authority, *Guideline on risk management practices deposit-taking sacco societies*, 2015, 9.

<sup>282</sup> Sacco Societies Regulatory Authority, *Guideline on risk management practices deposit-taking sacco societies*, 2015, 9.

regulator so that it can be established the steps the management took in risk identification, and whether the process was sufficient in identifying risk.<sup>283</sup>

Risk measurement is another important element in the process, whereby the potential impact of risk is estimated using tools such as basic ratios.<sup>284</sup> Risk control is also a key element that involves internal control procedures, policies, set standards, internal audit measures, and staffing measures established to ensure that risk is maintained at tolerable levels.<sup>285</sup> Risk monitoring is paramount in the risk management process. According to the SASRA Guidelines, this is where changes in levels of risk are identified in order to ensure that the institution is adhering to the established controls.<sup>286</sup>

### 3.4. Corporate Culture in DT-SACCOs

As discussed in the previous chapter, the BOD of an organization is responsible for influencing the corporate culture of an institution. The board of directors of a DT-SACCOs owe a fiduciary duty to the members of the SACCO. According to the OECD, the fiduciary duties of the BOD include loyalty, where they directors are expected to demonstrate fairness in all processes of decision making, which calls for inclusion of INEDs.<sup>287</sup> They also owe a duty of care, and to exercise proper judgement expected from persons engaged in such capacities.<sup>288</sup> They are also entrusted with the duty of disclosure, whereby they are to make full disclosure of all relevant material when an instance of conflict of interest arises, or when such information is to be used by shareholders in making decisions.<sup>289</sup>

Various challenges that affect institutions, such as financial distress, have been attributed to characteristics of the boards that lead these institutions.<sup>290</sup> Empirical studies have revealed that financial distress in organization were as a result of lapses in corporate governance practices,

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<sup>283</sup> Sacco Societies Regulatory Authority, *Guideline on risk management practices deposit-taking sacco societies*, 2015, 9.

<sup>284</sup> Sacco Societies Regulatory Authority, *Guideline on risk management practices deposit-taking sacco societies*, 2015, 10.

<sup>285</sup> Sacco Societies Regulatory Authority, *Guideline on risk management practices deposit-taking sacco societies*, 2015, 10.

<sup>286</sup> Sacco Societies Regulatory Authority, *Guideline on risk management practices deposit-taking sacco societies*, 2015, 10.

<sup>287</sup> Prof. Black PS, 'The principal fiduciary duties of boards of director' The Third Asian Roundtable on Corporate Governance, Singapore, 4 April 2001, 2.

<sup>288</sup> Prof. Black PS, 'The principal fiduciary duties of boards of director' The Third Asian Roundtable on Corporate Governance, Singapore, 4 April 2001, 2.

<sup>289</sup> Prof. Black PS, 'The principal fiduciary duties of boards of director' The Third Asian Roundtable on Corporate Governance, Singapore, 4 April 2001, 2.

<sup>290</sup> Munene HN, Ndegwa J, Senaji T, Mugambi KM, 'Influence of board characteristics on financial distress of deposit taking SACCOs in Nairobi County, Kenya' 9 *International Journal of Finance & Banking Studies* (2020), 98.

and also particularly, board characteristics.<sup>291</sup> Board characteristics is an important element of corporate governance. The corporate culture of an organization is established and instilled in the whole organization by the BOD, as they are mandated with the responsibility of providing strategic direction to the organization.

Key elements affecting board characteristics include board composition, the size of the board, and board independence.<sup>292</sup> Fauzi and Locke have stated that board independence is also an important factor of board characteristics.<sup>293</sup>

In the Financial Services Authority Bill of Kenya, 2016, the legislation sought to introduce measures to ensure safety and soundness in financial institutions that are prudentially regulated.<sup>294</sup> According to Otieno et al, financial distress in SACCOs was attributed to gaps left that created opportunities for the mismanagement of the organizations.<sup>295</sup> Studies done by Mwaura revealed that direct actions by the board had been found to have adverse effects on the performance of SACCOs.<sup>296</sup> This is consistent with the findings of Kiaratha, where he found that high failure rate in licensed DT-SACCOs resulting in the revocation of their licenses had been due to negligence by the BOD of these institutions in addressing non-compliance, which left interests on members' deposits exposed, and ultimately led to financial distress of the DT-SACCOs in question.<sup>297</sup>

### 3.5. Conclusion

The regulation of DT-SACCOs with regard to corporate governance was covered by this chapter. As has been established, incorporation of the OECD principles of accountability, disclosure and transparency, and risk management, have been incorporated into the legal and regulatory framework governing DT-SACCOs in Kenya. The role of the boards of directors of

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<sup>291</sup> Munene HN, Ndegwa J, Senaji T, Mugambi KM, ' Influence of board characteristics on financial distress of deposit taking SACCOs in Nairobi County, Kenya', 98.

<sup>292</sup> Elad FL, Bongbee NS, Wong MN, ' The role of board characteristics in effective corporate governance: the case of airbus group' 2 *International Journal of Social Science Perspectives* (2018), 4.

<sup>293</sup> Fauzi F, Locke S, 'Board structure, ownership structure and firm performance: a study of New Zealand listed-firms' 8 *Journal of Accounting and Finance* (2012), 43–67.

<sup>294</sup> Section 6, *The Financial Services Authority Bill* (2016).

<sup>295</sup> Otieno K, Mugo R, Njeje D, Kimathi A, ' Effect of corporate governance on financial performance of SACCOs in Kenya' *Research Journal of Finance* ( 2015),48–59.

<sup>296</sup> Mwaura F, ' An analysis of factors affecting performance of Savings and Credit Cooperatives in Kenya' Unpublished, University of Nairobi, Nairobi,2005, 40.

<sup>297</sup> Kiaratha HW, 'Determinants of the financial performance of savings and credit co-operatives in the banking sector in Kenya' Unpublished, Jomo Kenyatta University of Agriculture and Technology, Nairobi, 2015, 7.(2015).

DT-SACCOs has also been discussed in this chapter, with the susceptibility to failure of these institutions being related to the characteristics of their BODs.



## **CHAPTER FOUR: EXTENT OF ADOPTION OF CORPORATE GOVERNANCE PRINCIPLES BY DT-SACCOS IN KENYA**

### **4.1. Introduction**

Having discussed the concept of corporate governance and financial performance in chapter 2, and the incorporation of the corporate governance principles of accountability, disclosure and transparency, and risk management into the legal and regulatory framework governing DT-SACCOS in Kenya in chapter 3, this chapter seeks to establish the extent to which these principles have been adopted by the DT-SACCOS sector, and the impact on financial performance. The chapter also looks into the significance of corporate culture in DT-SACCOS, and how it impacts the extent to which they adopt the corporate governance principles being discussed in this research, and consequently, the effect on financial performance.

This research was focused on compliance by DT-SACCOS in Kenya to corporate governance principles that are already provided for by the domestic laws, and the extent to which the domestic laws have adopted the OECD corporate governance principles of accountability, disclosure and transparency, and risk management.

Despite the enactment of various laws addressing corporate governance, the efficacy of these laws has been a matter of concern. After laws have been enacted, it is upon the relevant organizations to comply and adopt the provisions. Whether the laws have been adopted, and to what extent they have been adopted by those to whom they apply is a question this research sought to establish.

As previously mentioned, the 90s were marked by great economic growth. However, this decade was also marked by a big wave of corporate scandals, more-so in the South East Asian region, and in the United States of America.<sup>298</sup> These scandals and corporate failings were attributed to inefficiency in the corporate governance structures or the abandonment of the practice as a whole.<sup>299</sup> Although the same kind of failure in the corporate sector has not happened to such an extent in Kenya, it is important that lessons from these incidences be taken account in establishing sound policies to be used in the management of the corporate sector so

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<sup>298</sup> Okeahalam C, Oludele A, ‘ A review of corporate governance in Africa: literature, issues and challenges’ Global Corporate Governance Forum, The Hague, 15 June 2003, 3.

<sup>299</sup> Okeahalam C, Oludele A, ‘ A review of corporate governance in Africa: literature, issues and challenges’, 3.

as to prevent similar occurrences that would be detrimental to the economy and the Kenyan people.

#### **4.2. Adoption of corporate governance principles in the SASRA regulations, and effect on financial performance of DT-SACCOs in Kenya**

Key in ensuring effective adoption and implementation of the corporate governance principles as envisaged by the OECD is careful analysis, and thereafter, adoption and implementation by the relevant institutions. The regulator, being SASRA, while developing the guiding documents, ought to have followed this process and ensure that the principles outlined in their corporate governance guidelines, in this case, accountability, disclosure and transparency, and risk management, are implementable and tailored to suit the needs specific to DT-SACCOs.<sup>300</sup>

The SASRA Guidelines on Good Governance as envisaged by the regulator was developed with the objective of enabling DT-SACCOs to implement as well as maintain the minimum standards required for the best governance practices.<sup>301</sup> Additionally, the provisions contained in the document were to act as guidelines to the BODs of DT-SACCOs on how to carry out their roles in the organizations, and also as a guideline for the regulator on how to evaluate how the boards of DT-SACCOs perform.<sup>302</sup>

The SASRA Guidelines state that the intention of the rules is to promote human development, and promote brotherhood, which can be achieved when people come together to work for the common good of their community and themselves.<sup>303</sup> As the SASRA Supervision Annual Report of 2019 indicated, cooperatives are not only for-profit organizations, but that they are organizations centered on their membership.<sup>304</sup> The report goes on to state that the membership of cooperatives is usually made up of persons from the communities within which the cooperatives operate, and that it is often some of these members that are elected by all members, who run the organizations with the aim of achieving common goals.<sup>305</sup> This is from the philosophy of cooperation and the role it plays in promoting the values of equity, equality, and

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<sup>300</sup> Okeahalam C, Oludele A, ‘ A review of corporate governance in Africa: literature, issues and challenges’, 3.

<sup>301</sup> Sacco Societies Regulatory Authority, *Guidelines on good governance practices for deposit-taking sacco societies*, 2015, 6.

<sup>302</sup> Sacco Societies Regulatory Authority, *Guidelines on good governance practices for deposit-taking sacco societies*, 2015, 6.

<sup>303</sup> Sacco Societies Regulatory Authority, *Guidelines on good governance practices for deposit-taking sacco societies*, 2015, 8.

<sup>304</sup> The Sacco Societies Regulatory Authority, *The sacco supervision annual report 2019, 2020*, 20.

<sup>305</sup> The Sacco Societies Regulatory Authority, *The sacco supervision annual report 2019, 2020*, 20.

self-help.<sup>306</sup> DT-SACCOs form part of the cooperatives sector, and they embrace these values, with a kin-ship formed from the common ground of membership, thus working together for the common good of the organizations.

DT-SACCOs in Kenya have grown in size, number, and significance to the financial sector of the country. One indication of this is that, in 2019, as the SACCO Supervision Annual Report revealed, DT-SACCOs paid interests on the deposits to their members at rates significantly higher than those paid by commercial banks.<sup>307</sup> This was an indication of just how much better the performance of DT-SACCOs has grown in terms of providing savings facilities at favourable rates and giving their members good interest rates for loans taken. However, in the report, it was also indicated that the drop in the interest by commercial banks may have been influenced by the removal of the interest cap rate on the interests payable to deposits that commercial banking institutions hold, a provision that took effect in October 2018.<sup>308</sup> The improvements that are reflected in the numbers can thus be argued to have been attributed to factors other than an improvement in the operations of the DT-SACCOs, which would then have an effect in performance.

In 2019, SASRA received funding from the National Treasury's Financial Sector Support Project for the purpose of developing a market conduct policy for DT-SACCOs, as well as further develop a legal and regulatory framework.<sup>309</sup> This project would be headed by an expert in the industry known as Gianfranco Vento.<sup>310</sup> This came about as a result of reports of malpractices that have plagued the DT-SACCO sector, some which have been reported to be charging of high fees, effecting charges that cannot be explained, delay in having members reimbursed their deposits, which is to be done on or before the expiry of 60 days which is the notice period required, and the reckless lending habits by the institutions, of which debt repayment follow up practices were poor to allow for maximum loan collection, all these vices which worked to fleece members of these DT-SACCOs.<sup>311</sup> These practices put DT-SACCOs in vulnerable positions whereby they could easily collapse and cause instability of the whole sector and the financial sector of the country.

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<sup>306</sup> Sacco Societies Regulatory Authority, *Guidelines on good governance practices for deposit-taking sacco societies*, 2015, 8.

<sup>307</sup> The Sacco Societies Regulatory Authority, *The sacco supervision annual report 2019*, 2020, 28.

<sup>308</sup> Section 33B (1)(b), *The Banking (Amendment) Act*, (Act No. 25 of 2016)

<sup>309</sup> Anyanzwa J, 'New rules to protect Kenyan Sacco members' *The East African*, 25 June 2019.

<sup>310</sup> Anyanzwa J, 'New rules to protect Kenyan Sacco members' *The East African*, 25 June 2019.

<sup>311</sup> Anyanzwa J, 'New rules to protect Kenyan Sacco members' *The East African*, 25 June 2019.

A circular that was sent to the Chief Executive Officers of DT-SACCOs from SASRA indicated that the current legal and regulatory framework for the industry was insufficient and inadequate and thus left the industry vulnerable to practices that would lead to the exploitation of customers and market abuse.<sup>312</sup> SASRA's CEO, John Mwaka, stated that the inadequacy of the market conduct regulations posed challenges that resulted to low savings in DT-SACCOs, as well as over-indebtedness, and ultimately led to the work the SASRA has done in the improvement of financial inclusion through making the DT-SACCO sector more accessible, undermined.<sup>313</sup> It was stated that the Act does cover certain elements of market regulation, such as product disclosures, conflict of interest, the fittingness of those to manage the institutions, among others, but these have not been sufficient in dealing with the issue.

#### **4.2.1. Adoption of the principle of accountability**

According to the SACCO Societies Act, DT-SACCOs are required to make fresh applications to the Authority in order to be licensed on or before the 30<sup>th</sup> of September of each subsequent year.<sup>314</sup> The Authority thus maintains a list of all DT-SACCOs licensed to operate on its website so as to allow members of the public to verify the status of the SACCOs they are members of, or to ascertain the status of SACCOs that they wish to join. It is a form of protection for the members of these institutions, as well as members of the public.

According to the SASRA Guidelines on Good Governance of Deposit Taking SACCOs, persons who accept to be directors of DT-SACCOs are expected to be honest, diligent, and ethical in the dispensation of their duties.<sup>315</sup> However, several reports in Kenya indicate that this has not been adhered to by various DT-SACCOs in the country.

A study by the Financial Sector Deepening (FSD) revealed that despite having a regulatory authority in place, SASRA, the DT-SACCO sector has remained almost as weak as a decade ago.<sup>316</sup> Similarly, David Mathuva found that despite efforts by the regulator to improve accountability by DT-SACCOs through enforcing regulations, levels of accountability have shown no improvement over the years.<sup>317</sup> In 2018, a stability report on the Kenyan financial

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<sup>312</sup> 'New rules to protect Kenyan Sacco members' *The Cooperator* 26 June 2019

<https://thecooperator.news/new-rules-to-protect-kenyan-sacco-members/> 20 May 2021.

<sup>313</sup> Anyanzwa J, 'New rules to protect Kenyan Sacco members' *The East African*, 25 June 2019.

<sup>314</sup> Sec 25, regulation 5(1) of 2010 regulations.

<sup>315</sup> Sacco Societies Regulatory Authority, *Guidelines on good governance practices for deposit-taking sacco societies*, 2015, 30.

<sup>316</sup> Sunday F, 'Weak controls leave many Saccos bleeding' *The Standard*, 15 February 2017,1.

<sup>317</sup> Mathuva D, 'Drivers of financial and social disclosure by saving and credit cooperatives in Kenya: a managerial perspective' 49 *Journal of Co-operative Organization and Management* (2016),1.

sector was compiled by the Financial Sector Regulators. In this report, from a survey done and data collected, it was found that poor management, which leads to misappropriation of funds by managers is one of the main issues that threatens the stability of DT-SACCOs in Kenya.<sup>318</sup>

In the case of Ekeza SACCO, a DT-SACCO, over five thousand members of the SACCO took part in public protests over allegations of theft of members' deposits by the chairman of the BOD of the SACCO.<sup>319</sup> Members of the SACCO filed several complaints with the Directorate of Criminal Investigations of Kenya, citing fraud, misappropriation, and theft of funds. Stima SACCO is another DT-SACCO that has had instances of fraud, mismanagement, and embezzlement of funds. A report revealed that the management of the SACCO is corrupt, and that the SACCO's secretary has a history of corrupt practices in his previous engagements.<sup>320</sup> The SACCO has failed to account for allowances given to board members, with reports indicating that directors of the board had irregularly been paid millions of shillings in allowances.<sup>321</sup>

A trend of mismanagement and corruption in DT-SACCOs in Kenya over the years has become a matter of concern for members, potential members, and stakeholders of these organizations. These vices have been perpetuated by the boards of directors and management teams.<sup>322</sup> In a speech by the Ethics and Anti-Corruption Commission (EACC) CEO, Mr. Twalib Mbarak, he posited that should an audit on the human resource of DT-SACCOs be done, the audit is likely to reveal that most employees are relatives of officials and directors.<sup>323</sup> It is for this reason that the CEO called for lifestyle audits to be conducted on high level officials of SACCOs.<sup>324</sup>

As of 2021, the EACC had received several complaints relating to misappropriation of funds, embezzlement, and abuse of office in the SACCO sector.<sup>325</sup> The Interior Cabinet Secretary of Kenya, Mr. Fred Matiangi, also made a firm declaration that if any persons who manage

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<sup>318</sup> Financial Sector Regulators, *The Kenya Financial Sector Stability Report 2018*, 2019, 29.

<sup>319</sup> Kariuki J, '5, 000 turn out for Ekeza Sacco fraud probe' *Business Daily*, 18 March 2019.

<sup>320</sup> 'Fraud, corruption and mismanagement threatens Stima Sacco' <https://thenairobistar.com/2021/02/06/fraud-corruption-and-mismanagement-threatens-stima-sacco/> on 1 June 2021.

<sup>321</sup> 'Fraud, corruption and mismanagement threatens Stima Sacco' <https://thenairobistar.com/2021/02/06/fraud-corruption-and-mismanagement-threatens-stima-sacco/> on 1 June 2021.

<sup>322</sup> Nasubo F, 'Is Sasra doing enough' *The Accountant* (2019), 1.

<sup>323</sup> Nasubo F, 'Is Sasra doing enough' 1.

<sup>324</sup> Ethics and Anti-Corruption Commission 'MOU puts Saccos corruption cartels on notice' <http://eacc.go.ke/default/mou-puts-saccos-corruption-cartels-on-notice/> on 1 June 2021.

<sup>325</sup> Suche C, 'EACC tightens war on corruption' *Kenya News Agency*, 9 June 2021, 1.

cooperatives are found to have misused deposits of members, they will be prosecuted to the fullest extent of the law.<sup>326</sup>

#### 4.2.2. Adoption of the principle of disclosure and transparency

The basis of disclosure is to make information available and known to others. Part of the process requires actively making this information available and known. According to Richard Smith, the concept of disclosure and transparency introduced new responsibilities to the BODs of corporations, as it is now an obligation placed upon them and a duty they need to fulfill to shareholders and stakeholders such as the regulators.<sup>327</sup> It is also an important tool used by regulators to monitor activities of organizations. Transparent disclosures are necessary in creating confidence in the markets. Where there are no disclosures, or where there are poor disclosures, a conducive environment is likely to be created to allow for unethical conduct by those in authority, thereby fostering a negative public perception of DT-SACCOs, being that it is a sector being run without integrity, which could have an adverse effect on the institutions.<sup>328</sup> The basis of disclosure and transparency according to the OECD is that periodic disclosures ought to be made at least annually, but could also be made on a semi-annual or quarterly basis.<sup>329</sup>

One of the disclosure requirements provided for under Section 42 of the SACCO Societies Act requires that any lending to insiders should be indicated in the financial statement of the DT-SACCOs. Insider lending has been cited to be one of the biggest contributors to failure in financial institutions.<sup>330</sup> In the case of Chase Bank, it was found that irregular lending was instigated by its board of directors, and that this is what ultimately led to its collapse.<sup>331</sup> Similarly, this is the reason that led to the collapse of another bank in Kenya, Imperial Bank.<sup>332</sup> The insider loans in the case of Chase Bank amounted to a total of Kshs. 13.62 billion, which was different from the figures that were reported by their board, which indicated the figure as

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<sup>326</sup> 'CS: Sacco heads to be censured' <https://www.kuscco.com/index.php/disclaimer/92-ticker/191-cs-sacco-heads-to-be-censured> on 1 June 2021.

<sup>327</sup> 'Role of disclosure in corporate governance' <https://tracc.schar.gmu.edu/wp-content/uploads/2020/09/borgia01.pdf> 20 May 2021.

<sup>328</sup> 'Role of disclosure in corporate governance' <https://tracc.schar.gmu.edu/wp-content/uploads/2020/09/borgia01.pdf> 20 May 2021.

<sup>329</sup> Organisation for Economic Co-operation and Development, *G20/ OECD Principles of corporate governance*, OECD Publishing, Paris, 2015, 37.

<sup>330</sup> Odipo JO, 'Determinants of financial distress: a case of deposit taking Savings and Co-operative Societies in Kenya' Unpublished, Strathmore University, Nairobi, 2019, 37.

<sup>331</sup> Amadala V, 'Revealed: how insiders' loans fraud sank Chase Bank' The Star, 18 February 2019.

<sup>332</sup> Amadala V, 'Revealed: how insiders' loans fraud sank Chase Bank' The Star, 18 February 2019.

Kshs. 5.72 billion.<sup>333</sup> From this, it can clearly be seen how the vice of insider lending can play a major role in the collapse of financial institutions.

In the case of DT-SACCOs, the SACCO Societies Act provides for insider lending under Section 42, which requires that the institutions make disclosures of insider lending in their financial statements.<sup>334</sup> In a survey conducted in a study done by Francis Mwangi and Dr. Phelgona Genya, it was found that individual DT-SACCOs had different policies on insider lending, and that these policies had an effect on the net surplus that these DT-SACCOs would have.<sup>335</sup> Furthermore, compliance to the bi-monthly notification to the regulator, SASRA, also had an effect on the net surplus achieved by the institution.<sup>336</sup> This is a part of compliance issue which is key in corporate governance. This study revealed that compliance to disclosure requirements does indeed have an effect on the financial position of DT-SACCOs. This is a fact that was also agreed upon by majority of the interviewees that participated in the survey, who revealed that compliance to the institutions' code of conduct relating to the issue of insider lending did indeed have an effect on financial performance.<sup>337</sup>

Ultimately, in the collapse of the banking institutions in Kenya, it was found that poor corporate governance practices had a big role to play in it. In the case of insider lending, it was found that the insider lending in the institutions was unregulated and that this was a serious indication of the poor implementation of good corporate governance in their structures and policies, and any observation of these principles were found to have been lax, and that such important aspects have been overlooked by the BOD. An evidence of this is that most of the loans taken from the bank were found to have been non-performing, and a big number of these non-performing loans were unsecured and had a small likelihood that they were going to be paid back.<sup>338</sup> From this, it is apparent that where corporate governance structure are not sufficient, directors and those to whom shareholders have entrusted with their funds may have a way of irregularly getting these funds for their own use or for unauthorized use. Furthermore, if there indeed are structures

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<sup>333</sup> Gathaiya R, 'Analysis of issues affecting collapsed banks in Kenya from year 2015 to 2016',9.

<sup>334</sup> Section 35, *Sacco Societies Act*, (Act No. 14 of 2008)

<sup>335</sup> Genga PA, Mugoto FM, ' Disclosure requirements and financial performance of deposit taking Savings and Credit Co-operatives in Nairobi County' 3 *International Academic Journal of Economics and Finance* ( 2019), 29.

<sup>336</sup> Genga PA, Mugoto FM, ' Disclosure requirements and financial performance of deposit taking Savings and Credit Co-operatives in Nairobi County',29.

<sup>337</sup> Genga PA, Mugoto FM, ' Disclosure requirements and financial performance of deposit taking Savings and Credit Co-operatives in Nairobi County',29.

<sup>338</sup> Gathaiya R, 'Analysis of issues affecting collapsed banks in Kenya from year 2015 to 2016',12.

addressing the issue of insider lending and other issues of disclosure, their implementation is important in order to prevent such incidences that can jeopardize people's money.

As study done by Pervan and Bartulovic found that in Croatia, there is a positive correlation between the transparency level on key financial accounting information indicating relevant disclosures, and the value relevance of accounting information in South European countries.<sup>339</sup> Furthermore, according to the study, the level of transparency could be used to differentiate between countries that have high value relevance and those that have low value relevance.<sup>340</sup> Value relevance is defined as the ability of disclosed financial information to be used to determine the true value of a firm. This information is important to members and stakeholders of DT-SACCOs, as it keeps them informed on the progression of their SACCOs in terms of financial performance, revealing areas that need attention. It is also useful in assessing trends in the sector within the country and beyond the borders. It is the responsibility of the BOD to ensure that the organization produces an annual report giving an accurate report on the financial performance of the institution, as well as the true financial position of the DT-SACCO.<sup>341</sup>

In 2008, the government of Kenya developed the SACCO Prudential Regulations on Liquidity, Capital Adequacy, and Asset Quality for DT-SACCOs for the purpose of increasing the quality of accountability and transparency in the burgeoning sector. In 2016, SASRA launched an online complaints portal whereby members of DT-SACCOs as well as members of the general public would be able to place their complaints to be addressed by SASRA. Thereafter, these reports were to be shared with the SACCOs that have had complaints filed against them, and thereafter, to facilitate the reaching of a resolution by those involved, confirm the resolution, and to also allow for members of the public to see decisions that have been made with regard to complaints.<sup>342</sup> This new addition was triggered as part of the improvement to services initiative to SACCO members, and to increase customer satisfaction levels. The purpose of the regulations was to also ensure that stakeholders are sufficiently catered to, all the while also improve data collection, reporting, and analysis of information so as to facilitate the quick

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<sup>339</sup> Bartulovic M, Pervan I, ' Value relevance of accounting information: evidence from South Eastern European countries' 27 *Economic Research* (2014), 186.

<sup>340</sup> Bartulovic M, Pervan I, ' Value relevance of accounting information: evidence from South Eastern European countries' 27 *Economic Research* (2014), 186.

<sup>341</sup> Braemeg Savings and Credit Co-operative Society Ltd, *Governance and leadership policy*, 25.

<sup>342</sup> The Sacco Societies Regulatory Authority, *Press statement on the status of deposit taking Saccos subsectors*, 28 February 2017.

resolution of issues that may arise as a result of miscommunication and failure by DT-SACCOs in adhering to the laid down business processes.<sup>343</sup>

BODs of DT-SACCOs should have in place transparent strategies to guide engagement with shareholders and members when it comes to making decisions.<sup>344</sup> The decision-making process must be transparent, and relevant information disseminated to ensure that decisions made on-behalf of members of the SACCO are made from an informed position, are objective, and capture the best interests of the members.<sup>345</sup> Minutes of board minutes are to be kept confidential. However, reasonable requests for access to these minutes should not be unreasonably denied.<sup>346</sup>

Uganda's Minister for Local Government, Jennipher Namuyangu, noted that lack of transparency by DT-SACCOs was a big issue that is likely to lead to the collapse of institutions in this sector.<sup>347</sup> She noted that lack of transparency by the executives that run these organizations are likely to thwart any positive objectives and goals members of the SACCOs seek to achieve from the activities of the institutions.

SASRA, as the regulator, is mandated to regularly review the openness of DT-SACCOs.<sup>348</sup> As the BOD of each DT-SACCO is also obligated to keep abreast with who the key stakeholders of DT-SACCOs are, what their needs are, and how these needs should be met.<sup>349</sup>

#### **4.2.3. Adoption of the principle of risk management**

Credit risk is one of the risks that DT-SACCOs, as financial institutions, need to be concerned with. Credit risk is the threat that a financial institution is likely to face in the event that persons to whom credit facilities are advanced fail to repay the loans or fail to meet their contractual obligations. In managing credit risk, it is important the credit history of a borrower is taken into consideration prior to the loan being approved. Furthermore, the institution should look into

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<sup>343</sup> The Sacco Societies Regulatory Authority, *Press statement on the status of deposit taking Saccos subsectors*, 28 February 2017.

<sup>344</sup> Braemeg Savings and Credit Co-operative Society Ltd, *Governance and leadership policy*, 23.

<sup>345</sup> Braemeg Savings and Credit Co-operative Society Ltd, *Governance and leadership policy*, 21.

<sup>346</sup> Sacco Societies Regulatory Authority, *Guidelines on good governance practices for deposit-taking sacco societies*, 2015, 29

<sup>347</sup> Nyango P, 'Lack of transparency killing Saccos, says minister' *PML Daily*, 27 March 27

<https://www.pmeldaily.com/news/2018/03/lack-of-transparency-killing-saccos-says-minister.html> on 1 June 2021.

<sup>348</sup> Sacco Societies Regulatory Authority, *Guidelines on good governance practices for deposit-taking sacco societies*, 2015, 29

<sup>349</sup> Sacco Societies Regulatory Authority, *Guidelines on good governance practices for deposit-taking sacco societies*, 2015, 29

the credit worthiness of the borrower. This information can be accessed through platforms such as the Credit Reference Bureau. Where there is poor credit risk management, there is a great likelihood of an institution having non-performing loans. According to a report by the Central Bank of Kenya, it was indicated that the non-performing loan ratio in DT-SACCOs has significantly increased from 6.15 percent in 2019, to 9.12 percent as of June 2020.<sup>350</sup> This is the highest the ratio has ever been since 2012. The level prescribed by the World Council of Credit Unions ( WOCCU) for loan portfolio risk is 5.23 percent, while that prescribed by SASRA is 3 percent.<sup>351</sup> DT-SACCOs in Kenya have failed to meet both of these standards in maintaining a desirable level of credit risk.

DT-SACCOs are also required to be aware of liquidity risk. This is the threat an institution faces whereby by it is unable to meet its short-term financial obligations as they fall due. A DT-SACCO might be facing liquidity issues if it finds itself in a position where it cannot be able to fund its day-to-day operations. It is thus desirable that a DT-SACCO maintains optimum liquidity. Following the capital adequacy requirements as prescribed by the SASRA regulations, it is important in ensuring that DT-SACCOs are cushioned against facing insolvency, as well as allowing them to sustainably operate in tough economic times. It is important for financial institutions to adopt the necessary practices that will protect them from one of the vices that is excessive risk-taking. It was reported that had the Lehman Brothers adopted more stringent regulations that would have curbed their risk-taking appetites, then this would have gone a long way in preventing the 2008 financial crisis.<sup>352</sup>

According to Benjamin Otwoko and Kimani Maina, empirical studies have revealed that there is correlation between the liquidity risk of a financial institution and its financial performance.<sup>353</sup> One of the main issues that have led to the revocation of licenses by SASRA is that affected DT-SACCOs were found to have liquidity problems.<sup>354</sup> Mwashu and Miroga

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<sup>350</sup> Alushula P, ‘ Sacco bad loans hit level recorded a decade ago’ Business Daily, 29 December 2020.

<sup>351</sup> <https://www.kuscco.com/index.php/about-us/background/92-ticker/147-loan-default-rate-and-members-deposits-threaten-sacco-s> on 1 June 2021.

<sup>352</sup> Wang M, ‘ SEC rebuked for regulatory failure with Lehman Brothers’ *ProPublica* ( 2010).

<sup>353</sup> Maina K, Otwoko BE, ‘ Effect of liquidity risk on the financial performance of deposit taking savings and credit cooperative organisations ( SACCOs ) in Kenya’ 10 *International Journal of Research Business and Social Science* (2021), 203.

<sup>354</sup> Miroga J, Mwashu P, ‘ Influence of liquidity management practices on profitability of deposit taking SACCOs in Kakamega county’ 5 *The Strategic Journal of Business & Change Management* (2018), 904.

have stated that poor liquidity is also one of the reasons where some DT-SACCOs in Kenya have been unable to start operations despite being registered.<sup>355</sup>

An effective risk management system of a financial institution is anchored on the quality of the organization's Management Information Systems (MIS).<sup>356</sup> DT-SACCOs handle large amounts of critical financial data and information, as well as members' information. It is important for this data to be properly stored, so that when it is presented to its users, they are able to easily access it so as to make sound decisions based on such information.<sup>357</sup> The MIS helps the BOD carry out its oversight function over the management, and the management oversee the day-to-day operations of the organization. It is from this system that information can be derived and used to assess the risk profile of the organization.

According to Christopher Moturi, the MISs of DT-SACCOs in Kenya have been ineffective as the adoption of Information and Communications Technology ( ICT) has been inconsistent in the country.<sup>358</sup> He further states that the MISs offered to DT-SACCOs in Kenya are not tailored for the kind of operations that the sector carries out, and is thus not sufficient.<sup>359</sup> Other challenges noted in the implementation of MISs in DT-SACCOs in Kenya is lack of sufficient funding for ICT projects in certain regions where DT-SACCOs operate, insufficient ICT policies, and the absence of monitoring mechanisms for these systems.<sup>360</sup>

According to SASRA's guidelines, the BOD should have in place fair internal policies and systems for dealing with accusations made by whistle blowers.<sup>361</sup> These policies and systems should be sufficient to protect whistleblowers from repercussions from making reports, and also to encourage persons with critical information to make reports without fear of threats or repercussions. These policies and systems should be made known to all employees of DT-SACCOs.

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<sup>355</sup> Miroga J, Mwash P, ' Influence of liquidity management practices on profitability of deposit taking SACCOs in Kakamega county', 904.

<sup>356</sup> Ambrose J, Nthimba AN, ' Financial risk management strategies employed by licensed deposit taking Saccos in Nairobi County' 4 *Global Journal of Commerce & Management Perspective* ( 2015), 59.

<sup>357</sup> Moturi C, Mbiwa P, ' An evaluation of the quality of management information systems used by Saccos in Kenya' 27 *TQM Journal* (2015), 799.

<sup>358</sup> Moturi C, Mbiwa P, ' An evaluation of the quality of management information systems used by Saccos in Kenya', 799

<sup>359</sup> Moturi C, Mbiwa P, ' An evaluation of the quality of management information systems used by Saccos in Kenya', 799

<sup>360</sup> Moturi C, Mbiwa P, ' An evaluation of the quality of management information systems used by Saccos in Kenya', 799

<sup>361</sup> <file:///C:/Users/linda/AppData/Local/Temp/Guidelines%20on%20Good%20Governance%20of%20DTS.pdf>  
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### 4.3. Significance of corporate culture in DT-SACCOs

The SASRA guidelines provide that it is the mandate of the BOD to uphold the objects, values, and social goals of the DT-SACCO.<sup>362</sup> It is upon the executives to inform and guide the corporate culture of their organizations. The BOD of DT-SACCOs are to ensure that they comply with the provision of the guidelines, which outlines disclosure requirements, stating that there be a report on Corporate Governance Disclosure in the BOD annual report, in which the board will state whether they have complied with the provisions of the guidelines.<sup>363</sup> In the report, if it is revealed that there was no compliance, the BOD is expected to state the reasons for the non-compliance, and what they will do to ensure future compliance.<sup>364</sup> It is indicated in the guidelines that compliance to the guidelines must be ensured, but however, BODs are encouraged to adopt best practices over and above what the SASRA has provided in order to enrich the policies that they already have and enhance results that could be realized from a sound organization performing in the best interests of its members, as well as working within the legal provisions in the guiding and anchoring legislations as that in itself is good corporate governance practice.<sup>365</sup> The BOD is accountable to the regulator, and is expected to be transparent in its engagement with SASRA.<sup>366</sup> As per the guidelines, it is imperative for the Board members to keep abreast with the affairs of the SACCO, and to monitor and supervise the officials employed by the SACCO.<sup>367</sup>

Any laxity in adhering to corporate governance regulations, as was seen in the case of Chase bank, can easily be taken advantage of by rogue board members. It would leave the institution vulnerable to fraudulent activity to the detriment of the institution as a whole. As part of the financial sector, it is important for DT-SACCOs to take note of this, as they have just gained popularity of the last few decades, thus it is imperative to have stringent measures in place in order to protect the institutions from collapse and in order to protect the members' funds from those to whom they have entrusted their money.

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<sup>362</sup> Sacco Societies Regulatory Authority, *Guidelines on good governance practices for deposit-taking sacco societies*, 2015, 29

<sup>363</sup> Sacco Societies Regulatory Authority, *Guidelines on good governance practices for deposit-taking sacco societies*, 2015, 7.

<sup>364</sup> Sacco Societies Regulatory Authority, *Guidelines on good governance practices for deposit-taking sacco societies*, 2015, 7.

<sup>365</sup> Sacco Societies Regulatory Authority, *Guidelines on good governance practices for deposit-taking sacco societies*, 2015, 7.

<sup>366</sup> Sacco Societies Regulatory Authority, *Guidelines on good governance practices for deposit-taking sacco societies*, 2015, 30.

<sup>367</sup> Sacco Societies Regulatory Authority, *Guidelines on good governance practices for deposit-taking sacco societies*, 2015, 30.

According to the SASRA Guidelines on Good Governance of DT-SACCOs, the BOD is accountable to members of the DT-SACCO, and also have a responsibility to the stakeholders of the organization. They are answerable to regulatory authorities regarding compliance to statutory and regulatory requirements. In ensuring statutory and regulatory compliance, the BOD must ensure that the SACCO employs a Compliance Officer to maintain a compliance schedule and checklist and make regular reports to the BOD on updates regarding compliance requirements, and how to implement the changes.<sup>368</sup>

In the US, initially, a *laissez-faire* approach was adopted in terms of having laws regarding board composition of corporations, the size of corporations, structure, director remuneration, the inclusion of non-executive directors and the ratio between insiders and outsiders.<sup>369</sup> According to the *laissez faire* approach, regulation is unnecessary as when things are left to their own devices, everything will adjust to how it's actually supposed to be; it is generally taking a completely hands off approach and is mainly concerned with the protection of consumers of service but not how things should be run by those who should run them.<sup>370</sup> By the US taking this approach, issues regarding the above-mentioned matters were left to the whims of the shareholders, which left these issues vulnerable to abuse from the directors as selection is left to them and it's at their discretion, and these are the people who are supposed to monitor the directors and thus leaving shareholders vulnerable.<sup>371</sup>

An empirical study was conducted in the US, whereby seven hundred and sixty-eight directors of companies in the US were interviewed. In this study, it was revealed that many of the interviewed directors were conflicted between doing what was expected from them by the shareholders with regard to protecting their interests, and the pressures they got from the BOD from which camaraderie was expected from them.<sup>372</sup>

Directors ought to ensure that they do not improperly use inside information that they are privy to regarding the SACCO, and to be honest in their conduct.<sup>373</sup> They are required to discharge

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<sup>368</sup> Sacco Societies Regulatory Authority, *Guidelines on good governance practices for deposit-taking sacco societies*, 2015, 30.

<sup>369</sup> Baysinger B and Butler H, 'Corporate Governance and the board of directors: performance effects of changes in board composition' 1 *Journal of Law, Economics & Organization* (1985), 102.

<sup>370</sup> Naggar T, 'Adam Smith's *Laissez Faire*' *The American Economist* (1977), 38.

<sup>371</sup> Obonyo MB, 'Engendering good corporate governance in the Kenyan banking sector: an examination of the limits of law' Unpublished, Strathmore University, Nairobi, 2019, 69.

<sup>372</sup> Lawler E and Finegold D, 'CEO compensation: what board members think' 16 *WorldatWork Journal* (2007), 38.

<sup>373</sup> Sacco Societies Regulatory Authority, *Guidelines on good governance practices for deposit-taking sacco societies*, 2015, 30.

their duties diligently in a manner that is reasonably expected from an individual holding such a position.<sup>374</sup> The guidelines also require that Directors of DT-SACCOs be adequately skilled in order to properly discharge their duties.<sup>375</sup>

Corporate social responsibility is an important aspect of corporate governance. The SASRA guidelines state that it is the responsibility of the BOD to ensure that the activities of the DT-SACCOs do not have a negative impact in the community within which it operates, and that the organization has sound corporate social responsibility policies in place.<sup>376</sup> According to the guidelines, the CSR practices of a DT-SACCO forms an important element of the organizations' corporate identity. Additionally, the guidelines state that the BOD must ensure that there are policies in place to mitigate adverse effects on the environment from the activities of the co-operative.<sup>377</sup>

The SASRA Guidelines require the BOD to conduct general meetings as per the by-laws of the SACCO in order to keep the members informed of the happenings of the organization, and these by-laws should reflect that it is wrong for the BOD to neglect, be unwilling, or refuse to hold such meetings.<sup>378</sup>

Annual reports of DT-SACCOs should indicate the extent to which the institution has adhered to the good corporate governance principles as outlined in the SASRA Guidelines on Good Governance of DT-SACCOs.<sup>379</sup> It is the mandate of the BOD to ensure that it has a committee in place to ensure and monitor the compliance to, and implementation of the guidelines, and generate a report on the status of implementation of the recommendations.<sup>380</sup> This report should be made available to members of the SACCO, and should contain attendance reports on BOD meetings.

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<sup>374</sup> Sacco Societies Regulatory Authority, *Guidelines on good governance practices for deposit-taking sacco societies*, 2015, 30.

<sup>375</sup> Sacco Societies Regulatory Authority, *Guidelines on good governance practices for deposit-taking sacco societies*, 2015, 30.

<sup>376</sup> Sacco Societies Regulatory Authority, *Guidelines on good governance practices for deposit-taking sacco societies*, 2015, 29.

<sup>377</sup> Sacco Societies Regulatory Authority, *Guidelines on good governance practices for deposit-taking sacco societies*, 2015, 29.

<sup>378</sup> Sacco Societies Regulatory Authority, *Guidelines on good governance practices for deposit-taking sacco societies*, 2015, 30.

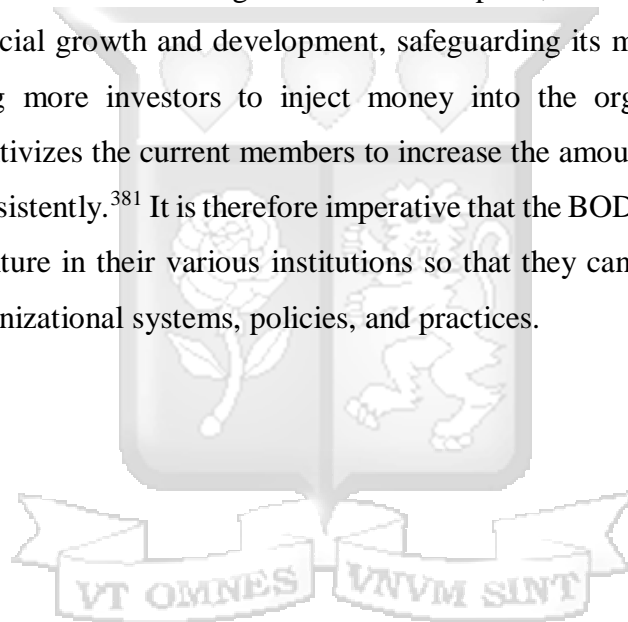
<sup>379</sup> Sacco Societies Regulatory Authority, *Guidelines on good governance practices for deposit-taking sacco societies*, 2015, 31.

<sup>380</sup> Sacco Societies Regulatory Authority, *Guidelines on good governance practices for deposit-taking sacco societies*, 2015, 31.

#### 4.4. Conclusion

This chapter noted that SASRA has incorporated the corporate governance principles of accountability, disclosure and transparency, and risk management in the guidelines for DT-SACCOs. The guidelines are in line with the principles outlined by the OECD. However, despite having the guidelines in place, reports have revealed that DT-SACCOs continue to face challenges in relation to these principles.

When corporations fully embrace and implement the corporate governance principles, it results in the organizations being better and more efficiently managed, which is for the good of the membership, as well as potential investors. Furthermore, a well-run organization mitigates the institution from instances of mismanagement and corruption, thus creating a conducive environment for financial growth and development, safeguarding its members and investors. Along with attracting more investors to inject money into the organization, a well-run corporation also incentivizes the current members to increase the amount of their investments and to be doing so consistently.<sup>381</sup> It is therefore imperative that the BODs of DT-SACCO build a strong corporate culture in their various institutions so that they can reap the benefits that come with sound organizational systems, policies, and practices.



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<sup>381</sup> Okeahalam C, Oludele A, ‘ A review of corporate governance in Africa: literature, issues and challenges’, 4.

## **CHAPTER FIVE: CONCLUSION AND RECOMMENDATIONS**

### **5.1. Introduction**

Kenya has assimilated corporate governance in its legal and regulatory frameworks. The focus of this research has been to ascertain whether the corporate governance policies and laws in place have been adopted by DT-SACCOs in Kenya, the extent to which they have been adopted, and the resultant effect on the financial performance of these institutions. This research has also considered the role of corporate culture in influencing the extent of adoption of corporate governance principles by DT-SACCOs. The previous chapters have addressed the significance of DT-SACCOs in Kenya to their membership, stakeholders, and the country at large.

This chapter presents the findings of this research and gives recommendations.

### **5.2. Conclusion on corporate governance and financial performance**

This research has established that good corporate governance practices does indeed have an effect on the financial performance of an organization. This is evident from the development of corporate governance practices and policies globally, which were triggered by the failures and collapse of big corporations, which ultimately had a significant negative financial impact on their shareholders and stakeholders. Some of these corporate failures had an impact beyond the organization itself, extending to stakeholders globally. A case in point would be the GFC of 2008, which triggered a financial recession during that period. It was revealed that corporate governance lapses in organizations, where there were weak structures in place to provide for checks and balances, was the primary reason leading to corporate failure.<sup>382</sup> Additionally, corporations did not have policies in place necessary to facilitate sound and ethical business practices. Most of the institutions that failed due to corporate governance lapses were cited to have had finance as their core business.<sup>383</sup> The crisis began in the Asian Continent, in Japan, and the U.S. However, the impact reached global levels due to the systemic significance that financial institutions have.

From this observation, it is evident that lapses in corporate governance practices by organizations directly impacts their financial performance. This is more-so in financial

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<sup>382</sup> Kumar N, Singh JP, ' Global financial crisis: corporate governance failures and lessons' 4 *Journal of Finance, Accounting and Management* (2013), 22.

<sup>383</sup> Kumar N, Singh JP, ' Global financial crisis: corporate governance failures and lessons',22.

institutions. Going by the asset base and deposits held by DT-SACCOs in Kenya, it is clear that these institutions have systemic significance, and poor corporate governance practices are likely to affect their financial performance, which could eventually lead to collapse. This would result in negative financial ramifications on the members and stakeholders of these institutions, and the country's economic development as a whole. Their impact can therefore not be ignored.

The OECD corporate governance principles were initially targeted for public listed companies, more-so in the financial sector.<sup>384</sup> Corporate governance is therefore necessary in financial institutions such as DT-SACCOs, whose primary business is finance related. This research concluded that corporate governance is necessary for organizations to ensure smooth running and efficiency, which would ultimately have a positive effect on financial performance.

There have been some studies that have been done that have indicated that corporate governance is not an accurate tool to predict the financial performance of an organization.<sup>385</sup> However, majority of studies done on the subject have confirmed that corporate governance does indeed affect the financial performance and position of an organization. It has been confirmed by several studies that institutions with strong corporate governance systems and structures in place are more likely to perform better than organizations with weak governance structures. In the Nairobi Securities Exchange, listed companies with good corporate governance structures were found to have these structures impact on return on investment, which translated into shareholders getting more dividends.<sup>386</sup>

With good corporate governance structures in place, persons in all positions, from the BOD, the management team, the employees, among others, are bound to improve in performance due to adherence to the systems set in place. Furthermore, it facilitates better management and control over resources placed in their custody, consistent with the stewardship and stakeholder theories, thus resulting in better financial performance.

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<sup>384</sup> Organisation for Economic Co-operation and Development, *G20/ OECD Principles of corporate governance*, 9.

<sup>385</sup> Aosa E, Kamau G, Machuki V, ' Corporate governance and performance of financial institutions in Kenya' 17 *Academic of Strategic Management Journal* (2018),

<sup>386</sup> Ahmed AH, Muiruri-Ndirangu JW, Mutiva JM, ' The relationship between voluntary disclosure and financial performance of companies quoted at the Nairobi Securities Exchange' 3 *Internal Journal of Managerial Studies and Research* ( 2015), 174.

### **5.3. Extent of adoption of the SASRA guidelines on corporate governance principles, and the influence of corporate culture**

As has been covered by chapter four of this research, SASRA has covered the corporate governance principles of accountability, disclosure and transparency, and risk management in its guidelines for DT-SACCOs in Kenya. SASRA developed these guidelines in compliance with Section 50 of the SACCO Societies Act. The guiding documents are the SASRA Guidelines on Good Governance Practices for Deposit-takings SACCO Societies, and the SASRA Guidelines on Risk Management Practices for Deposit-Taking SACCO Societies. In terms of risk management and the fast-developing technological infrastructure, SASRA has gone further to develop extensive guidelines on these and has also recently incorporate Cyber Security Guidelines for DT-SACCOs. SASRA has made strides in this considering the evolution of mobile banking, electronic banking, and online platforms that DT-SACCOs use. As the CBK reported, DT-SACCOs in Kenya have lacked capacity in managing cyber security risks, and have had poor management controls, which has led to instances of misappropriation of members' funds by executives of these SACCOs, who have used members' deposits to acquire risky assets, and failed to observe the risk management guidelines provided by SASRA.<sup>387</sup>

The guidelines developed by SASRA have extensively covered the corporate governance principles of accountability, disclosure and transparency, and risk management as envisaged by the OECD. However, the guidelines are not legal requirements, which lowers their efficacy in the operations of DT-SACCOs, also affecting the monitoring and supervisory role of the Authority, the corporate culture of DT-SACCOs, and ultimately the financial performance of these institutions.

### **5.4. Recommendations**

As the CEO of SASRA, John Mwaka, states on the foreword section of SASRA Guidelines on Good Governance Practices for Deposit-takings SACCO Societies, the provisions contained in the guidelines are advisory in nature, and not binding. SASRA developed these guidelines based on the mandate given to it under Section 50 of the SACCO Societies Act of Kenya, which states that the Authority may make recommendations on how DT-SACCOs may conduct

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<sup>387</sup> Financial Sector Regulators, *The Kenya financial sector stability report 2018, 2019, 29.*

their businesses. For these guidelines to be enforceable and binding, they need to be made legal requirements. This will enhance compliance by DT-SACCOs to the provisions on good corporate governance practices. Furthermore, it will enhance the supervisory and monitoring role of the Authority, as it will have a legal basis on which to assess and monitor compliance by DT-SACCOs to corporate governance requirements. The guidelines should thus be gazetted as a matter of urgency and a strict timeline provided within which DT-SACCOs should demonstrate compliance.

Sanctions for non-compliance with legal and regulatory provisions with regard to corporate governance principles should be clearly provided for. SASRA, as the regulator, would therefore be able to instill tough sanctions on DT-SACCOs that fail to comply with the guidelines on good corporate governance. Sanctions can only be imposed where there is failure to comply to legal and regulatory requirements. This means that the SASRA Guidelines ought to be gazetted so as to increase their enforceability. When institutions are legally required to comply, they will extensively adopt corporate governance principles, which will have a positive effect on the financial performance of these institutions.

As Ms. Mungai of the Financial Service Association said, SASRA should be facilitated in enforcing prudential regulations so as to strengthen the DT-SACCO sector, improve its growth, and seal regulatory loopholes that leave these SACCOs vulnerable to exploitation by those put in charge of them.<sup>388</sup> Additionally, the BODs of DT-SACCOs must ensure that internal measures and controls are in line with the provisions of the SACCO Societies Act, the SASRA Regulations, and all other guiding legislations. Any vices that may threaten the stability and soundness of an institution should be mitigated at once and a no-tolerance policy instituted. This includes illegal activities such as fraud, corruption, theft, and any activities that are in contravention with guiding legislations, and the DT-SACCO's internal policies and regulations on good corporate governance.

Strick adherence to capital adequacy requirement has been shown to improve the financial performance of DT-SACCOs.<sup>389</sup> As this research has revealed, overborrowing affected the financial performance of DT-SACCOs in Kenya. It was reported that external borrowing had

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<sup>388</sup> 'Sacco body escapes regulatory coalition' <https://www.kuscco.com/index.php/about-us/disclaimer/92-ticker/132-sacco-body-escapes-regulatory-coalition> on 15 June 2021.

<sup>389</sup> Genga P, Mugoto MF, 'Disclosure requirements and financial performance of deposit taking savings and credit co-operatives in Nairobi County, Kenya' 3 *International Academic Journal of Economics and Finance* (2019), 19.

exceeded the rate set by SASRA, and the number of non-performing loans by the year 2020 were at an all-time high, only comparable to the status a decade ago.<sup>390</sup> It is the recommendation of this research that DT-SACCOs strictly observe these requirements and ensure that there is periodic evaluation to make certain that this is observed, or to mitigate any instances of these requirements not being observed.

From the conclusions of this research, I would recommend that DT-SACCOs in Kenya provide timely disclosures, and that these disclosures are accurate. Furthermore, the management of DT-SACCOs should strive to be honest and forthright during the preparation of these documents. Proper books of account and financial statements should be maintained at all times and the regulations and statutory requirements complied with, as well as the internal policies set by the DT-SACCO's BOD. Furthermore, these should be presented at the periodic meetings aside from the AGM, so that the BOD is always abreast with the financial position of the organization, and any alarming issues pointed out early to allow for early intervention and mitigation measures. Having quarterly reviews on the financial position of DT-SACCOs was found to have a positive effect on the net surplus of these institutions.<sup>391</sup> The financial reports should always reflect the current positions of the DT-SACCOs. Those concerned should thus ensure that these records are regularly updated. Transparent disclosures are important in creating confidence in the DT-SACCO sector, which is likely to attract prospective members, and retain current members. DT-SACCOs should also ensure that all matters regarding conflict of interest are disclosed, as these affect the operations of the organization and the financial performance.

For the purpose of accountability, and in meeting the needs of stakeholders, it is the recommendation of this research that all DT-SACCOs ensure that the interests of stakeholders are factored in their codes of conduct. This has been found to have a positive effect on the market share of organizations.<sup>392</sup> This information should be included in governance statements submitted to the regulator. The laws and regulations guiding DT-SACCOs should thus make this a requirement, whose compliance can be monitored through periodic reporting.

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<sup>390</sup> Gathaiya R, 'Analysis of issues affecting collapsed banks in Kenya from year 2015 to 2016,12.

<sup>391</sup> Genga P, Mugoto MF, 'Disclosure requirements and financial performance of deposit taking savings and credit co-operatives in Nairobi County, Kenya', 32.

<sup>392</sup> Kajanathan R, 'Corporate governance practices and its impact on firm performance: special reference to listed banking institutions in Sri Lanka' 12 *Global Journal of Management and Business Research* ( 2012), 20.

Voluntary disclosures are not provided for in the SACCO Societies Act, nor the SASRA Guidelines on Good Corporate Governance. They are not a legal requirement. However, this research recommends that voluntary disclosures be adopted and embraced by DT-SACCOs in Kenya. Studies have shown that there is a correlation between an organization's voluntary disclosure policies and its financial performance.<sup>393</sup> Voluntary disclosures help in enabling financial institutions to obtain cheap capital as well as create a good impression on potential and current investors. In DT-SACCOs, this would help in attracting more members and encouraging the current members to increase their deposits, thus increasing the institution's capital and asset base. However, the main reason for incorporating voluntary disclosures in DT-SACCOs would be to increase the levels of accountability and transparency in financial reporting.

Voluntary disclosure involves the presentation of financial and non-financial information to users of this information beyond legal and statutory requirements. According to Shaban Mohammadi and Behrad Nezhad, in the past, corporations have been wary of making voluntary disclosures as they believed that making this information public would reveal sensitive information that ideally gives them a competitive edge amongst industry players.<sup>394</sup> Voluntary disclosures will help in ensuring that shareholders and stakeholders of DT-SACCOs, both prospective and current, are privy to whatever additional disclosures there may be, which would encourage them to invest more into DT-SACCOs. Voluntary disclosure also helps in giving an organization a good reputation, which is very attractive to current and potential investors.

The corporate culture of DT-SACCOs has been found to have an effect on the market share of DT-SACCOs.<sup>395</sup> It is very important for all persons working in these organizations to be trained on business ethics and be empowered with the necessary skills to be able to make the right decisions in situations that are unclear with regard to ethics. These trainings should be held frequently enough to ensure that a culture of good ethical practices is entrenched at all levels of the organization. Poor ethical practices such as corruption are a risk to the business of the DT-SACCOs, and may jeopardize the stability of the institutions, their members and stakeholders, and the Kenyan economy at large. As it has been found by studies, codes of

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<sup>393</sup> Ahmed AH, Muiruri-Ndirangu JW, Mutiva JM, ' The relationship between voluntary disclosure and financial performance of companies quoted at the Nairobi Securities Exchange', 171.

<sup>394</sup> Nezhad MB, Mohammadi, ' The role of disclosure and transparency in financial reporting', 61.

<sup>395</sup> Mathenge P, Muriuki EN, ' Business ethics and market share of tier one deposit taking Saccos in Nairobi County, Kenya' 6 *The Strategic Journal of Business and Change Management* (2019), 746.

conduct that informed the ethical culture of DT-SACCOs had a positive effect on the market share of the DT-SACCOs in Kenya.<sup>396</sup> I would thus recommend that DT-SACCOs in Kenya ensure that they have codes of conduct in place, and that they are adhered to by all persons in the organization, from the BOD, the management team, and all employees. This affects the extent to which the organization will adopt and implement corporate governance policies and practices. Where there is poor corporate culture, there is bound to be laxity in the adoption of good corporate governance practices. Ultimately, this is likely to have a negative effect in the performance of a financial institution.

This research recommends that the BOD of DT-SACCOs be made up of qualified and well-educated persons who possess the necessary competency to effectively carry out their mandates and fulfill their fiduciary duties. They should also carry out continuous professional development trainings so that they remain abreast with matters that are relevant to DT-SACCOs, and how to apply them to continuously improve the financial performance of these institutions. Well informed and educated board members are better equipped to set the necessary corporate governance strategies and policies in place to guide the organization.

From this research, in terms of oversight by the board and management, it is concluded that oversight and monitoring are key functions that affect the financial performance of DT-SACCOs. This is in terms of internal monitoring mechanisms, as well as that by the regulatory authority, SASRA. This aspect also calls for the establishment of various committees such as the audit committee, in which independent auditors can assess and advice on the way forward in terms of enhancing financial performance and mitigating risk. DT-SACCOs should therefore ensure that these committees are in place.

The management team is responsible for the day-to-day running of DT-SACCOs. It is thus important to ensure that their roles are clearly spelt out with regard to what is expected of them in relevance to accountability, disclosure and transparency, and risk mitigation. It is necessary that in their employment, it is considered whether they have the necessary skills and competencies to carry out their duties. They should also have managerial skills and specialized skills specifically needed in the DT-SACCOs. Professionals should be hired. They should be aware of the laws and regulations guiding the industry. The management teams of DT-SACCOs, who run the day-to-day operations, should ensure that they adopt a style of

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<sup>396</sup> Mathenge P, Muriuki EN, ' Business ethics and market share of tier one deposit taking Saccos in Nairobi County, Kenya', 746.

management that motivates all employees of the organization so as to increase the productivity levels, which should translate into positive financial performance. The style of management of DT-SACCOs affects the extent of adoption of corporate governance practices of these institutions, and this translates into financial performance.

The size of the BOD has been found to affect the financial performance of organizations.<sup>397</sup> It was found that the larger the board, the more dismal the financial performance. I would thus recommend that DT-SACCOs have smaller boards of directors in order to increase efficiency in decision making and giving advice, as well as in executing their monitoring and oversight functions. A big board size will slow down the decision-making process, which is undesirable, especially when critical and urgent decisions need to be made.

This research recommends that BODs of DT-SACCOs have independent non-executive directors, which is necessary to increase the accountability of the board through providing checks and balances in terms of vetting decision making. The audit committee should also constitute independent members in order to minimize the likelihood of having insiders influence the oversight authority of the committee.

## **5.5. Conclusion**

This chapter summarized the findings of this research, giving recommendations to address lapses in corporate governances by DT-SACCOs in Kenya, and their regulator, SASRA, in terms of enhancing the adoption of corporate governance principles of accountability, disclosure and transparency, and risk management, so as to enhance operations and improve financial performance of these SACCOs.

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<sup>397</sup> Guest PM, 'The impact of board size on firm performance: evidence from the UK' 15 *The European Journal of Finance* (2009), 394.

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# APPENDICES

## Appendix A- SU-IERC Ethical Approval Report



26<sup>th</sup> January 2022

Ms Yegon, Linda  
linda.yegon@strathmore.edu

Dear Ms Yegon,

**REF: Extent of Adoption of Corporate Governance Principles by Deposit-taking SACCOS in Kenya and the Effect on Financial Performance**

We acknowledge receipt of your application reference number **SU-IERC1198/21** for ethical approval regarding the referenced study, which was accompanied by the following:

1. A Study Proposal dated 14<sup>th</sup> September 2020.
2. Curriculum Vitae.

The Strathmore University Institutional Ethics Review Committee has reviewed submitted documents and **Not Approved** the study “**Extent of Adoption of Corporate Governance Principles by Deposit-taking SACCOS in Kenya and the Effect on Financial Performance**” for ethical clearance over the following concerns not being adequately addressed:

- *The student relied on secondary data and did not make any efforts to collect data from the sacco on grounds of Covid 19. “Reviewer comments: For the study to be comprehensive and fair to the SACCOS you need to bring to the fore their voice on the extent of adoption of corporate governance principles. Finally, the researcher cannot claim that due to time constraints they cannot collect data or do interviews.”*
- *The study is well conceptualised but is missing data collection via questionnaires.*

Sincerely,

for: Prof Fred Were,  
Chairperson; SU-IERC



Ole Sangale Rd, Madaraka Estate. PO Box 59857-00200, Nairobi, Kenya. Tel +254 (0)703 034000  
Email admissions@strathmore.edu www.strathmore.edu

## Appendix B- Plagiarism report



### Document Information

Analyzed document	EXTENT OF ADOPTION OF CORPORATE GOVERNANCE PRINCIPLES BY DEPOSIT- TAKING SACCOS IN KENYA AND THE EFFECT ON FINANCIAL PERFORMANCE.docx (D119124568)
Submitted	2021-11-19 07:05:00
Submitted by	
Submitter email	Linda.yegon@strathmore.edu
Similarity	13%
Analysis address	library.strath@analysis.orkund.com

### Sources included in the report

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