Examination of the relationship between corporate governance and financial soundness of licensed deposit taking saccos in Kenya

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DECLARATION

I declare that this work has not been previously submitted and approved for the award of a degree by this or any other University. To the best of my knowledge and belief, the thesis contains no material previously published or written by another person except where due reference is made in the thesis itself.

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ABSTRACT

The aim of this study was to explore the relationship between corporate governance and the financial soundness of the licensed deposit taking SACCOs in Kenya. The study specifically examined how boards' responsibility, transparency and disclosure and internal controls influence the financial soundness of licensed deposit taking SACCOs in Kenya. Financial soundness was measured using PEARLS monitoring systems. A questionnaire was administered to the CEOs and senior management officers of the SACCOs. These subjects were deemed conversant with the issues of corporate governance in their respective SACCOs. Regression analysis was used to establish the relationship of corporate governance on the financial soundness of the SACCOs.

The study found out that internal controls played a significant role in corporate governance. Three variables namely; board responsibility, transparency and disclosure and internal controls were found to be key factors in financial soundness of the SACCOs. However in ranking according to their role in financial soundness of SACCOs, board responsibility was considered the least. Regression analysis showed that when protection and rates of return coefficients were used as a measure of financial soundness; board responsibility, transparency and internal controls did not explain the variation individually. When the effective financial structure and liquidity coefficients were used, the three independent variables explained the variation. Multiple regressions showed that the variations in the financial soundness were explained by the three independent variables.

The study concludes that CEOs and seniors officers can also measure the importance of financial soundness using PEARLS since it evaluates and monitors the SACCOs financial systems more than the usual CAMEL method.

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List of Acronyms:

ACE	Area Cooperative Enterprise
ACCOSCA	Africa Confederation of Cooperative Society Savings & Credit Association
ANOVA	Analysis of Variances
BCCI	Bank of Credit Commerce and International
CAMEL	Capital adequacy, Asset quality, Management, Earnings, Liquidity
CFV	Cooperative Federation Victoria
CAK	Cooperative Alliance of Kenya
CSFI	Centre for the Study of Financial Innovation
D T SACCO	Deposit taking SACCO
FOSA	Front Office Saving Activity
GSA	Government of South Africa
ICA	International Cooperative Alliance
ISDA	International Swaps and Derivatives Association
KNFC	Kenya National Federation of Cooperatives
KUSCCO	Kenya Union of Saving and Credit Co operatives
OCDC	Overseas Cooperative Development Council
OECD	Organization for Economic Co-operation and Development

PEARLS	Protection, Effective financial structure, Asset Quality, Rates of return and cost, Liquidity, Signs of Growth
PSCGT	Private Sector Corporate Governance Trust
RPO	Rural Primary Organizations
SACCO	Savings and Credit Cooperatives limited
SASRA	SACCO Societies Regulatory Authority
SME	Small & Medium Enterprise
WOCCU	World Council of Credit Union

CHAPTER ONE: INTRODUCTION

Savings and Credit Co-operative Societies (SACCOs) are usually established in Kenya with firm bases of small savings accounts thus creating a stable and relatively low-cost source of funding and low administrative costs (Branch, 2005). Moreover, SACCOs in Kenya have been in a position to issue loans to their members at interest rates lower than those required by other established financial institutions such as banks. In addition, these SACCOs also have the ability to reach their customers in places that are unattractive to banks, such as the less financially endowed upcountry areas. Consequently, the SACCOs have an upper edge over their competitors in relation to customer base. One of the key objectives of the SACCOs is to empower members through encouraging savings and releasing credit to clients (Ofei, 2001). SACCOs have been successful in achieving this objective. In Kenya, the SACCOs have managed to generate over Kshs.200 billion in savings, contributing to over 30% to gross domestic saving (Co-operative Bank of Kenya, 2010).

1.1 Background of the study

Governance is concerned with structures and processes for decision making, accountability, control and behavior at the top of organizations (Brownbridge, 2007). In addition, corporate governance is a concept that involves practices that entail the organization of management and control of companies. Corporate governance is considered the means by which an organization is directed and controlled. In wider terms according to Brownbridge, corporate governance refers to the processes by which organizations are directed, controlled and held accountable. Governance therefore entails authority, accountability, stewardship, leadership, direction and control exercised in corporations. Governance reflects the interaction among those persons and groups, which provide resources to the company and contribute to its performance such as shareholders, employees, creditors, long-term suppliers and subcontractors (Brownbridge, 2007).

Corporate governance contributes in developing the relationship between the organization and its general environment, the social and political systems in which it operates. Corporate governance interlinks with the organizations' economic performance and further determines the conditions for access to capital markets and investor confidence (Brownbridge, 2007).

Governance is the set of processes, customs, policies, laws and institutions affecting the way a corporation is directed, administered or controlled (Knell, 2006). Corporate governance therefore includes the relationships among the many players involved (the stakeholders) and the goals for which the institutions are governed. The principal players are the shareholders (members), management and the board of directors. Other stakeholders include employees, suppliers, customers, bankers and other lenders, regulators, the environment and the community at large (Knell, 2006).

Many problems in different co-operatives societies across Europe like mismanagement, financial scandals and failure of democracy lead to the questioning of the quality of corporate governance (Lees 1995; Lee and Volkers 1996). Therefore, concerns like these have led to renewed professional and academic interest in corporate governance.

Improvements in the management and administration of many organizations are essential if the global efforts to halt corruption and other types of irregularity are to achieve desired results. An appropriate legal framework is necessary to define the roles of governing bodies, and chief executives and the related framework of authorities and responsibilities of each level of corporate governance. For instance, before and after the Asian financial crisis in 1997, firms that were practicing corporate governance fared better and provided higher protection to the shareholders (Joh 2003;Mitton 2002).

1.1.1. Pillars of corporate governance

In this study the pillars of corporate governance covered include board, transparency and disclosure and internal controls. Board of directors who hold office are supposed to be competent individuals who are able to add value in decision making process (CBK, 2001).Board of directors should ensure the survivability of corporations by setting strategies and standards that protect organizations assets .Transparency is a system of checks and balances between the stakeholders (Bhasin,2009). Disclosure on the other hand consists of all forms of voluntary corporate communications (Healy and Palepu, 2001). Internal controls ensure that appropriate financial, operational and compliance systems are there (Sulaiman, 2003).Inadequate controls can cause fraud and if unchecked will cause the downfall of the organization.

1.1.2. Financial performance of DT SACCOs

The financial performance of licensed DT SACCOs has been improving year by year. In the year 2013 total assets increased by 16.6 percent from Kenya shillings 207.3 billion in December 2012 to Kenya shillings 241.6 billion in December 2013. Turnover increased by 32.1 percent from Kenya shillings 28.4 billion of year 2012 to Kenya shilling 33.7 billion in 2013 (SACCO Supervision Annual Report 2013).

A number of studies that have examined the relationship between corporate governance and the operations of the firm show that good governance practices increase the economic value of the firm, as well as higher productivity and lower systematic risk (Shleifer and Vishny, 1997; John and Senbet, 1998 and Hermalin and Weisbach, 1991). Brown & Caylor (2009) analyzed US firms and their findings indicate that better governed firms are relatively more profitable, more valuable and pay more cash to their shareholders as good governance was associated with the firm performance.

1.1.3. Corporate governance

Corporate governance protects a firm from vulnerability to future financial distress (Bhagat and Jefferis, 2002). Firms have ability to react to external factors that have some effects on its financial soundness due to the governance structure of the entity (Donaldson, 2003). Therefore better governed organizations do well since good corporate governance is of importance to organization's operation and hence an increase in firm's financial sustainability (Demsetz &Villalonga, 2002). A well-functioning corporate governance system helps a firm to attract investment, raise funds and strengthen the foundation for firm operations (Demsetz &Villalonga, 2002).That a well-functioning governance system is of importance in growth of the firm's finances. This means that implementation and enforcement of proper corporate governance practices is vital for enhancing the development of firms and their long-term prosperity (Khiari, Karaa, and Omri, 2007).

For developing countries, significant benefits can be linked to higher corporate governance standards in the private sector. These include better access to external finance, lower costs of capital and better firm performance (Claessens 2003).The argument is that poor corporate governance weakens firm financial soundness, and is the primary cause of financial crises such as the 1997 East Asia crisis. It therefore retards growth of the firm. Other studies show that good

corporate governance is of essence for improving investor motivation and market liquidity (Donaldson, 2003). Parker (2007), theory of the separation of ownership and management's domination, argued that agency problem occurs when the principal have inadequate power to monitor and control the agent and when the compensation of the principal and the agent is not considered.

Key elements of good corporate governance principles include honesty, trust and integrity, openness, performance orientation, responsibility and accountability, mutual respect, and commitment to the organization (Private sector governance trust Kenya, 1999). Corporate governance principles are designed as a basis to help each company formulates their individual codes of best practice (Private sector governance trust Kenya, 1999). The following is a summary of the principles of good corporate governance as per private sector corporate governance trust Kenya (1999) and the Capital Market Act (CAP.485A) 2002:

Authority and duties of members or shareholders: Members as owners of the organizations jointly and severally protect, preserve and actively exercise the supreme authority of the corporation in general meetings. Members of the entity ensure that only competent and reliable persons, who can add value, are elected or appointed to the board of directors and ensure that the board is constantly held accountable and responsible for the efficient and effective governance of the corporation so as to achieve corporate objectives, prosperity and sustainability (PSGT,1999).

Board: Each organization should be guided by an efficient board that should exercise leadership, enterprise, integrity and judgment in facilitating the corporation so as to achieve future prosperity and to act in the best interest of the enterprise in a manner based on transparency, accountability and responsibility (Kariuki et al.). Selecting the board of directors should be through a proper managed process and ensure that a balanced mixture of proficient individuals is made and that each of those appointed is able to add value and bring independent judgment to bear on the decision-making process (PSGT, 1999).

Strategy and Values: The purpose and values of the organizations should be determined by the board of directors (PSGT, 1999).

Structure and Organization: Management structure organization, systems and people are put in place by the board so that the organization keeps integrity, reputation, and responsibility (PSGT,

1999).This assist to put strong internal controls to safeguard the financial soundness of the organization.

Corporate performance, viability and financial sustainability: Monitoring and assessing the implementation of strategies, policies and performance in organization is the work of the board. Besides, reviewing the financial viability and sustainability constantly and regularly should be done by the board (PSGT, 1999).This enhances the transparency of organization and increases the participation of the stakeholder strengthening the financial soundness of organization.

Corporate Compliance: All relevant laws, regulations, governance practices, accounting and auditing standards should be complied with and ascertained by the board (PSGT, 1999).This is the Board responsibility to ensure all regulatory requirements are achieved.

Integrity and ethical behavior: This is important for public relations, risk management and avoiding lawsuits. A code of conduct that promotes ethical and reasonable decision making for directors and executives should be developed by organizations (PSGT, 1999). This improves the transparency and disclosure which increases investment and thus improving the financial soundness of the organization.

Disclosure and transparency: The responsibilities and duties of board and top management need to be disclosed to the stakeholders in order to provide accountability to the organization. Procedures have to be implemented to independently review and protect the integrity of the firm's financial reporting. Disclosure of financial and other relevant matters of the organization should be timely and balanced to ensure that all investors have access to clear, factual information (PSGT, 1999). Disclosure and transparency improves the image of organization and reduces risk to the stakeholders hence improves the financial soundness of the organizations.

1.1.4. Savings and credit co-operatives

Ghana had the first SACCO Society in Africa in 1959 (Ng'ombe & Mikwamba, 2004). This SACCO was founded with an aim of assisting villagers in improving their economic conditions (Ng'ombe & Mikwamba, 2004).The idea of the SACCOs were first adopted by the English speaking nations of Africa with the first entrants into SACCO community included: Ghana, Uganda, Nigeria, Tanzania, and Kenya. Most of the Non-English speaking nations in Africa

started appreciating SACCOs in 1960s, with major influx into the SACCO community in the 1970s (Mwakajumilo, 2011).

The formation of the SACCOs in Africa grew tremendously to the extent that the African countries formed a continental association of SACCOs, Africa confederation of cooperative society savings and credit association (ACCOSSCA) in 1965. The ACCOSSCA was formed with the principal objective of promoting the SACCO principles, offer SACCOs insurance, and educate members on SACCOs issues (Ng'ombe and Mikwamba, 2004).

The first Co-operative society in Kenya was formed in 1908. It was called Lumbwa co-operative society and was for the European farmers. The key objective of this society was to support activities involving agriculture and farming products and to take advantage of producing less costly (Kenya Union of Saving and Credit Co-operatives [KUSCCO], 2006).

The Government of Kenya (GOK) controlled the co-operatives through the co-operative Ordinance Act passed in 1945. An amendment of the act was done in 1997 decentralizing government control and giving it to the commissioner of co-operatives under the co-operative Societies Act 1997. This Act was formed to put a policy guideline for co-operative development in Kenya .This therefore, removed co-operatives from the control of the Government by assisting withdrawal of state control over the co-operative movement. The idea behind this was to ensure co-operatives were independent, self-reliable, autonomous controlled and economically viable institutions. The role of the government became that of regulating and facilitating co-operatives autonomy. This ensured the co-operatives competed with other private enterprises in the marketing of agricultural produce (Republic of Kenya, 1997Act). In 2004 an amendment to the 1997 Act was made. This amendment strengthened state regulation of the co-operative movements through the office of the Commissioner for Co-operative Development.

In 2008 the SACCO societies Act was passed to assist in licensing, regulating, super visioning and promotion of savings and credit co-operatives by the SACCO society regulatory authority. Through this Act, the SACCO society regulatory authority (SASRA) was established. Its functions include permitting SACCOs to carry out deposit – taking business, regulating and supervising SACCOs (Republic of Kenya, 2008b) (Wanyama, 2009).

1.1.5. Deposit taking SACCOs

The two major categories of co-operatives in Kenya include financial co-operatives (Savings & credit co-operative societies- SACCOs) and non-financial co-operatives (includes farm produce and other commodities marketing co-operatives, housing, transport and investment co-operatives). SACCOs have experienced quick growth than other co-operatives in the recent past (SACCO Supervision Annual report, 2010). The SACCO society Act 2008 was created so that the licensing, supervision and regulation of deposit taking should be under the SACCO society regulatory authority (SASRA). Due to this new legal framework, important regulations have been established to guide SACCO's growth and development.

The Kenya SACCO sub sector comprises both deposit taking and non-deposit taking SACCOs. The deposit taking SACCOs (DT SACCOs) are licensed and regulated by SACCO society regulatory authority (SASRA) while non-deposit taking SACCOs is supervised by the commissioner for co-operatives. SASRA licenses SACCOs that have been duly registered under the cooperative societies Act CAP 490.

In the year 2013 the licensed DT SACCOs gained in performance with total assets increasing by 16.6 percent from Kenya shillings207.3 billion in December 2012 to Kenya shillings 241.6 billion in December 2013.This increase was contributed by member's deposits, share capital and retained earnings. Turnover grew to Kenya shillings 33.7 billion compared to Kenya shillings 28.4 billion of 2012 an increase of 32.1 percent (SACCO Supervision Annual Report 2013).

As at 31st December 2013, the total number of DT SACCOs was 215, of which 135 of them had been licensed (SACCO Supervision Annual Report 2013). The remaining 80 SACCOs were at different levels of compliance with the provisions of the law. The DT SACCOs are spread across the Counties and are categorized as follows: Teacher based 45, Government 41, Farmers 73, Private institutions 24, and Community based SACCOs 32 (SACCO Supervision Annual Report 2012). All these DT SACCOs were in operation prior to establishment of SASRA in 2009 and have applied to be considered for licensing as undertaking DT SACCO business (SACCO Supervision Annual Report 2013).

SASRA adopted CAMEL method to assess financial soundness of deposit taking SACCOs in Kenya just like the other financial institutions (SASRA, 2012). However, majority of other SACCOs and credit unions in other countries use PEARLS method. The Capital adequacy, Asset quality, Management, Earnings and Liquidity (CAMEL) rating system is based upon an evaluation of five critical elements of SACCOs operations: Capital Adequacy, Asset Quality, Management, Earnings and Liquidity. This rating system is designed to take into account and reflect all significant financial and operational factors that assess evaluation of SACCOs financial soundness.

Protection ,Effective financial structure, Asset quality, Rates of return, and cost , Liquidity and Signs of growth (PEARLS) system was developed by the World Council of Credit Unions to monitor the financial stability of credit unions and serve as an early warning system for management decision – making (Credit Management, 2002). PEARLS system was designed to go beyond the identification issue, helping managers to find vital solutions to solve institutional problems. The PEARLS system can identify if a credit union is based on weak capital and indicate the causes of such weakness. The system also creates a universal financial language to evaluate credit unions worldwide with an easy-access language that can improve the communication and information uniformity (Richardson, 2002).

1.1.6. Effects of Corporate governance on SACCOs

Most of the problems bedeviling SACCOs arise from bad governance and poor economic management (Wanyama 2009).Wanyama goes on to state that the directors of SACCOs direct and control the organizations, and managers run them. Members of the SACCOs have the right to demand and enforce good governance in their organizations by electing directors and attending annual general meeting (AGM). At the same time Wanyama emphasizes that corporate governance principles seek to ensure that directors act in the best interest of the organization that they lead in order to achieve the objectives for which was founded. If SACCOs are to remain commercially viable and sustainable enterprises for socio-economic development, they must embrace good governance (Wanyama 2009).

As Kenyan SACCO sub-sector continues its growth trajectory it needs to embrace the new regulatory framework that promotes transparency, accountability and good governance practices.

The SACCO board of directors is charged with the responsibility of ensuring sound and prudent management of SACCO affairs through the implementation of a sound and effective policy framework. This however, has been noted to lack in the majority of SACCOs. It is the view of the authority that SACCOs need to improve on the governance front to ensure SACCOs realize their potential (SACCO Supervision Annual Report 2012).

Key challenges in the growth of SACCOs are to establish proper governance systems. The long term survival and good performance of SACCOs can be attributed to good governance. Governance is regarded as one of the weakest areas in SACCOs and therefore has become of increasing interest. The high growth in service providers, several institutional and legal changes, and changes of institutions and the behavior of public authorities towards SACCOs are some of the reasons for governance to be of a major concern in the SACCO debate (Odera, 2012).

The SACCO crisis in Benin, Morocco and Kenya in the year 2010 suggests the rationale of having control in institutional development. Due to their many objectives, SACCOs are considered to differ in organizational forms, products, methodologies, social ranking, and profit seeking attitude (Odera, 2012).

One of the core sources of financing economy of recent years in developing countries is from the SACCOs. This has made SACCOs to grow rapidly and their importance being considered highly by academics as are also importantly contributing a major role in today's microfinance market (Odera, 2012).

1.2. Statement of the Problem

SACCOs management challenges include poor corporate governance and lack of members' confidence (Ademba, 2010). According to Ndung'u (2010), SACCOs suffer from mismanagement and poor investments. Despite the seemingly tight regulatory framework being put in place by SASRA, corporate governance is still weak in Kenya (Mang'unyi, 2011). A study by (Chavez, 2006) found that the financial performance of the SACCO sector is very weak and spread weakness to other areas, like governance, fiscal discipline, financial, operational, internal controls, and the risk management involved in running a financial institution. Previous studies

(Agrawal et al, 2007; Adeyemo and Bamire,2005; Deji ,2005; Asher ,2007) have shown that lack of growth of SACCOs wealth do threaten their sustainability due to poor corporate governance.

According to Brasilia (2008), the use of good practices of corporate governance has proved to be the basic in the success and continuity of co-operatives, mainly in what regards security and returns to members in the developing world. A well-developed system of corporate governance yields more transparent relations, reducing several risks and improving security in all co-operatives of the system (Brasilia,2008). Good corporate governance can improve the performance of a SACCO and help assure its long term survival (Thomsen, 2008). According to (Mpiira, et al., 2013) members will not join SACCO where there is no viable economic enterprise that would generate them income and where corporate governance is weak.

Why this study is important is that DT SACCOs have three quarters of the SACCO subsector's assets, deposits and membership (SASRA, 2013). Deposit taking SACCOs help in savings mobilization; they present a substantial element of the financial system; and provide essential services to a large number of low income household in Kenya. Corporate governance in these SACCOs, if well managed, promises better future performance (SACCO Supervision Annual Report 2013).

Thus, from the above we can see that some of the studies suggest positive and significant relationship between corporate governance and financial soundness; while some studies suggest no significant association between corporate governance and financial soundness. Thus, the existing studies provide mixed and inconclusive results. Therefore, arising from these controversies, the study seek to examine the relationship between the key pillars of corporate governance and financial soundness of the licensed deposit taking SACCOs in Kenya.

1.3. Objective of the Study

The main objective of the research project was to examine the relationship between corporate governance and financial soundness of the licensed deposit taking SACCOs in Kenya.

The specific objectives of the study are:

1. To assess the status of the pillars of corporate governance in licensed deposit taking SACCOs in Kenya.

2. To assess the relationship between corporate governance and financial soundness of the licensed deposit taking SACCOs in Kenya.

1.4. Research Questions

This study seeks to answer the following questions:

1. What is the status of the pillars of corporate governance in licensed deposit taking SACCOs in Kenya?
2. What is the relationship between the corporate governance and financial soundness of the licensed deposit taking SACCOs in Kenya?

1.5. Significance of the Study

Findings of this research will be important to the management of the SACCOs; who will understand how various aspects of corporate governance affect SACCOs operations. The management will also be able to identify the constraints that SACCOs face in approaching various corporate governance that affect financial management. The findings of this study will also enhance the efforts of government regulators in coming up with regulations that will govern the operations of the SACCOs. The study will contribute to the achievement of the government's policy of prosperity for all through sensitizing the members and non- members on how to benefit from properly run SACCOs and mobilizing citizens to save through SACCOs. The research will be of importance to the SACCOs members as they will be able to ascertain the strength of their SACCOs, gain confidence on the well performing ones and be able to question the poorly performing ones. This will encourage more saving and investments in SACCOs and hence an increase in SACCOs assets.

1.6. Scope of the study

The study focused on licensed deposit taking SACCO in Nairobi. As at June 2014 there were estimated 43 licensed deposit taking SACCO in Nairobi. The study covered a period of 4 years from year 2010 to 2013.The primary data were collected from 43 SACCOs and secondary data from 13 audited SACCOs. We analyzed 13 audited SACCOs since they were the only ones available for the four years under study.

CHAPTER TWO – LITERATURE REVIEW

2.1. Introduction

This chapter explicates the factors and principles influencing corporate governance and theories supporting corporate governance. It reviews prior studies on the relationship between corporate governance and the firm. The chapter justifies the selection of the elements of corporate governance necessary for good governance. It explains the concept of financial soundness.

2.2. Theoretical Review

Several theories can be used to explain the need for good corporate governance (Salleh & Mallin, 2002; Leng, 2004; Seifert, Gonenc & Wright, 2005). Donaldson and Preston (1995) advocate the use of stakeholder theory to explain why good corporate governance is necessary for the success of an entity. On the other hand Davis et al. (1997) claim that firm performance is directly related to shareholders' wealth maximization and stewardship protection. Abdullah and Valentine (2009) bring in Agency Theory as the relationship between the principal and the agent of the firm.

In a SACCO, individuals become members by contributing their money to the SACCO, either in the form of capital or deposits. Hence, the ownership of a SACCO resides with the members in a SACCO; they are the principals. They appoint managers, their agents, to carry out the day-to-day running of the SACCO. Agency Theory points out that the agents will act opportunistically to their own advantage. Anecdotal evidence states that the majority of SACCO managers do act for their own benefit, rather than for the benefit of the members of the SACCO. Hence, agency theory is appropriate to explain the need for controls to be put in place to achieve good governance. In addition, stakeholder and stewardship theories do so as well.

The Resource dependency and Managerial hegemony theories can also be used to explain the need for good governance; but they do not have the same explanatory power as the three theories mentioned. As a result, only these three theories are dealt with here.

2.2.1. Agency theory

Abdullah & Valentine (2009) state that Agency Theory explains the relationship between principals and their agents. Members, the owners or principals of the SACCOs, elect the management board as their agents (Alchian & Demsetz, 1972; Jensen & Meckling, 1976; Mitnick, 2006; Bruton et al., 2000), who in turn hire and delegate authority to the managers (Clarke, 2004). Daily et al. (2003) note that two factors influence the prominence of agency theory. Firstly, the theory conceptually divides the SACCO into two groups of participants, one the managers and the other, the owners. Secondly, Agency Theory suggests that employees and managers in SACCOs will be self-interested. Members of SACCOs expect the agents to act and make decisions in the principals' interest; but the agent may not necessarily make decisions in the best interests of the principals (Padilla, 2002). In Agency Theory, the agent may succumb to self-interest, opportunistic behavior and falling short of the agreement between the interest of the principal and the agent's pursuits. However, Agency Theory was introduced basically as a separation of ownership and control (Bhimani, 2008). Agency theory in this study is applied to explore the relationship between the ownership and management structure and to align the goals of the management with that of the owners.

The Agency Theory is relevant in that it recognizes the separation of the ownership of the SACCOs from the agents. Through agency theory, the board plays the role of conformance in safeguarding the principals' interest by overseeing the management of the SACCOs and checking compliance. Agency theory identifies the roles of the board in serving the members by ratifying the decisions made by the managers and monitoring the implementation of those decisions. Agents will act opportunistically, maximizing their own benefit at the cost of the principals. Hence, a series of controls have to be imposed on agents to ensure that they do all they can for the shareholders. The principal incurs monitoring costs in hiring an external auditor as part of the controls.

2.2.2. Stakeholder Theory

Stakeholders are those who affect or are affected by the actions of the organization. In Stakeholder theory the suppliers, employees and investors have a relationship with the managers who serve them (Donaldson and Preston, 1995).

Communities are interested in the SACCO society's governance as key stakeholders as they derive benefits from being employees, suppliers, customers of quality products and beneficiaries of corporate social responsibility policies of SACCOs (Agumba, 2008).

SACCOs are voluntarily set up by their members, aiming to satisfy their own needs. Members have two relationships with SACCOs. They are both owners and consumers. Because of their ownership relationship to SACCOs they are investor-driven and stakeholders by design (Tirole, 2002). By virtue of their user-relationship to the SACCO, members are user-driven and natural stakeholders (Tirole, 2002). Members are therefore the final and dominant stakeholders (Mitchell, Agle and Wood (1997), having the power to make their claims heard and to influence the way in which they will be taken care of. Their claims are critical (Jonker & Foster, 2002), being the very reason for the SACCOs' existence.

Freeman (1984) agrees that the relationship with many groups can affect decision making processes as stakeholder theory is concerned with the nature of these relationships in terms of both processes and outcomes for the firm and its stakeholders. Stakeholder theory concentrates on decisions made by managers and the interests of all stakeholders that have a face value and no sets of interest are assumed to dominate the other (Donaldson and Preston, 1995). The relevance of this theory is to the systems of SACCOs, mainly financial in nature, owned and controlled by the members for the provisions of small scale financial services. Every member of the SACCO is a stakeholder and is expected to participate in the major decision making of the SACCOs with a view to ensuring its survival.

The theory is relevant in SACCO governance due to transparency and disclosure purposes. Stakeholders of SACCOs have the right to be provided with information about how the SACCO is affecting them for example provision of employment, community sponsorship, safety initiative, public reporting etc. The inter relationship between various stakeholders increase the transparency of SACCOs activities and performance, hence achieving its goals including an increased profitability. SACCOs are motivated to disclose information about their various programs to the stakeholders concerned as a sign of conformance with the stakeholders' expectations. Therefore stakeholder related activities are useful in developing and maintaining

satisfactory relationship with members, creditors, employees, customers etc. of the SACCOs. Disclosing essential reports to the stakeholders of the SACCOs is the work of management because proper disclosure builds good relationships between owners and managers'.

2.2.3 Stewardship theory – a partnership model

Firm survival is a result of shareholders' wealth maximization and stewardship protection (Davis et al, 1997). By doing so, the stewards' utility functions are maximized. Stewards protect and make profits on behalf of shareholders and therefore are considered as managers. Stewardship theory therefore insists on the role of management and integrates the goals as part of the organization (Abdullah & Valentine, 2009). The idea of stewardship is that managers are satisfied and motivated when organizational success is achieved. Governance structures that empower managers and that offer maximum independence built on trust are highly recognized in stewardship theory. It emphasizes employees working independently so that the returns of shareholders can be maximized. This minimizes the costs and controls the employee's behavior. Managers are supposed to maximize the firm's financial soundness and the shareholders' profits in order to protect their reputation. It is therefore argued that the firm's performance has a direct impact on the steward's individual performance (Odera, 2012).

Stewardship Theory in a SACCO considers how managers work effectively as stewards of the respective SACCOs. At the same time, the role of the board of a SACCO needs to be strategic in order to add value to top decision making in regards to stewardship theory. Therefore the appointment of the board members requires expertise to add value to the organization's decision making. For SACCOs this raise the questions on how can the boards have the necessary expertise when their members are elected.

The Stewardship Theory is useful to this study in that it stresses the role of executive management (stewards) in maximizing the members' wealth. They achieve this goal by implementing sound internal control systems to protect SACCOs members' wealth. The theory appreciates the importance of structure which empowers the agents and allows steward's independence, thus segregating their duties. Stewards are satisfied and motivated when SACCOs' objectives of financial soundness and profit are attained. This theory will assist in

identifying the role of internal controls set by board for the stewards to safeguard the principals' wealth in the SACCOs.

2.3. Factors and principles influencing corporate governance

The Organization for Economic Co-operation and Delivery OECD principles describe corporate governance as a set of relationships between a company's management, its board, its shareholders, and other stakeholders. Corporate governance provides the structure in which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.

OECD (2003) and Claessens (2003) note that the following issues are behind the move to affect corporate governance among institutions:

The downfall of major firms, both in the financial and non-financial sectors, such as Polly Peck, BCCI and later Barings led to more importance on controls (OECD, 2003). The change in the patterns of share ownership in the United Kingdom and United States led to a bigger concentration of share ownership in the hands of institutional investors like pension funds and insurance firms. External funding to family owned business and State owned enterprises from local or overseas sources seeks corporate governance to play a major role to provide legitimacy so that they can obtain external funding at the lowest risk. This has made organizations to enhance the importance of internal controls as a component of corporate governance.

One aim of the Basel Committee on Banking Supervision (2006) was to enhance corporate governance practices for banking organizations. The areas in which the committee thought required adequate focus include: board responsibilities; senior management; risk management and internal controls; compensation; complex or opaque corporate structure; and transparency and disclosure. These areas were considered to protect the financial soundness of the banks.

Therefore, the key governance pillars mostly acceptable and forming the frameworks in this study are as follows:

2.3.1 Board and Corporate Governance

Boards of directors should be elected through a managed and effective process which ensures that an appropriate mixture of competent individuals holds office who are able to add value and

bring self-judgment in the decision making process (CBK 2001). Boards of directors should ensure the survivability of corporations by determining the purpose and values of these corporations, setting strategies and standards that protect corporation assets (CBK, 2001).

The board should ensure that a proper management structure is in place to maintain corporate integrity, reputation and responsibility. Implementation of strategies, policies and management performance assessment should be looked at and approved by the board of directors of the organization. In addition, the boards constantly review the viability and financial sustainability of the enterprise and do so at least one a year (CBK, 2001). The board should identify the corporation's internal and external stakeholders and determine how the corporation should relate to all these groups. The board should ensure that no one person or group of persons has unfettered power and that there is an appropriate balance of power on the board so that it can function objectively and with independent judgment (CBK, 2001). This improves the management of the organization by reducing any conflict that may arise hence strengthening the corporate governance.

It is not always that directors do perform their legal duties of control and services as directors neither evaluate CEOs performance thoroughly; enhance the company's reputation; nor do they advise managers properly (Epstein, 1986; Louden 1982). This happens because most of the directors work outside the organization and are not employed full time. This limit directors in controlling and evaluating the CEOs performance.

Lynch (1979), in analyzing two organization found an increased revenue turnover and profits when board members increased their involvement in strategic activities. A study done on 418 US corporations in regards of CEO compensation and firms performance index found a positive correlation between CEO compensation and firm performance (Tosi & Gomez-meja, 1994). When board members are involved in strategic activities, they ensure those activities are implemented to the end and to the stakeholders' satisfaction.

2.3.2. Transparency and disclosure

Transparency is a system of checks and balances between the major players, i.e. the board of directors, senior level of management, auditors and other stakeholders (Bhasin, 2009). Steger & Amman (2008) found that every institution has a governance mechanism which distributes power and responsibilities and as a result, accounts for its performance. The separation of the

ownership from management is an important aspect of corporate governance since it creates an effective framework of transparency and accountability (Alo, 2008).

Disclosure consists of all forms of voluntary corporate communications (Healy and Palepu, 2001). Good corporate governance disclosure systems indicate that the organization is able to impress the market with its integrity. All key issues concerning corporate governance of the firm should be disclosed in a timely fashion and the disclosure should be clear, concise, precise and governed by the 'substance over form' principle (Bhasin and Manama, 2009).

Due to governance scandals, organizations have carried out regulatory changes. Some changes are to increase disclosure standards in organizations. After Enron, WorldCom and other public company governance failures, the Sarbanes Oxley Act were adopted which requires detailed information of off- balance – sheet financing.

The Cadbury Report (1992) noted the risk of incomplete information or distorted disclosure. Incomplete information is intended to mislead, distort or confuse stakeholders. The lemon problem comes in when investors cannot separate between good and bad information (Healy and Papelu, 2001). Voluntary disclosure mitigates the lemon problem since a poor security may appear as a good one and as result, more bad securities will be offered than good securities. The cost of the capital to the skeptical investor can be lowered by greater disclosure and transparency (Lundholm and Van Winkle, 2006). Thus by adverse selection avoidance, disclosure and transparency lower the firm's cost of capital. A well governed organization is seen by investors to be responsive to information on governance issues (Okeahalam and Akinboade, 2003).

Total transparency and disclosure of financial information are important pillars of corporate governance framework (OECD, 1999). Firms with higher corporate governance quality make more informative disclosures (Beeks & Brown, 2005). Timely and accurate disclosure of information improves common understanding of the structures, activities and policies of the firm and as a result the firm gains confidence and attract investors (Junarso, 2006, p.4)

Lack of transparency has been identified as a key reason for the financial crisis facing organization (Hellwig, 2009). Companies which provide voluntarily information on governance have a lower cost of equity capital(Collet & Hrasky,2008).Disclosure policy is a predictor for the

interrelation between corporate governance and firm performance (Habib,2008).However, there is causality between timely disclosure and economic profit (Haat et al,2008).

2.3.3 Internal Controls

Internal controls ensure that appropriate financial, operational and compliance controls are put in place (Sulaiman, 2003).It is the board's duty to report on the strength and weaknesses of these controls and whether they are functioning as required. The inadequacy or lack of controls can cause fraud which if unchecked, will cause the downfall of the organization. Internal control is connected with the risk management function and linked with the internal audit function.

The accounting scandals like Enron which were happening in early 21st century brought in the Sarbanes-Oxley Act of 2002; requiring firms to keep and disclose internal controls over financial reporting. Firms with material internal control weakness are complex, smaller and less profitable (Ge & McVay, 2005); have a lower earnings quality (Doyle et al, 2005).The effect of material weakness have a negative return on the cost of capital and on stock prices (Beneish et al,2006). However, Ashbough-Skaife et al. (2006) and Bryan and Lilien (2005) did not find a negative market reaction to the disclosures of material weaknesses.

2.4. Governance of SACCO societies as per SASRA 2008 Act

The current study reviews the relationship between the corporate governance and financial soundness with a focus on the governance of SACCO societies as per SASRA 2008 Act. SASRA 2008 Act highlights the importance and the role of the three pillars of corporate governance. The three pillars include transparency and disclosure, internal controls and the board responsibilities.

Transparency and disclosure: The chief executive of a SACCO frequently and adequately informs the board about the operations through presentations of relevant board papers. The Board is entitled to get monthly, quarterly and annual financial statements showing present performance compared with the previous period actual performance, budget compared with actual expenditure and narrations for any variance. The Board should be informed about the capital structure and adequacy. Disclosure of delinquent loan list, loan losses, recoveries and provisioning is required. A comprehensive statement of income monthly, quarterly and yearly with the budgeted against actual should be prepared. Sources and distribution on profit of savings and deposits need to be presented to the board. All insider dealings and non- performing

insider loans require to be disclosed. Compliance with the Act or departure from it, and any other applicable laws need be reported. Disclosure of large risk exposure, investment portfolio, regulatory reports, internal reports and any other relevant areas to the SACCO Society's operations are to be reported.

Internal control: The audit committee, composed of independent members of the board of directors, is supposed to review the financial situation of the SACCO society, its internal controls, performance and findings of the internal auditors and to recommend remedial actions at least once in every three months. The committee makes sure that internal controls are there and effectively maintained to achieve financial reporting objectives. The audit committee also reviews internal controls plus the scope of the internal audit program, findings and recommend action to be taken. They do review internal audit reports and their overall effectiveness, the scope and depth of audit coverage, reports on internal control and any recommendations and confirm that appropriate action has been taken. They make sure that accounting records and financial reports are prepared and reflect the performance of the SACCO.

Co-ordination between the internal and external audit functions and monitoring independence of external auditors in consideration of the relevant professional and regulatory requirements is done through the audit committee. With the assistance of external auditor, the internal auditors reviews the scope of the annual audit plan, the systems of internal audit reports and recommend the auditor's remuneration to the board. Management reviews, internal and external reports in regards to deviations and weaknesses in accounting and operational controls. The audit committee reviews the internal audit plan in reference to the procedures for identifying regulatory risks and controlling their results plus receiving communication from the authority and the response from the management.

The committee also looks at the ethical conduct of the SACCO plus the effectiveness of procedures for handling and reporting complaints. Any third party transactions arising within the SACCO are reviewed by the audit committee, which makes sure that relevant plans, policies and control procedures are set and properly administered. It is their duty to ensure those policies and control procedures are adequate to protect against error, carelessness, conflict of interest, self-dealing and fraud. To enhance internal controls, they do investigate members' complaints, keep

minutes of their work and take into account any matter of significance raised at the Annual General Meeting.

Board: According to SASRA (2008) the board of directors exercises fiduciary duties. The management of the SACCO is required to keep proper and accurate records reflecting the true and fair position of the SACCO under the control of the board. It is the role of the board to see that the SACCO functions effectively and has effective and adequate internal control systems. Other board duties include the setting key policies, including those relating to human resource, credit, investment, savings, liquidity, information preservation, dividend, and risk management.

The board is supposed to meet not more than twelve times in a financial year; not more than two months should lapse between the date of one meeting and the date of the next meeting. The SACCO is supposed to make adequate provisions for known and probable losses which are likely to occur as stipulated by the regulations formulated by the board. SASRA requires the SACCO to keep a positive image within the industry and the economy as a whole; this is another role of the board. The directors set the number of the management committees like audit and credit which may be required to assist discharging the functions of the board. The board is responsible for the production of annual audited accounts which must be presented at an annual general meeting held not later than four months after the end of a financial year. A SACCO director must attend board meetings regularly; s/he ceases to hold office if s/he fails to attend three consecutive meetings without permission or reasonable cause.

2.5. Review of Related Empirical Literatures on corporate governance and firm's finance soundness

There is a positive relationship between corporate governance and the growth of the firm valuation. This was found in a study by Beiner, Drobetz, Schmid and Zimmerman (2004). The study based firm valuation by using corporate governance indices and related variables such as ownership structures and board characteristics for Swiss firms.

Research done in Ghana, South Africa, Nigeria and Kenya found that good corporate governance practices are associated with high valuations and better operating performance (Kyereboah-Coleman (2007).

A study done to establish corporate governance practices and their relationship with the growth of listed companies in Nairobi found a positive linear relationship between growth and corporate governance (Kariuki et al; 2011) .Ongore and K'Obonyo (2011) did a study on the relationship between ownership, board and manager characteristics and firm performance for 54 companies listed at the Nairobi Securities Exchange. From this study it was found that there was a positive relationship between the board performance and corporate governance. Mang'unyi (2011) carried out a study to explore the ownership structure and corporate governance and its effects on the performance of firms. His study focused on selected banks in Kenya. His study revealed that there was a significant difference between corporate governance and financial soundness of banks. The study recommended that corporate entities should promote corporate governance to send positive signals to potential investors and those regulatory agencies, including the government, should promote and socialize corporate governance and its relationship to firm performance across industries. Miring'u and Muoria (2011) analyzed the effects of corporate governance on the performance of commercial state corporations in Kenya. Using a descriptive study design, the study sampled 30 state corporations out of 41. The study found a positive relationship between Return on Equity (ROE) and board composition in regards to gender balance of all state corporations.

2.6. Corporate governance of SACCOs

Firms with a higher quality of corporate governance do well financially (Bauer and Guenster, 2003; Beiner et al., 2004; Schmidt & Zimmermann, 2004). Diversified companies with good governance have 2.1 percent higher return compared to organization with poor corporate governance (Bauer and Guenster, 2003). There is a positive correlation between good corporate governance and better operating results and market valuation (Klapper and Love, 2002).

Corporate governance mechanisms assure investors in corporations that they will receive adequate returns on their investments (Shleifer and Vishny, 1997). In addition, Williams (2000), Drobetz *et al.* (2003) and Gemmill and Thomas (2004) concluded in their respective studies that there is a positive relationship between good corporate governance practices and firm financial soundness.

Good corporate governance requires several decisions to be made as SACCOs are becoming bigger and more complex. Managers are recruited to make critical management decisions since

the shareholders may not have the needed managerial skills and technical knowledge (Abdullah & Valentine, 2009). Professional expertise needs to operate in an entrepreneurial manner due to the specialization of decisions. It is however noted that the separation of ownership and decision making leads to principal-agent problems (Odera, 2012).

Board: This is the interrelationship between the shareholders and the management of the organization with the latter being authorized to carry out the day today operations (Stiles and Taylor, 2001). Key responsibilities of the board include strategic, controlling, institutional capacity, approving core philosophy, maintenance of legal and ethical practices, communication with shareholders and review (Riana, 2008; Zahra and Pearce, 1989; ICC, 2009). The statutory framework of a company explains the onus of the board of directors.

Internal management decisions of SACCOs are delegated by the board (Branch &Baker, 1998). Major policy initiatives and the general strategy of the SACCOs are controlled and approved by the board besides hiring, firing and setting the compensation packages of the managers (Odera, 2012).

Another way of monitoring and controlling SACCOs is through a supervisory committee. Regular supervision and surveillance ensures SACCOs operate with an established legal framework, therefore ensuring safety, soundness and integrity of their operations, with the ultimate goal of protecting SACCO members' funds. SASRA processes the licenses for Deposit Taking SACCO Societies, monitors and evaluates their performance continuously reviews and improves policy, and the regulatory and supervisory framework (SACCO Supervision Annual Report 2012).

2.6.1 SACCO governance problems

SACCO managers need specific knowledge and skills to make a number of specialized decisions as they become bigger and more complex (Branch & Baker, 1998). According to Branch & Baker (1998), problems in SACCOs mostly occur due to one or more of the following causes:

(i) SACCO members tend to have a lower to moderate level of income and these have an impact on elected board members who may interfere with the management of the SACCO. This interference contributes to weak administration, low morale and the inability of the SACCO to

attract good quality managers (Odera, 2012). The operations of the SACCO are interfered with by members of the Board of directors for example, when a member is denied a loan by the management team he/she contact a director who comes in and over-rules the decision of management.

(ii) Failure of the members and boards to exercise fiduciary responsibility: Due to the large number of SACCO members which some SACCOs operate with more than 50,000 or 100,000 members, operational interference by the management board may occur (Branch & Baker, 1998). This makes only a few members to carry out the duties of monitoring the performance of the SACCO by attending the annual general meeting or by looking elected members in the board. Collusion amongst the board, manager and supervisory committee may occur so as to protect one another's interest at the expense of the SACCO due to minimal supervision from the membership (Odera, 2012).

(iii) The borrower domination effect: SACCO members are at the same time clients, savers, borrowers and suppliers. This complicates the corporate governance system of SACCOs as it is supposed to respond to two sets of owner-clients. The customers and supplier relationship lack clear governance rules and may provide a weak credit approval policy which can be manipulated by the directors (Odera, 2012).

(iv) Membership ownership: Berle and Means (1932) set forth that ownership dispersion implies when management is distinguished from ownership, which, as Jensen and Meckling (1976) emphasize, may contribute to agency problems between managers and shareholders or shareholders and debtors. On the other hand, Shleifer and Vishny (1986) and Morck, Shleifer and Vishny (1988) detect the phenomenon of ownership concentration. La Porta et al. (1999) and Claessens et al. (2000) usher in the concept of ultimate controller and noted that most of the shareholders control and dominate listed firms by means of pyramid structure and cross holding, which could result in a central agency problem. Shleifer and Vishny (1997) argue that ownership concentration is, along with legal protection, one of two key determinants of corporate governance.

(v) Lack of clear rules, combined with credit rationing: This occurs when there is excessive and poor manipulation of the procedures in credit granting by the board. These governance problems

are due to the combination of the traditional borrower – dominated service structure plus situations in which rules for decision making and controls are not properly defined and enforced. Weak internal controls of SACCOs facilitate the board members to give out loans for their own gain and as political favours (Branch & Baker, 1998).

2.7. Relationship between Governance and financial soundness

A number of studies that have examined the relationship between corporate governance and the operations of the firm show that good governance practices increase the economic value of the firm, as well as higher productivity and lower systematic risk (Shleifer and Vishny, 1997; John and Senbet, 1998 and Hermalin and Weisbach, 1991). Brown & Caylor (2009) analyzed US firms and their findings indicate that better governed firms are relatively more profitable, more valuable and pay more cash to their shareholders as good governance was associated with the firm performance.

In his study, Mitton (2002) found out that the firms which record better price performance are associated with those which have indicators of higher disclosure quality and higher outside ownership concentration. A firm's financial soundness improves by limiting the board size, since the benefits of larger boards are reduced by poorer communication and decision – making of larger groups (Lipton, Lorsch, 1993). However, Yermack (1996) shows that there is no relationship between board size, profitability and asset utilization. Because creditors see firms with bigger boards having effective monitoring in their financial processes, the cost of debt is therefore lower (Anderson et al.2004).

Adjaoud et al. (2007) examined the relationship between firm performance and governance scores. They found that the relationship was not significant between the scores and accounting-based measures of performance (such as ROI, ROE, EPS, and market-to-book) while the relationship between the scores and measures of value created, such as market value added and economic value added, was generally significant.

2.7.1. Measuring licensed deposit taking SACCO's financial soundness

The licensed deposit taking SACCOs are required to observe minimum operational regulations and prudential standards in the conduct of SACCO business. SASRA adopts the CAMEL evaluating framework to measure and monitor the financial soundness of the deposit taking

SACCOs (SACCO Supervision Annual Report 2012). The acronym "CAMEL 'refers to Capital adequacy, Asset quality, Management, Earnings and Liquidity. However, Credit unions and other savings institutions use PEARLS as a monitoring system for financial soundness; the acronym is explained below; it is used for management guidance; it is an international measure and is recognized globally (Richardson 2001). It is also a tool to regulate the managers of SACCOs. PEARLS as a set of financial ratios assists in harmonizing terminology between credit unions. It helps managers find meaningful solutions to serious institutional problems. Therefore in this research we used PEARLS to measure the financial soundness of SACCOs.

The acronym PEARLS measures key areas of SACCO's operations as follows:

Protection: Protection ensures that SACCOs provide depositors a safe place to save their money. Adequate protection of assets is a basic tenet of the new SACCOs model. Protection is measured by comparing the adequacy of the allowances for loan losses against the amount of delinquent loans. Loans that are greater than 12 months delinquent must be fully provided for (Richardson 2001).

Effective financial structure (EFS): The EFS variable affects the growth, the profitability and the efficiency of SACCOs. The assets, the liabilities and the capital of a SACCO are measured and an ideal structure is recommended. For the assets of SACCOs, 95% of total assets must be composed of loans to members and the ideal range is between 70% and 80% whereas liquid investments is between 10% and20%.Unproductive assets such as fixed assets i.e land , buildings, equipment takes the balance of 5%. The most profitable asset of the SACCOs is the loan portfolio and the World Council of credit Unions recommends 70-80% of total assets in the loan portfolio. Under liabilities, 70-80% is recommended on member deposit savings (World council of credit Unions, 2002). A high percentage of deposit savings shows that the SACCO is in it way of achieving financial independence. A SACCO has an effective financial structure when assets, financed by savings deposits, generate sufficient income to pay market rates on savings, cover operating costs and maintain capital adequacy. The effective financial structure concentrates on an institution's sources of funds and its uses of funds.

Asset quality: Asset Quality is the most important component that affects SACCO's profitability. Excessive default or prolonged loans repayment and high rate of other non –

earning assets impact negatively on SACCO's earnings since these assets are not earning income. The delinquency ratios as total outstanding balance of loans greater than 30 days is a measure of institutional weakness since if it is high, other important areas of SACCO operations could be weak for example loan loss provision, institutional capital and net income. The ideal goal is to maintain the delinquency rate below 5% of total loan outstanding. Percentage of Non-Earning Assets ratio implies that the higher the ratio, the more difficult it is to generate enough earnings. The goal is to keep this ratio to a maximum of 5% of the total SACCO assets. Financing of Non- Earning Assets such as fixed assets without impacting earnings negatively, need to be financed with no-cost capital such as institutional capital or reserves (World council of credit Unions, 2002).

Rates of return and costs: The Rates of return and costs measures the return earned on each type of assets and the cost of each liability. One can therefore know the types of assets in SACCO's that generate highest returns and the least and most expensive source of funds on the liability side. SACCOs or institution growth rates are directly affected by yields and costs.Net Loan Income divided by Average Net Loan Portfolio aim for loan prices to be set at entrepreneurial rates which is required to cover the cost of funds, operations, administration, provisions and cost of contributions to increase capital (World council of credit Unions, 2002).

Liquidity: Managing liquidity is an important component of administering a SACCO. Liquidity in a SACCO refers the cash needed for withdrawals. A sound financial management of SACCOs requires keeping adequate liquidity reserves. The total liquidity reserves which measures the percentage of savings deposits invested as liquid assets is maintained at a minimum of 15% after paying all short-term obligations (30 days and under). Idle liquidity reserves is kept to a minimum level and therefore reduced to a percentage close to zero (World council of credit Unions, 2002).

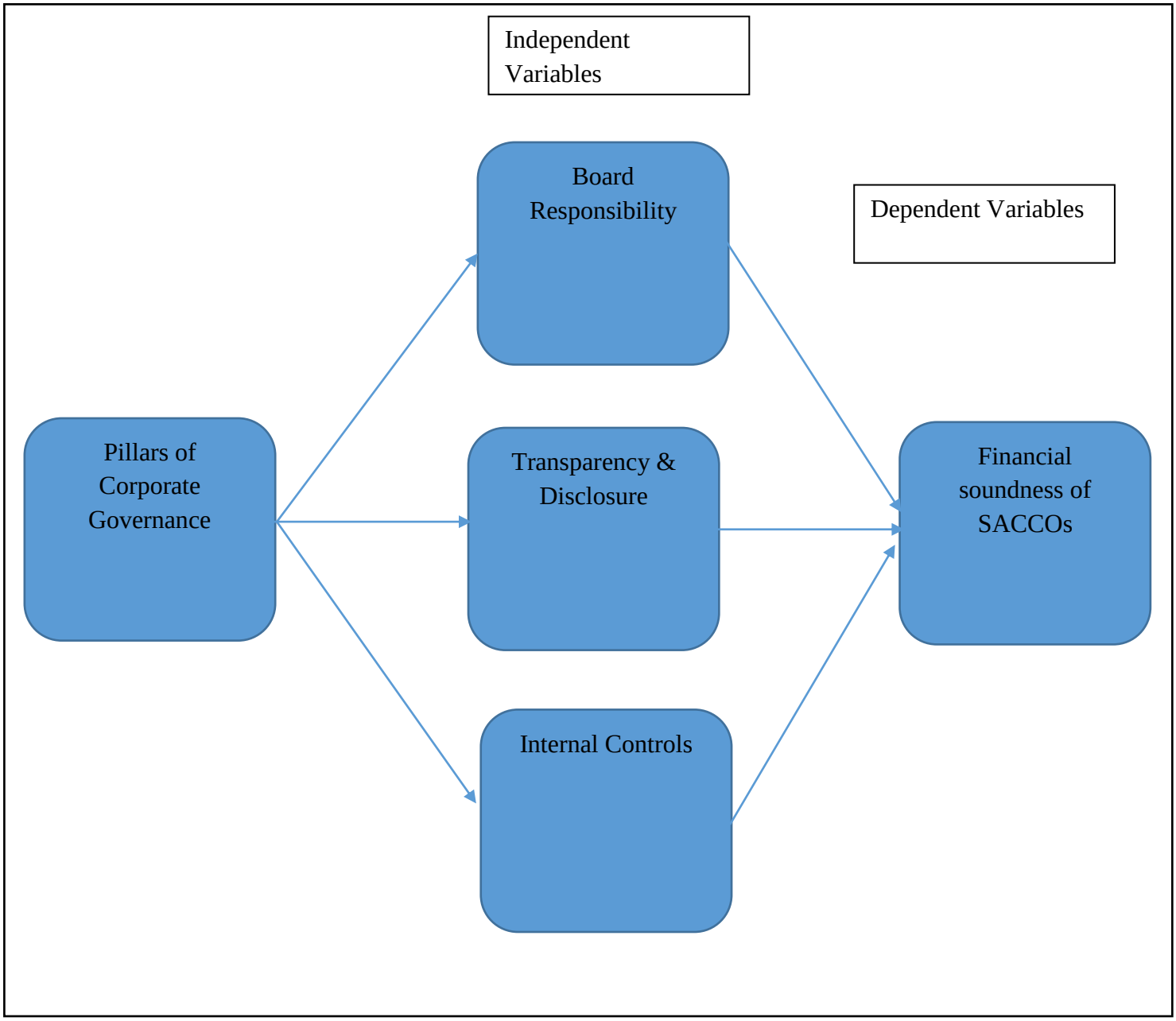
Signs of Growth: Signs of growth shows satisfaction of member – client and likeness of product offered plus the financial strength of SACCOs. SACCO financial structure is linked directly by the growth and therefore requires close monitoring to maintain balance. Growth in total assets is a key ratio and by comparing it to other important areas, enables to detect changes in the balance

sheet that may impact positively or negatively on earnings. The ideal goal of all SACCOs is to get real positive growth each year. If the loan portfolios grow hands in hand with total assets, profitability will be maintained. Due to savings mobilization, savings deposits are the new key of growth in SACCOs since it affects the growth of other important areas. The best indicator of profitability in SACCOs is the growth of institutional capital and especially when it is greater than the growth of total assets.

2.7.2. Conceptual Framework

The variables considered were independent and dependent. The independent or predictor variables are the inputs tested to see if they are the cause. The dependent or response variable are the output and is tested to show the effect.

Figure 2.1: Conceptual diagram on the financial soundness of SACCOs



2.8. Operationalization of variables

2.8.1. Dependent variables

The financial soundness of SACCOs as dependent variables is based on PEARLS framework as follows:

1. P- Protection

Protection ration is measured on allowances for loan losses divided by delinquency greater than twelve months

P =Allowance for Loan Losses / Allowances Required for Loans Delinquent >12 months.

Goal is to achieve 100%.

2. E- Effective Financial Structure

This is measured by net loans divided by total assets ratio

E= Net Loans/Total Assets

Goal is between 70 -80%.

3. A- Asset Quality

This is measured by total loan delinquency divided by gross loan portfolio

A=Total Loan Delinquency / Gross Loan Portfolio

The goal of excellence is less than or equal to 5%.

4. R- Rates of Return and Costs

Rates of return and costs were measured by total operating expenses divided by average total assets ratio.

R=Total Operating Expenses / Average Total Assets

Goal is less than 10%.

5. L- Liquidity

The ratio used to measure liquidity is liquid investments plus liquid assets minus short term payables divided by savings deposits.

L=S.T Investments + Liquid Assets - S.T. Payables /Savings Deposits

Goal was minimum 15%.

6. S- Signs of Growth

This is measured by the growth in total assets.

S =Total current year assets/Total assets as of the Last year –end

The goal is that the growth in total assets should to be higher than the inflation rate.

Thirteen cross sections of SACCOs are represented in the sample. To compare performance measures across this SACCOs, financial ratios are transformed by corresponding goals of

excellence ratios set by WOCCU for PEARLS system. This method is like that of Dehaene, De Vuyst, and Ooghe (2001); and Platt and Platt (1991), who transformed financial data by industry ratios.

The financial ratios used in this study are transformed as follows:

$$Y_{aj} = \frac{Y_j}{\bar{Y}a}$$

Where Y_{aj} represents the transformed performance variable of choice, $_j$ is the individual SACCOs, a indicates the sector (WOCCU), $\bar{Y}a$ is the WOCCUs goals of excellence (median) financial measure. In this study Y_j is the calculated ratios for the 4yrs and $\bar{Y}a$ is the goals of excellence set by WOCCU.

2.8.2. Independent Variables

Board, Transparency and disclosure plus the internal controls were the independent variables.

The Board was measured by assessing duties and responsibilities it plays in SACCO performance. Transparency and disclosure was measured based on factors like presentation of relevant board papers, completeness of financial statements , declaration of delinquent loan list , loan losses etc. The internal controls were measured by looking the role of the audit committee it played in the performance of the SACCO.

2.8.3. Basic Model

The study used multiple linear regression analysis in determining the relationship between corporate governance and financial soundness of SACCOs. The basic model for this concept is shown below:

FSS=f (BO, leverage) (1)

Where,

FSS is financial soundness of the SACCOs (PEARLS); BO is the Board, and leverage factors (Transparency and disclosure, and internal controls).

The expansion of the basic model given in equation 1 will give a simple regressions model given in equation 2 which was used to determine if there is an association between corporate governance and financial soundness of SACCOs

$$FSS = \beta_0 + \beta_1 B0 + \beta_2 TD + \beta_3 IC + \varepsilon \qquad (2)$$

Where FSS measured by PEARLS = Protection, Effective financial structure, Asset quality, Rates of return, Liquidity and Signs of growth are the dependent variables,

$\beta 0$ = The constant terms,

$\beta 1 - \beta 3 =$ Coefficient of independent variable i.e Board, Transparency and disclosure and Internal controls,

$\varepsilon =$ Error term which represents other factors not included in the model.

2.9. Conclusion

From the literature, it can be seen that there is, a link between good corporate governance and the financial soundness of the entity. This study aims to replicate these studies to examine whether the soundness of SACCOs is positively correlated with the governance of the SACCOs.

CHAPTER THREE – METHODOLOGY

3.1 Introduction

This chapter provides information on the type of research design applied for the study, population and sampling, data collection and data analysis.

3.2 Research Design

The research used a descriptive design to determine objective one .This assured useful and reliable information answering the questions based on who, what, when and how (Rombo and Tromp, 2006). In the second objective the aim was to see if there is a relationship between corporate governance and financial soundness; therefore correlation design was appropriate. This was to explore or examine data and looking for potential relation between variables.

3.3 Target Population and Sampling of the study

The target population of this study was all the licensed deposit taking SACCOs that are operating in Nairobi County, estimated to number 43 as at June 2014.The study considered the entire population of the 43 SACCOs. The respondents were the Chief Executive Officers (CEOs), senior managers and other senior officers of the SACCOs. This is because they are conversant with the management of their respective SACCOs.

3.4 Data Collection

The study collected primary data for the purpose of studying the effect between corporate governance and financial soundness of licensed deposit taking SACCOs in Kenya. Primary data were collected using a questionnaire (appendix A) which was dropped in the SACCOs offices; SACCO officials CEO, senior managers and other senior officers completed the questionnaires and later collected. The questionnaire was in likert-scale format. To measure the financial soundness, secondary data were collected from the thirteen audited financial statements of SACCOs at SASRA office.

3.5 Data Analysis

3.5.1 Inferential analysis

Data collected were analyzed by descriptive and inferential techniques. The findings were presented using tables and charts, percentages, means and other central tendencies. Tables were used to summarize responses for further analysis and facilitate comparison. The tables generated quantitative reports through tabulations, percentages, and measures of central tendency. The questionnaires which were in likert type scales were analyzed using descriptive techniques i.e mean, standard deviation and frequencies.

3.5.2 Financial ratios

The SACCOs PEARLS financial ratios were computed and analyzed basing on the goals of excellence set by the World council of credit union (Richardson, 2001).PEARLS ratios are an internationally proven methodology for improving operational efficiency in credit unions worldwide. SASRA adopted CAMEL model since most of the commercial financial institution use it and to be in line with peer regulator (The Central Bank of Kenya).In this study we used PEARLS since it has two more significant ratios which are not in CAMEL model. The two ratios are the effective financial structure and the signs of growth ratios which play important roles for the survivability of SACCOs (Richardson, 2001). The effective financial structure ratio evaluate the financial structure of the balance sheet which has a direct impact on efficiency and profitability. Signs of growth ratio considers growth of total assets as a key strategy to preserve the value of SACCOs assets. The world council of credit union which is the umbrella regulator of cooperative unions worldwide recommends PEARLS model as the rating framework for unions (Richardson, 2001).

3.5.3 Correlation analysis

Correlation analysis was used to determine the level of association between independent and dependent variables (Levin & Rubin, 1998). Correlation value of 0 indicated that there was no relationship between independent and dependent variables. Correlation of ± 1.0 means that there is a perfect positive or negative relationship. The variables were analyzed between 0 and 1.0 relationship. The relationship was ranked as follows: r = ± 0.1 to ± 0.29 small; r = ± 0.3 to ± 0.49 medium; r = ±0.5 and above considered as strong.

3.5.4 Regression analysis

This study applied a multiple linear regression analysis using PEARLS ratios as dependent variables for the SACCOs financial soundness whereas independent variables comprised of board responsibility, transparency and disclosure and internal controls.

The regression analysis generated an equation to examine the statistical relationship between the corporate governance pillars (independent variables) and PEARLS ratios (dependent variables).

The mean change in the response variable for one unit of change in the prediction variable was represented by regression coefficients while holding other predictors in the model constant. The regression coefficients isolate the role of one variable from all of the others in the model (Bails & Peppers, 1993). ANOVA was used to test whether deposits taking SACCOs have proper corporate governance structures or not.

P-values and F-values and R – squared in the model were interpreted to examine the strength between dependent and independent variables.

This study employed following model:

$$FSS = \beta_0 + \beta_1 B0 + \beta_2 TD + \beta_3 IC + \varepsilon \qquad (2)$$

Where = the Financial soundness of the SACCOs measured by PEARLS as dependent variables,

$\beta 0$ = The constant terms,

$\beta 1 - \beta 3$ = Coefficient of independent variable i.e. Board, Transparency and disclosure and Internal controls,

ε = Error term which represents other factors not included in the model.

The above model is modified as below to examine the relationship between corporate governance and financial soundness of Licensed Deposit Taking SACCOs in Kenya.

Regression analysis 1.Protection ratio (P)

$$P\ ratio = \beta_0 + \beta_1 B0 + \beta_2 TD + \beta_3 IC + \varepsilon$$

Regression analysis 2.Effective financial structure (E)

$$E\ ratio = \beta_0 + \beta_1 B0 + \beta_2 TD + \beta_3 IC + \varepsilon$$

Regression analysis 3.Asset Quality ratio (A)

$A\ ratio = \beta_0 + \beta_1 B0 + \beta_2 TD + \beta_3 IC + \varepsilon$

Regression analysis 4.Rates of return and costs (R)

$R\ ratio = \beta_0 + \beta_1 B0 + \beta_2 TD + \beta_3 IC + \varepsilon$

Regression analysis 5.Liquidity ratio (L)

$L\ ratio = \beta_0 + \beta_1 B0 + \beta_2 TD + \beta_3 IC + \varepsilon$

Regression analysis 6.Signs of growth ratio (S)

$S\ ratio = \beta_0 + \beta_1 B0 + \beta_2 TD + \beta_3 IC + \varepsilon$

Regression analysis 7.FSS ratio

$FSS\ ratio = \beta_0 + \beta_1 B0 + \beta_2 TD + \beta_3 IC + \varepsilon$

3.6. Validity and Reliability of data

The study conducted a pilot study on a group of 5 individuals from the target sample of the staff working in deposit taking SACCOs to test the reliability of the research instrument. The pilot study allowed for pre-testing of the research instrument. The clarity of the instrument items to the respondents was necessary so as to enhance the instrument's validity and reliability. The aim was to correct any inconsistencies arising from the instruments, which ensured that they measured what is intended. The data were tested for reliability to establish issues such as data sources, methods of data collection, the time of collection and the level of accuracy.

3.7 Ethical issues

The data collected was for the research purposely only and treated with a lot of confidentiality to protect the clients and were not manipulated in any way.

CHAPTER FOUR: DATA ANALYSIS AND RESULTS

4.1 Introduction

This chapter analyses the data collected and presents research findings. Quantitative data was described using statistical analyses. In particular, measures of central tendency; means and standard deviation were used. Inferential statistics were also used to draw inferences. Tables, graphs and charts were also used in data presentation.

4.2 Response Rate

A total of 43 questionnaires were given out to the CEOs, senior managers and other senior officials of the 43 licensed deposit taking SACCOs in Nairobi out of which 32 were returned giving a response rate of 74.42%.

The response rate for this study can be therefore said to be very good at this level. This is in accordance to the ranking response rate; 50% adequate, 60% good and above 70 % is rated very good (Mugenda & Mugenda, 2003).

The subjects who answered the questionnaires included 2 CEOs, 19 senior managers, and 11 other staff members who have deep knowledge in their respective SACCOs as indicated in Table 4.1 below.

The majority of those who responded to the questionnaire had an experience of 5- 10 yrs in their SACCOs. 45.5% were in this range as shown in Table 4.2. This shows that they had a wider exposure of the operations in their SACCOs.

Table 4.1: Job positions of those interviewed

		Frequency	Percent
Valid	CEO	2	6.2
	Senior Management	19	59.4
	Others	11	34.4
	Total	32	100.0

The study also found that majority of the respondents was in senior management. This means that they had deeper knowledge of their respective SACCOs which assisted in answering the questionnaire.

Table 4.2: Job Experience of those interviewed

		Frequency	Percent
Valid	0-5 years	9	28.1
	5-10 years	15	46.9
	10-15 years	5	15.6
	Over 15 years	3	9.4
	Total	32	100.0

From the study it was found that majority of the respondents had experience of 5- 10 years meaning they had worked long enough to give credible information which was used in this study.

4.3 Corporate Governance of SACCOs

The study analyzed three pillars of governance; transparency &disclosure, internal controls and Board responsibility using a questionnaire (see appendix A) to establish their influence on

financial soundness of SACCOs. The responses were rated on a basis of likert scale 1-5 with five implying that the respondents strongly agrees and one strongly disagrees.

The summary of the responses using a mean scores and standard deviation are represented on table below.

Table 4.3: Means and Standard Deviations for the pillars of governance

Variable	MEANS	SD
Transparency & Disclosure	3.49	0.65
Internal Controls	3.71	0.67
Board Responsibility	3.32	0.77

The study showed that the majority of the respondents highly considered internal controls as a tenet of corporate governance in SACCOs than the other two pillars of governance as indicated in table 4.3 above. Internal Controls had a mean of 3.70, Transparency and disclosure 3.49, whereas Board responsibility scored a mean of 3.32. The standard deviation of Internal Controls was one of the lowest among the other variables meaning that it was accepted among the SACCOs as an applicable tenet on governance compared to the four.

Transparency and Disclosure

Table 4.4: Transparency and Disclosure

Descriptive Statistics					
	N	Minimum	Maximum	Mean	Std. Deviation
Financial Statements Presented	32	2.00	5.00	3.45	.67
Loan Lists Presented	32	2.00	5.00	3.50	.72
Statement Of Income	32	3.00	5.00	3.63	.61
Profile Of Saving And Deposits	31	2.00	5.00	3.35	.75
Insider And Non Insider Loan Info Disclosed	31	3.00	5.00	3.45	.57
Reports On Violation Of SACCO Act	32	2.00	5.00	3.69	.64
Reports Relevant To SACCO Operations Declared	32	2.00	4.00	3.38	.61
Statements On Capital Structure And Adequacy Prepared	32	2.00	5.00	3.47	.62

Mean of means: 3.49

Standard Deviation: 0.65

The study sought to establish the influence of transparency and disclosure on the financial soundness of the SACCOs. Using a 5 point Likert scale, Table 4.4 shows a simple descriptive statistics with a mean score of 3.49 and a standard deviation of .65 .This indicates that majority of the respondents do agree with the view that transparency and disclosure is a component of corporate governance of most SACCOs in Nairobi.

Thus with a mean score 3.49 from a maximum point of 5 which is above the midpoint of 5, it is observable that transparency and disclosure is an important pillar of corporate governance in SACCOs.

The research reviewed the importance of transparency and disclosure on corporate governance of SACCOs. The respondents agreed that the reports on the violation of SACCO act plus other applicable law is prepared and remedial actions taken to comply as it had a mean of 3.69. Respondents also agree that a comprehensive statement of income (monthly, quarterly and annual) comparing budget and actual is prepared scoring a mean of 3.63. Delinquent loan list,

growth in loans, loan losses, recoveries and provisions were agreed to be well disclosed as indicated with a mean of 3.5.

These findings concur with Junarso (2006) who argued that timely and accurate disclosure of information improves the structures, activities and policies of the firm and hence the firm gain confidence and attract investors. Okeahalam and Akinboade (2003) also found that a well governed organization is seen by investors to be responsive to information on governance issues.

Internal controls

Table 4.5: Internal controls

Descriptive Statistics					
	N	Minimum	Maximum	Mean	Std. Dev.
Established Internal Audit Function	32	2.00	5.00	3.65	.70
Financial Statements Submitted every 3 Months	32	2.00	5.00	3.66	.70
Audit Committee Reviews Financial Conditions Of SACCO	32	2.00	5.00	3.72	.73
AGM Four Months After Financial Year	28	3.00	5.00	3.75	.75
Internal Controls Set	31	3.00	5.00	3.71	.59
Accounting And Financial Records	31	3.00	5.00	3.64	.66
Reports Reviewed Concerning Deviations And Weaknesses	32	3.00	5.00	3.78	.61
Policies And Procedures Safeguard Against Errors	32	3.00	5.00	3.75	.62

Mean of means: 3.71

Standard Deviation: 0.67

This was to ascertain the influence of internal controls on financial soundness of SACCOs. Using a 5 point Likert scale in Table 4.5 the simple descriptive statistics shows a mean score of 3.71 and a standard deviation of .67 .With this statics the majority of the respondents do agree that internal controls in SACCOs governance plays a vital role in SACCOs operations.

Therefore with a mean score 3.71 from a maximum point of 5 which is above the midpoint of 5, we say that internal controls are very necessary in corporate governance of SACCOs.

The study was to review the role of internal controls in the corporate governance of SACCOs.

The research reviewed the importance of internal controls on corporate governance of SACCOs. The respondent agreed that SACCO management reports and reports from the internal and external auditors are reviewed concerning deviations and weaknesses in accounting and operational controls. This scored highly since it is a risk mitigating measure and had a mean score of 3.78 and a standard deviation of .61.The respondents were also in agreement that SACCOs policies, procedures are adequate to safeguard against errors, carelessness, conflict of interest, self dealing and fraud as it had a score of 3.75 and standard deviation of .62.The reason behind this is that majority of the SACCO members are interested on how they are being managed to ensure their assets are safe.

The findings of the study concur with Sulaiman (2003) who state that internal controls ensure that appropriate financial, operational and compliance controls are put in place.

Board Responsibility

Table 4.6: Board Responsibility analysis

Descriptive Statistics					
	N	Minimum	Maximum	Mean	Std. Dev.
Management Maintains	32	2.00	5.00	3.13	.71
Board Ensures SACCO functions	32	2.00	5.00	3.16	.68
Board Ensures Adequate Provision	30	2.00	5.00	3.47	.78
Board Assists In Maintaining Image	32	2.00	5.00	3.44	.84
Board Sets Up Committees	32	2.00	5.00	3.34	.83
Board Produces Annual Audited Accounts	32	2.00	5.00	3.19	.78
Board Appoints And Removes CEO	32	2.00	5.00	3.34	.83
Board Established Qualification And Competence Of CEO	30	2.00	5.00	3.50	.73

Mean of means: 3.32

Standard Deviation: 0.77

A 5 point Likert scale in Table 4.6 the simple descriptive statistics showed a mean score of 3.32 and a standard deviation of .77 .With this statistics the majority of the respondents hardly agree that Board responsibility in SACCOs governance plays a major role in SACCOs operations.

Therefore with a mean score 3.32 from a maximum point of 5 which is above the midpoint of 5, we say that board responsibility is essential in corporate governance of SACCOs though not as much like in the transparency and internal controls.

The study sought to establish the influence of Board of director's responsibility on financial soundness of the SACCO. The report showed that most of the respondents agreed that the board have established the qualifications and competence of chief executive officer (CEO).It was also agreed that the board should ensure adequate provisions for known and probable losses likely to occur are made. The means were 3.5 and 3.47 respectively. The respondents were neutral to the rest of questionnaires on the Board responsibility as shown by the means they got from the study in table 4.6.

Results of this study concur with the findings of Epstein (1986) and Louden (1982) who argued that not always do directors perform their legal duties of control and services .CEOs performance are not always evaluated well and that managers are not always advised properly.

4.4. Financial soundness of SACCOs

The second objective of this study was to assess the relationship between corporate governance and financial soundness of SACCOs. The financial soundness of SACCOs was measured by analyzing secondary data using PEARLS ratios for thirteen SACCOs and then run a regression analysis to correlate corporate governance with primary data of the corresponding thirteen SACCOs.

4.4.1 PEARLS ratios Analysis

The PEARLS ratios Analysis was measured using selected PEARLS ratios and compared against the monitoring system goals of world council of credit unions. Protection was measured with ratio P1, Effective financial structure E1, Asset Quality A1, Rates of return and costs R9, Liquidity L1, Signs of growth S11.This ratios were considered according to their contribution in each category.

Table 4.7: Protection

	P=PROTECTION	SACCOS GOAL	1	2	3	4	5	6	7	8	9	10	11	12	13
P1	Loan Losses Allowances /Allowances for loan Delinquent > 12 months	100%	100%	100%	126%	100%	100%	100%	100%	100%	100%	145%	100%	100%	100%
P2	Net Allowance for Loan Losses/ Allowances for loans delinquent less than 12 month	35%	35%	30%	12%	35%	35%	36%	16%	17%	18%	14%	90%	0%	25%
P3	Total charge -Off of delinquent Loans > 12 months	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
P4	Annual Loan Charge -offs/Average Loan Portfolio	Minimized	1%	1%	3%	2%	4%	0%	1%	1%	1%	0%	1%	1%	1%
P5	Accumulated Loan Recoveries/Accumulated Loan Charge -offs	100%	0%	0%	239%	100%	100%	0%	102%	100%	0%	2%	100%	100%	100%
P6	Solvency (Net value of Assets/Total Shares & deposits)	>=100	210%	107%	106%	114%	112%	165%	110%	104%	111%	106%	128%	262%	129%
Source: Worked out from Audited Accounts of the SACCOS															

Loan losses allowances /Allowances for loan delinquent >12 months

The most critical ratio under protection is allowance for loan losses divided by delinquency greater than twelve months. The standard of excellence to measure this ratio is 100%. From the above we observe that all the indicated SACCOs achieved this ratio. Results from the data collected showed that the savings of the SACCOs member were not at risk. From appendix C, it showed that all SACCOs under study achieved 100% provisions for loan losses from loans that were greater than 12 months delinquent. This showed that the SACCOs were prepared against any unexpected losses to the firms. However, majority of the SACCO made provisions in the two previous year's .i.e. 2013 and 2012. Therefore, it can be concluded that before year 2012, majority of the SACCOs were operating under risk for not adequately protecting members' savings.

Table 4.8:Effective financial structure

		SACCOS	1	2	3	4	5	6	7	8	9	10	11	12	13
	E= EFFECTIVE FINANCIAL STRUCTURE	**GOAL**													
E1	Net loans/ Total Assets	70-80%	72%	72%	68%	91%	58%	81%	86%	67%	76%	82%	84%	81%	85%
E2	Liquid Assets to Total Assets	Max 20%	13%	3%	7%	2%	6%	3%	12%	8%	5%	13%	5%	1%	14%
E3	Financial investments/Total Assets	Max 10%	1%	1%	2%	2%	20%	2%	0%	0%	1%	0%	9%	2%	0%
E4	Non - financial investments/Total Assets	0%	0%	0%	0%	0%	0%	11%	0%	3%	0%	0%	0%	0%	0%
E5	Savings Deposits /Total Assets	70-80%	79%	68%	75%	79%	77%	71%	80%	83%	76%	85%	88%	74%	82%
E6	External credit /Total Assets	Max 5%	8%	13%	8%	3%	6%	2%	0%	3%	1%	0%	0%	0%	0%
E7	Member Share Capital/Total Assets	10-20%	4%	4%	6%	3%	14%	16%	2%	5%	15%	10%	5%	17%	6%
E8	Institutional capital /Total Assets	Min 10%	-4%	4%	4%	6%	8%	14%	7%	4%	15%	6%	2%	15%	3%
E9	Net Institutional Capital/Total Assets	Min 10%	-4%	4%	4%	6%	8%	14%	7%	4%	15%	6%	2%	15%	3%

Source: Worked out from Audited of the SACCOs

Net loans/ Total Assets

From data on Table 4.8 above, it is observable that 77 % of the SACCOs under review met the goal of placing 70-80% of its total assets in loans to its members in 2013. SACCOs 3,5 and 8 achieved 68%,58% and 67% respectively below the goal of 70-80%. However , in the last three years , 2012,2011 and 2010 SACCO 3 achieved the target as follows; 73%,80% and 80% respectively.SACCO 5 had 58 % ,63%, and 63% . SACCO 8 had72%, 74%, and 73% . This shows that the majority of SACCOs had a high opportunity on maximising returns on productive assets and at the same time provided their members with the credit services. From appendix C ,in the last four years only SACCO 5 did not get the required percentage of 70-80% on average.We can say that the majority of SACCOs were able to fund their assets basically with member-client deposits and therefore were independent from the fluctuating price of external funds.

Table 4.9:Asset Quality

		SACCOS	1	2	3	4	5	6	7	8	9	10	11	12	13
	A= ASSET QUALITY	**GOAL**													
A1	Total Loan Delinquency/ Gross Loan Portfolio	5%	1%	1%	5%	2%	4%	5%	0.1%	1%	1%	7%	1%	1%	3%
A2	Non -Earning Asset /Total Assets(cash+AR+FA& AP)	5%	19%	22%	30%	5%	19%	-3%	4%	24%	3%	16%	6%	16%	3%
A3	Net Institutional & Transitory capital+Non interest -Bearings liabilities/Non Ear	>200	-20%	18%	14%	133%	6%	-428%	181%	18%	33%	63%	47%	105%	98%
Source: Worked out from Audited Accounts of the SACCOS															

Total loan delinquency/Gross loan portfolio

From the thirteen SACCOs under study, twelve achieved the ideal goal of maintaining the delinquency ratio below 5% of total loans outstanding. This shows that there is an improvement in credit administration and collection and this has minimized the portfolio risk. In the last four years only SACCO 5 did not achieve a ratio below 5% (Appendix C). Asset quality ratio as a measure of institutional weakness, shows that majority of SACCO were strong even in other areas of operations.

Table 4.10:Rates of return and costs

		SACCOS	1	2	3	4	5	6	7	8	9	10	11	12	13
	R= RATES OF RETURN & COSTS	**GOAL**													
R1	Net Loan Income /Average Net loan Portofolio	E/Rate(10%)	16%	20%	17%	15%	13%	8%	5%	7%	18%	13%	14%	14%	16%
R2	Total Liquid Investment Income /Average Liquid Investments	M/Rates	0%	0%	0%	0%	0%	0%	2%	4%	0%	8%	5%	2%	7%
R3	Total Financial Investment Income/Average Financial Investments	M/Rates	2%	10%	30%	14%	37%	12%	75%	15%	4%	330%	5%	26%	0%
R4	Total Non - Financial Investment Income /Average Non-Financial Investments	Greater R1	60%	0%	0%	0%	0%	0%	0%	0%	0%	0%	88%	0%	0%
R5	Total Interest Cost on Savings Deposits/Average Savings Deposit	M/Rates	1%	3%	5%	5%	0%	0%	10%	5%	12%	3%	10%	0%	14%
R6	Total Interest Cost on External credit /Average External credit	M/Rates	16%	15%	21%	14%	17%	22%	14%	24%	11%	0%	10%	0%	0%
R7	Total Interest(Dividend) Cost on shares /Average Member shares	M/Rates > R5	0%	0%	0%	0%	0%	0%	0%	0%	0%	10%	0%	50%	0%
R8	Total Gross Income Margin/Average Total Asset	10%	7%	8%	10%	11%	16%	4%	5%	6%	5%	12%	5%	7%	4%
R9	Total Opertaing Expenses/Avg. Total Assets	<5%	5%	7%	10%	9%	12%	4%	3%	4%	4%	7%	3%	4%	3%
R10	Total Loan Loss Provision Expense /Average Total Asset	100 & 35%	0%	1%	4%	2%	3%	0%	0%	1%	1%	3%	1%	1%	1%
R11	Non- Recurring Income or Expense/ Average Total Asssts	Minimized	0	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
R12	Net Income/Average Total Assets (ROA)	10%	1%	6%	0%	2%	18%	1%	2%	2%	2%	5%	2%	2%	1%

Source: Worked out from Audited Accounts of the SACCOS

Total operating expenses/Average total assets

The operating expense divided by average total assets indicates the degree of operational efficiency or inefficiency. This ratio measures the cost associated with the management of the SACCO. Out of the thirteen SACCOs reviewed, only SACCO 5, whose ratio was 12%, had more than 10% which is considered as the standard of excellence. The rest had less than 10% showing that they are operating efficiently. This was the same case in the last four years as indicated in the appendix C.

The average gross margin divided by average total assets for all the thirteen SACCOs is 8%.This indicates that the SACCOs are able to generate enough income to cover operating expenses and allowances for loan losses.

Table 4.11:Liquidity

		SACCOS	1	2	3	4	5	6	7	8	9	10	11	12	13
	L= LIQUIDITY	GOAL													
L1	S.T Investments+Liquid Assets- S. T payables/Total savings deposit	Min 15%	25%	135%	28%	8%	17%	6%	5%	24%	16%	19%	20%	4.03%	16%
L2	Liquidity Reserves /Total Savings Deposits	10%	17%	-62%	38%	10%	43%	21%	17%	10%	15%	21%	7%	2%	17%
L3	Non- earning Liquid Assets/Total Assets	<1%	2%	2%	4%	1%	7%	3%	0%	5%	1%	1%	0%	13%	0%
Source: Worked out from Audited Accounts of the SACCOS															

Short term Investments/Total savings deposit

For the 13 SACCOs under review, 9 SACCOs faced no difficulties maintaining a minimum of 15% of its savings deposits in liquid instruments in order to satisfy member-client withdrawal requests. During the study period consisting of the latest four years (2010 to 2013), SACCO 6 had a very poor liquidity ratio as shown in appendix C.

Table 4.12:Signs of growth

		SACCOS	1	2	3	4	5	6	7	8	9	10	11	12	13
	S=SIGNS OF GROWTH	GOAL													
S1	Growth in Loans to Members	70-80%	10%	28%	2%	26%	12%	0%	9%	-3%	10%	16%	40%	24%	10%
S2	Growth in Liquid investments (cash)	Max 20%	32%	10%	37%	-30%	23%	225%	111%	28%	-16%	112%	30%	-55%	56%
S3	Growth in Financial Investments	Max 10%	3%	0%	87%	18%	84%	92%	0%	18%	68%	0%	77%	1189%	-61%
S4	Growth in Non- Financial Investments	0%	0%	-10%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
S5	Growth in Savings Deposits	70-80%	13%	24%	14%	17%	9%	9%	16%	2%	11%	20%	48%	21%	15%
S6	Growth in External credit	Max 5%	-51%	-14%	-11%	16%	-34%	-69%	-100%	-37%	-52%	0%	-92%	100%	0%
S7	Growth in Share Capital	10-20%	79%	-2%	0%	37%	65%	8%	0%	177%	16%	112%	33%	19%	20%
S8	Growth in Instituional Capital	Min 10%	-27%	28%	-3%	-11%	26%	47%	26%	15%	19%	218%	107%	180%	17%
S9	Growth in Net Institutional Capital	Min 10%	-27%	28%	-3%	-11%	26%	47%	26%	15%	19%	218%	107%	180%	17%
S10	Growth in Membership	>12%	-2%	4%	2%	9%	5%	2%	3%	6%	5%	19%	69%	11%	7%
S11	Growth in Total Assets	Inflation	11%	20%	10%	19%	22%	10%	15%	4%	12%	25%	44%	26%	15%
Source: Worked out from Audited Accounts of the SACCOS															

Growth in total assets

The total assets of the studied SACCOs were growing, keeping pace with inflation. The growth in SACCO assets has been steady and above annualized inflation of 5.7% for the year 2013 (National Bureau of Standards, 2013). In appendix C, the majority of the SACCOs showed positive trends in total assets growth over the study periods. This growth rate was above the inflation rate meaning that SACCOs were able to maintain the real value of the members' assets and protect them from the impact of inflation. A study done to establish corporate governance

practices and their relationship with the growth of listed companies in Nairobi found a positive linear relationship between growth and corporate governance (Kariuki et al ; 2011)

4.5 Relationship between Corporate Governance and Financial soundness of SACCOs

4.5.1 Pearson Correlation

The main objective of the study was to analyze the relationship between financial soundness and corporate governance. The analysis was done using Pearson correlation coefficient and regression analysis. The Confidence limit was at 95% and used a two tailed test at a significance level of 0.05.

P-Value less than or equal to 0.05 was considered to be significant and above 0.05 was insignificant.

Table 4.13 Pearson Correlation Analysis

		Board Responsibility	Transparency and Disclosure	Internal Controls
Protection	Pearson Correlation	-.296	-.105	-.202
	Sig. (2-tailed)	.326	.732	.508
	N	13	13	13
Effective Financial Structure	Pearson Correlation	.709*	.678*	.731*
	Sig. (2-tailed)	.017	.021	.010
	N	13	13	13
Asset Quality	Pearson Correlation	.233*	.188	-.125
	Sig. (2-tailed)	.020	.538	.685
	N	13	13	13
Rates of Return and Costs	Pearson Correlation	.118	-.146	.102
	Sig. (2-tailed)	.701	.634	.740
	N	13	13	13
Liquidity	Pearson Correlation	.748*	.602*	.712*
	Sig. (2-tailed)	.009	.023	.018
	N	13	13	13
Signs of growth	Pearson Correlation	.239	-.550	.100
	Sig. (2-tailed)	.432	.051	.745
	N	13	13	13

*. Correlation is significant at the 0.05 level (2-tailed).

Using Pearson correlation coefficient model of assessing financial soundness of the SACCOs, it was noted there was a positive correlation coefficient between effective financial structure ratio and the three pillars of governance; board .709, transparency and disclosure .678 and internal controls .731.The study also found a positive correlation between asset quality and board and transparency and disclosure as shown by a coefficient of .233 and .188 respectively. There was a positive relationship between the rates of return and the board responsibility and internal controls as shown by the Coefficient of .118 and .102 respectively. Liquidity had a positive correlation of coefficients to the three pillars of governance; board .748, transparency .602 and internal controls .712 .Signs of growth indicated a positive correlation of .239 with the board and 0.1 with the internal controls. The positive correlations of the above meant that as the independent variables increase in value the dependent variables also increase in value and conversely if there is a decrease.

However, the study showed that protection had a negative correlation of -.296 to the board, -.105 on transparency and .202 to internal controls; rates of return -.146 to transparency; signs of growth - .55 to the transparency respectively. This means that when the independent variables increase, the dependent variables decrease and vice versa.

4.5.2 Regression Analysis

Regression Analysis was used to examine the effect of corporate governance pillars on a single outcome PEARLS ratios variable. This was to examine whether if pillars of governance predicts financial soundness of the SACCOs.

Regression analysis 1: Relationship between protection and board, transparency and internal controls

The first regression equation is that board, transparency and Internal controls have a significant positive correlation on the SACCOs financial soundness (protection ratio, P1). The equation is:

P1 ratio = 493.6-2.7BO-.71TD-2.1IC

Table 4.14 : Protection Coefficient

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	493.656	319.578		1.545	.157
	Board Responsibility	-2.672	2.208	-.380	-1.210	.257
	Transparency and Disclosure	-.707	3.579	-.063	-.198	.848
	Internal Controls	-2.143	2.486	-.284	-.862	.411

a. Dependent Variable: Protection

R = .420 R-Sq = .177 R-Sq (adj) = -.098

This regression (1) has the protection ratio (P1) as the dependent variable and board, transparency and internal controls as the independent variables. There are negative outputs i.e (-2.7,-.71 and -2.11) and the result is that as independent variables decreases the dependent variable increases. However, the data had p- values of .257, .848 and .411 respectively which shows that the data are insignificant for making conclusion on financial soundness of SACCOs since the values of significance (p-value) are greater than 5%. The model therefore is statistically non-significant. R –sq shows the proportion of variability between the study variables. The variability in the protection ratio accounted for by variation in board, transparency and internal controls is .177 which is considered as low. This means that board, transparency and internal controls alone cannot explain variation in protection ratio.

This is in line with the findings of Adjaoud et al (2007) who examined the relationship between firm performance and governance scores and found that the relationship was not significant between the scores and the accounting – based measures of performance.

Regression analysis 2: Relationship between effective financial structure and board, transparency and internal controls

The second regression equation is that board, transparency and Internal controls have a significant positive correlation on the SACCOs financial soundness (Effective financial structure E1). E1 = the net loans to total assets is the response variable. The equation is:

E1 ratio = 95.2 + .52 BO +.67 TD+.11IC

Table4.15: Effective financial structure coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	95.224	56.424		1.688	.006
	Board Responsibility	.520	.390	.396	-1.333	.021
	Transparency and Disclosure	.668	.632	.319	1.057	.018
	Internal Controls	.110	.439	.078	-.251	.007

a. Dependent Variable: Effective Financial Structure

R = .897 R-Sq = .805 R-Sq (adj) = .72 P= .405

The outputs in this equation have positive correlations of .52, .67 and .11.This means that as board, transparency and internal controls variables increases the net loans to total assets also increases. The results show that the three pillars of governance explain variations in financial soundness of SACCOs. The respective p- values (.021, .018, .007) indicate the statistical significant of this variables in explaining the financial soundness of the SACCOs.

Effective financial structure variables affect the growth, profitability and efficiency of the SACCOs (Richardson, 2001). Therefore this is in line with Brown & Caylor (2004) findings that indicated that better governed firms are relatively more profitable, valuable and pay cash to their shareholder.

Regression analysis 3: Relationship between asset quality and board, transparency and internal controls

The third regression equation is that board, transparency and Internal controls have a significant positive correlation on the Asset quality (A1).

Asset quality ratio = 373.1- 4.44 BO +2.21 TD-2.6C

Table 4.16 Asset quality coefficient

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	373.105	214.317		1.741	.116
	Board Responsibility	-4.447	1.481	-.708	-3.003	.015
	Transparency and Disclosure	2.209	2.400	.221	.921	.381
	Internal Controls	-2.604	1.667	-.385	-1.562	.153

a. Dependent Variable: Asset Quality

R = .733 R-Sq = .537 R-Sq (adj) = .383

The results show that the board responsibility explains a variation in asset quality ratios as its levels decreases hence more profitability; t-value -3.0 and p- value of 0.015 confirming the statistical significance of this variable. This is in line of Lynch (1979), who found an increased revenue turnover and profits when board members increased their involvement in strategic activities.

From the results, transparency and disclosure recorded a positive coefficient of 2.2 meaning that as transparency and disclosure increases the assets quality ratio too increases, however the t-value of .92 and a p-value of .381 show that the variable is not statistically significant. This contradicts Beeks & Brown (2005) who found that higher corporate governance quality makes more informative disclosures.

Internal controls had negative coefficients of -2.6 and the t- value of -1.5 and a p-value of .15 and therefore not statistically significant since the calculated p- value is higher than .05level. This confirms Ge & Mcvay (2005) findings that firms with material internal control weakness have a lower earnings quality (Doyle et al, 2005).

Regression analysis 4: Relationship between Rates of return and costs and board, transparency and internal controls

The fourth regression equation is that board, transparency and Internal controls have a significant positive correlation on the Rates of return and costs (R9).

Rates of return ratio =78.5 +1.4 BO -2.9 TD+2.1C

Table 4.17 Rates of return and cost coefficient

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	78.533	473.635		.166	.872
	Board Responsibility	1.443	3.272	.148	.441	.670
	Transparency and Disclosure	-2.999	5.304	-.193	-.565	.586
	Internal Controls	2.140	3.684	.204	.581	.576

a. Dependent Variable: Rates of Return and Costs

R = .258 R-Sq = .066 R-Sq (adj) = .245

The result shows as the transparency (-2.9) increases the rates of return decrease. The t- value and p- value finds that the equation is not statistically significant.

The board and internal controls had coefficients of 1.4 and 2.1 respectively; meaning that as their ratios increase the rates of return also increases. Both variables were not statically significant.

Again this is in line of of Adjaoud et al (2007) findings who examined the relationship between firm performance and governance scores and found that the relationship was not significant between the scores and the accounting – based measures of performance.

Regression analysis 5: Relationship between Liquidity and board, transparency and internal controls

The fifth regression equation is that board, transparency and Internal controls have a significant positive correlation on the Liquidity (L1). The regression equation is as follows

Liquidity ratio =1536.7 +1.6 BO+22.2 TD +.049 IC

The coefficient of the variables are 1.6, 22.2 and 0.049 which are statistically significant with p-values of .013, .004 and 0.015 respectively meaning corporate governance have direct impact on the SACCOs liquidity. This is a confirmation of Brown & Caylor (2004) findings that better governed firms are relatively more profitable, valuable and pay cash to their shareholder. Thus ensuring the firm is financially sound.

Table 4.18 Liquidity and cost coefficient

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	1536.758	944.806		1.627	.008
	Board Responsibility	1.681	6.528	.071	.258	.013
	Transparency and Disclosure	22.339	10.580	.592	2.111	.004
	Internal Controls	.049	7.349	.002	-.007	.015

a. Dependent Variable: Liquidity

R = .893 R-Sq =.797 R-Sq (adj) =.756

Regression analysis 6: Relationship between Signs of growth and board, transparency and internal controls

The Sixth regression equation is that board, transparency and Internal controls have a significant positive correlation on the signs of growth (S11). The regression equation is as follows

Signs of growth ratio =1259.7 -3.9 BO+16.2 TD +4.031C

Table 4.19 Signs of growth coefficient

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	1259.765	571.015		2.206	.055
	Board Responsibility	-3.985	3.945	-.259	-1.010	.339
	Transparency and Disclosure	16.213	6.395	.662	-2.535	.032
	Internal Controls	4.031	4.442	.244	.908	.388

a. Dependent Variable: Signs of growth

R = .67 R-Sq = .45 R-Sq (adj) = .27

The results shows that transparency and disclosure ratios predict changes in signs of growth ratio which is indicated by t-value of -2.5 and p- value 0.032 less than 5%.The positive coefficient of transparency and disclosure (16.2) indicates that the more transparency and disclosure the SACCOs are, the more they report high signs of growth . The variables are statistically significant at p-value of 0.032.This is in conformity of Habib (2008) findings that transparency and disclosure policy is a predictor for the interrelation between corporate governance and firm performance

Board and internal controls were found to be statistically insignificant as indicated by p-values of .34 and 0.39 respectively.

For the board, it contradicts Lynch (1979), who found an increased revenue turnover and profits when board members increased their involvement in strategic activities and hence more growth.

Regression analysis 7: Relationship between financial soundness (PEARLS) and board, transparency and internal controls

The regression below looks how the three variables board, transparency and disclosure and internal controls together affects financial soundness (PEARLS ratio) of the SACCOs. The regression equation is:

FSS ratio= 639.5 + 1.4 BO+ 6.5 TD+ .21IC

Table 4.20: PEARLS coefficient

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	639.545	209.334		3.055	.014
	Board Responsibility	1.417	1.446	.241	.980	.035
	Transparency and Disclosure	6.561	2.344	.701	2.799	.021
	Internal Controls	.209	1.628	.033	.128	.040

a. Dependent Variable: Performance (PEARLS)

Table 4.21: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.704[a]	.496	.328	36.27168

a. Predictors: (Constant), Internal Controls, Board Responsibility, Transparency and Disclosure

Table 4.21: ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	11636.953	3	3878.984	2.948	.041[b]
	Residual	11840.716	9	1315.635		
	Total	23477.669	12			

a. Dependent Variable: Performance (PEARLS)

b. Predictors: (Constant), Internal Controls, Board Responsibility, Transparency and Disclosure

From table 4.20 it can be seen that a unit of board responsibility would lead to an increase in financial soundness (PEARLS) of the SACCOs by a factor of 1.4, a unit increase in transparency and disclosure would lead to increase in financial soundness of SACCOs by a factor of 6.5 and a unit increase in Internal controls lead to an increase by a factor of .21.

At 5% significant level board, transparency and internal controls had .035, .021 and .040 level of significance respectively. Thus all the variables were statistically significant.

The prediction that board responsibility has positive significant impact on financial soundness is supported. The board responsibility coefficient is positive 1.4, t-value =.98 and p- value =.035

showing that the more the board is involved in management of the SACCOs the higher the financial soundness (PEARLS) ratios.

The positive coefficient 6.5 for transparency and disclosure indicate that the relationship with financial soundness is statistically significant, t-value 2.8, p-value 0.021.This indicates that as more transparency is disclosed in the SACCO a lot of confidence is gained and members increase their contributions which improves SACCOs financial soundness.

The prediction that internal control also has positive significant impact on financial soundness is supported with a positive coefficient .21, t-value .13 and p-value .04. This indicates a SACCO with sound internal controls has a positive impact on finance performance as it is able to prevent against any risk and contains fraud.

From table 4.21 model summary, adjusted squared which is a coefficient of determination inform us the variation in the dependent variable due to changes in the predictor variable, is 49.6 % (.496). This indicates there is a variation of 49.6% on financial soundness (PEARLS) of SACCOs due to changes in board responsibility, transparency and disclosure and internal control. R-.70 shows there is a strong positive relationship between the variables under the study.

From table 4.22 the ANOVA statistics indicate the model is good for making conclusion on the variables as the value of significance is less than 5% (p-value 0.041).

The findings agree with Beiner & Drobetz (2004) who indicated that improved corporate governance is associated with high firm valuation.

4.6 Summary of Findings

The study was to examine the relationship between corporate governance and the financial soundness of licensed SACCOs. Three of the most vital corporate governance mechanism such as board responsibility, transparency and disclosure and internal controls were examined. From the respondents i.e. CEOs, senior managers and other senior staff all agreed that three pillars of corporate governance have an impact on the financial soundness of the SACCOs. However an internal control plays a major role than the other two.

From the computed PEARLS ratios which were examined, the findings are that majority are within the recommended goals of excellence by WOCCU.

From the regression analysis, using one dependent variable indicate that board responsibility, transparency and disclosure and internal controls do not individually explain variations in PEARLS ratios on protection and rates of return and costs. However board, transparency and internal control do explain variations on effective financial structure and liquidity.

From the multiple regressions, high variation of 49.6% financial soundness levels are explained by the predictor variables in this study and therefore the model is good in predicting financial soundness levels of the SACCOs (See table 4.20 and 4.21).

CHAPTER FIVE: SUMMARY , CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the summary of the findings, conclusion and recommendation of the study.

5.2 Summary

The following important conclusions were made in regards to the objectives of the study.

5.2.1 Governance pillars

For objective one the study found that internal controls play an important role in SACCOs corporate governance: there was a high degree of agreement that it was the most important factor in corporate governance. SASRA lays down a number of requirements in relation to Board responsibility, Transparency and Disclosure, and internal controls to achieve good corporate governance. The requirements that relate to internal controls are the ones that respondent state on average to be those most complied with: the SACCO management reports from both internal and external auditors were reviewed and actions taken concerning any deviations and weaknesses in accounting and operational controls. In addition, the research found that the majority of the SACCOs have enough policies and procedures to safeguard against error, carelessness, conflict of interest and fraud. It was also observed that most of the SACCOs were cautious in ensuring that audited financial statements were submitted within the required time. Thus the SACCOs were responsible in ensuring proper records were kept and approvals from the members were obtained during annual general meeting.

Internal controls were prominent in contributing to the financial soundness of the SACCOs compared to the other two pillars, namely transparency and disclosure and board responsibility. This prominence is because the internal controls concept was broad as it refers to risk management and accountability which bring in legitimacy in SACCOs' management. This gives confidence to the members.

Most of the SACCOs under study reported good profits for the four years and this is in line to the findings of Ge & McVay (2005) that firms with material internal control weakness are less profitable and vice versa.

5.2.2 Regression analysis

For objective two, the study found that the relationship between the effective financial structure s and the liquidity ratios and the pillars of corporate governance to be significant. Effective financial structure relates to the growth, efficiency and profitability and hence improves the liquidity of the SACCOs.

This finding confirms Brown & Caylor (2004) findings that better governed firms are relatively more profitable, valuable and pay dividends to their shareholder.

The multiple regressions revealed that a unit of independent variables led to an increase in financial soundness of SACCOs and were statistically significant. This is in agreement with the Beiner & Drobetz (2004) findings.

5.3 Conclusion

From the findings on the effect of the three pillars of governance under study, we established that internal controls affect financial soundness of SACCOs more than transparency and disclosure and the board responsibility. However, collectively the three pillars affect SACCO's financial soundness.

From regression analysis protection ratio was found to negatively affect SACCOs financial soundness. Effective financial structure and liquidity ratio positively affected SACCOs. However from the multiple regression analysis we found that the three pillars of governance are statistically significant and therefore influence the financial soundness of SACCOs.

The study thus concludes that board responsibility, transparency and disclosure and internal controls do positively influence the financial soundness of licensed deposit taking SACCOs in Kenya.

5.4 Recommendations

Results of the study show that there is great need for SACCOs to put more pressure on the application of the corporate governance pillars and especially on board responsibility. Ignoring the role of the board can jeopardize all the other tenets of corporate governance in the SACCO since it is the oversight and strategic body for the institution. The board of directors of SACCOs needs to be educated on their role and mandate and especially on the supervisory element.

Members of SACCOs should also be educated on how to appoint able members of the board so that those appointed are persons who understand the essence of corporate governance, which will enhance financial soundness in SACCOs.

There is great need for SACCOs' financial soundness to be measured using PEARLS which is an international tool. This will help the licensed deposit SACCOs to be competitive globally and improve on those ratios which they are not performing well and include the two ratios which are not in the CAMEL model.

5.5 Recommendation for further studies

The research recommends that a study to determine other factors in addition to corporate governance should be carried out so that other factors which may contribute to the financial soundness of SACCOs can be discussed.

A further study would be on financial soundness of SACCOs using PEARLS against CAMEL.

A further study would be on how other variables like human resource and net – work branches which are outside the PEARLS and CAMEL framework affects SACCOs performance.

5.6 Limitations of the Study

The study considered a sample of 13 audited financial statements out of 43 SACCOs (30%). This might not be representative enough to arrive at a truly conclusive result in examining the relationship between corporate governance and the financial soundness of all deposit taking SACCOs. Some SACCOs omitted from the sample could have a better or a worse relationship.

Some SACCOs had not submitted their audited financial statements to SASRA and therefore we were not able to access their financial statements. This limitation was caused by lack of follow – up by SASRA. However, the failure to file the financial statements with SASRA would suggest that corporate governance in those SACCOs is weak: but no conclusion can be arrived at with regards to the financial soundness of these SACCOs.

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Appendices

Appendix A: Questionnaire

Strathmore University

22 October 2014

Dear Sir/Madam,

I am a Master of Commerce student in the School of Management and Commerce at Strathmore University, Kenya. My study project is on the relationship between corporate governance and financial soundness of licensed deposit taking SACCOs. The purpose of this research is to assess the effectiveness of the existing corporate governance practices in achieving better finance performance by Kenyan SACCOs.

I invite your participation in this research by completing the attached questionnaire which will take approximately 10-15 minutes. Your cooperation in this regard is highly appreciated. The information collected will be treated with utmost confidence and therefore the confidentiality of your responses is assured.

Thank you for your cooperation.

Yours faithfully,

David Kariuki

Strathmore University

Section A: Background Information

A1. Name: (Optional) ----------

A2. What is the name of your SACCO? _____

A3. For how long has this SACCO been in operations in Kenya …….years?

A4. What is your Job position?

Chairman [ ]

CEO [ ]

Director [ ]

Senior Manager [ ]

Others (Specify) [ ]

A5. How long have you been working with this SACCO?

0-5 yrs [ ]

5-10 yrs [ ]

10-15 yrs [ ]

Over 15 yrs [ ]

Use a scale of 1 to 5 where 1 is Strongly disagree, 2 – Disagree, 3- Hardly agree, 4- Agree and 5 – Strongly Agree in regards to the statement about SACCO and finance soundness of SACCOs for sections B,C and D.

B. Board Responsibility	**1**	**2**	**3**	**4**	**5**
B1.Management maintains proper and accurate records showing true and fair position of the SACCO's financial condition					
B2. Board ensure that the SACCO functions effectively and an adequate and strong internal control system is in place					
B3. The board ensures that adequate provisions for known and probable losses likely to occur are made					

B4. The board assist in maintaining a positive image of the SACCO within the industry and the economy as a whole by setting key policies affecting stakeholders					
B5. The board set up a number of management committees like audit and credit to effectively discharge its functions					
B6. The board is responsible for the production of annual audited accounts to be presented at annual general meeting held not later than four months after the end of a financial year					
B7.The Board is involved for the appointment and removal of the chief executive officer of the SACCO					
B8.The board have established criteria for required expert and professional knowledge and experience , as well as other conditions for appointment of the CEO					
C.Transparency and disclosure					
C1.Monthly, quarterly and annual financial statements showing current compared to last year period actual performance , the budget against the actual expenditure is presented to the board					
C2.Delinquent loan list , growth in loans, loans losses, recoveries and provisions are well disclosed					
C3.A comprehensive statement of income (monthly , quarterly and annual) comparing budget and actuals is prepared					
C4.Sources and distribution on profile of savings and deposits is disclosed					
C5.All insider dealings and non- performing insiders loans are disclosed					
C6.Reports on the violation of SACCO Act plus other applicable law are prepared and remedial actions taken to comply					
C7.Big risk exposures, investment portfolio , any regulatory reports ,and internal reports which are relevant to the SACCO operations are declared					
C8.A Statement showing capital structure and adequacy is prepared					
D .Internal Controls					
D1.The SACCO has established an internal audit function which is responsible for reviewing and reporting adequacy of the internal audit system and the financial matters					

D2.The Internal auditor reports to the Audit committee of the board					
D3.The audited financial statements are submitted for approval to the authority within three months after the end of the financial year					
D4. The audit committee reviews the financial conditions of the SACCO ,internal controls, performance and findings of the internal auditors and recommend remedial actions at least once in every three months					
D5.SACCO have set adequate internal controls to achieve SACCO financial reporting objectives					
D6.The SACCO keep the accounting records and financial reports are accurately prepared to reflect its operations and results					
D7.The SACCO management reports from the internal and external auditors are reviewed concerning deviations and weaknesses in accounting and operational controls					
D8.SACCOs have mechanisms and rules for performing supervision and controls established to safeguard against internal control weaknesses					

THANK YOU!!

Appendix B: List of SACCOs

A.SCHEDULE OF LICENCESED DEPOSIT –TAKING SACCO SOCIETIES

1	AFYA SACCO SOCIETY LTD
2	AIRPORT SACCO SCCIETY LTD
3	ARDHI SACCO SCCIETY LTD
4	ASILI SACCO SCCIETY LTD
5	CHAI SACCO SCCIETY LTD
6	CHUNA SACCO SCCIETY LTD
7	COMOCO SACCO SCCIETY LTD
8	ELIMU SACCO SCCIETY LTD
9	FUNDILIMA SACCO SCCIETY LTD
10	HARAMBEE SACCO SCCIETY LTD
11	HAZINA SACCO SCCIETY LTD
12	JACARANDA SACCO SCCIETY LTD
13	JAMII SACCO SCCIETY LTD
14	KENPIPE SACCO SCCIETY LTD
15	KENVERSITY SACCO SCCIETY LTD
16	KENYA BANKERS SACCO SCCIETY LTD
17	KENYA POLICE SACCO SCCIETY LTD
18	KINGDOM SACCO SCCIETY LTD
19	MAGEREZA SACCO SCCIETY LTD
20	MAISHA SACCO SCCIETY LTD
21	MILIKI SACCO SCCIETY LTD
22	MWALIMU NATIONAL SACCO SCCIETY LTD
23	MWITO SACCO SCCIETY LTD

24 NACICO SACCO SCCIETY LTD
25 NAFAKA SACCO SCCIETY LTD
26 NAKU SACCO SCCIETY LTD
27 NASSEFU SACCO SCCIETY LTD
28 NATION SACCO SCCIETY LTD
29 NEST SACCO SCCIETY LTD
30 SAFARICOM SACCO SCCIETY LTD
31 SHERIA SACCO SCCIETY LTD
32 STIMA SACCO SCCIETY LTD
33 TELEPOST SACCO SCCIETY LTD
34 TEMBO SACCO SCCIETY LTD
35 TRANSCOM SACCO SCCIETY LTD
36 UFANISIS SACCO SCCIETY LTD
37 UFUNDI SACCO SCCIETY LTD
38 UKRISTO NA UFANISI WA ANGLICANAI SACCO SCCIETY LTD
39 UKULIMA SACCO SCCIETY LTD
40 UNITED NATION SACCO SCCIETY LTD
41 WANANGA SACCO SCCIETY LTD
42 WANANDEGE SACCO SCCIETY LTD
43 WAUMINI SACCO SCCIETY LTD

B. LIST OF SACCOs FOR SECONDARY DATA

1	AFYA SACCO SOCIETY LTD
2	AIRPORT SACCO SOCIETY LTD
3	ASILI SACCO SOCIETY LTD
4	CHAI SACCO SOCIETY LTD
5	ELIMU SACCO SOCIETY LTD
6	HARAMBEE SACCO SOCIETY LTD
7	KENPIPE SACCO SOCIETY LTD
8	KENYA BANKERS SACCO SOCIETY LTD
9	MWALIMU SACCO SOCIETY LTD
10	NATION SACCO SOCIETY LTD
11	SAFARICOM SACCO SOCIETY LTD
12	SHERIA SACCO SOCIETY LTD
13	UNITED NATIONS SACCO SOCIETY LTD

Appendix C: Secondary data for four years on thirteen (13) SACCOs

	THE PEARLS MONITORING SYSTEM GOALS	SACCOS	1				2				3				4				5				6			
PEARL		GOAL	2013	2012	2011	2010	2013	2012	2011	2010	2013	2012	2011	2010	2013	2012	2011	2010	2013	2012	2011	2010	2013	2012	2011	2010
	P=PROTECTION																									
P1	Loan Losses Allowances /Allowances for loan Delinquent > 12 months	100%	100%	100%	100%	100%	100%	100%	100%		126%	100%	100%		100%	100%			100%	100%			100%	100%		
P2	Net Allowance for Loan Losses/ Allowances for loans delinquent less than 12 month	35%	35%	35%	35%	35%	30%	30%	30%		29%	30%			35%	35%			35%	35%			36%	35%		
P3	Total charge -Off of delinquent Loans > 12 months	100%	100%	100%	100%	100%	100%	100%	100%		100%	100%			100%	100%			100%	100%			100%	98%		
P4	Annual Loan Charge -offs/Average Loan Portfolio	Minimized	1%	1%	1%	1%	1%	1%	1%		3%	2%	3%		2%	2%	2%	2%	4%	4%						
P5	Accumulated Loan Recoveries/Accumulated Loan Charge -offs	100%	100%	100%	97%	96%	102%	101%	98%	95%	239%	100%	100%		100%	100%			100%	100%						
P6	Solvency (Net value of Assets/Total Shares & deposits)	>=100	210%	97%	110%	109%	107%	106%	242%	218%	106%	108%	111%	111%	114%	97%	213%	215%	112%	97%	154%	188%	165%	187%	178%	154%
Source: Worked out from Audited Accounts of the SACCOS																										

	THE PEARLS MONITORING SYSTEM GOALS	SACCOS	7				8				9				10				11				12				13			
PEARL		GOAL	2013	2012	2011	2010	2013	2012	2011	2010	2013	2012	2011	2010	2013	2012	2011	2010	2013	2012	2011	2010	2013	2012	2011	2010	2013	2012	2011	2010
	P=PROTECTION																													
P1	Loan Losses Allowances /Allowances for loan Delinquent > 12 months	100%	100%	100%			100%	100%	100%		100%	100%			145%	106%			100%	100%			100%	100%			100%	100%	558%	408%
P2	Net Allowance for Loan Losses/ Allowances for loans delinquent less than 12 month	35%	16%	18%			17%	15%	15%		18%	20%			14%	3%			90%	75%			0%	180%			25%	33%	207%	199%
P3	Total charge -Off of delinquent Loans > 12 months	100%	100%	100%			100%	100%	100%		100%	100%			100%	100%			100%	100%			100%	100%			100%	100%	100%	100%
P4	Annual Loan Charge -offs/Average Loan Portfolio	Minimized	1%	2%			1%	1%	1%		1%	1%			0%	0%			1%	1%			1%	1%			1%	1%	1%	
P5	Accumulated Loan Recoveries/Accumulated Loan Charge -offs	100%	102%	96%	98%		100%								2%	36%			100%	100%			100%	100%						
P6	Solvency (Net value of Assets/Total Shares & deposits)	>=100	110%	109%	107%	110%	104%	101%	106%	203%	111%	206%	205%	189%	106%	100%	104%	106%	128%	156%	141%	135%	262%	323%	324%	303%	129%	126%	103%	103%
Source: Worked out from Audited Accounts of the SACCOS																														

	SACCOS	1				2				3				4				5				6			
E= EFFECTIVE FINANCIAL STRUCTURE																									
E1 Net loans/ Total Assets	70-80%	72%	73%	73%	72%	72%	66%	67%	82%	68%	73%	80%	80%	91%	86%	83%	81%	58%	63%	63%	69%	81%	90%	87%	82%
E2 Liquid Assets to Total Assets	Max 20%	13%	11%	10%	12%	3%	4%	4%	0%	7%	9%	12%	11%	2%	7%	7%	10%	6%	5%	7%	9%	3%	-2%	2%	3%
E3 Financial investments/Total Assets	Max 10%	1%	8%	7%	6%	1%	1%	0%	1%	2%	1%	1%	1%	2%	2%	2%	2%	20%	13%	10%	3%	2%	2%	2%	2%
E4 Non - financial investments/Total Assets	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	11%	8%	8%	8%
E5 Savings Deposits /Total Assets	70-80%	79%	77%	76%	74%	68%	66%	63%	80%	75%	72%	67%	73%	79%	81%	77%	79%	77%	86%	83%	84%	71%	71%	72%	71%
E6 External credit /Total Assets	Max 5%	8%	13%	12%	11%	13%	18%	25%	11%	8%	10%	9%	0%	3%	3%	6%	3%	6%	10%	12%	16%	2%	7%	5%	5%
E7 Member Share Capital/Total Assets	10-20%	4%	2%	2%	2%	4%	4%	5%	3%	6%	6%	7%	9%	3%	3%	2%	3%	14%	-1%	-5%	-15%	16%	13%	12%	12%
E8 Institutional capital /Total Assets	Min 10%	-4%	-6%	-6%	-6%	4%	4%	0%	1%	4%	5%	8%	9%	6%	8%	8%	8%	8%	-1%	-9%	-42%	14%	11%	11%	11%
E9 Net Institutional Capital/Total Assets	Min 10%	-4%	-6%	-6%	-6%	4%	4%	0%	1%	4%	5%	8%	9%	6%	8%	8%	8%	8%	-1%	-9%	-17%	14%	11%	11%	11%
Source: Worked out from Audited Accounts of the SACCOS																									

	SACCOS	7				8				9				10				11				12				13			
E= EFFECTIVE FINANCIAL STRUCTURE																													
E1 Net loans/ Total Assets	70-80%	86%	91%	92%	92%	67%	72%	74%	73%	76%	78%	79%	77%	82%	89%	86%	87%	84%	86%	87%	85%	81%	79%	80%	78%	85%	89%	86%	86%
E2 Liquid Assets to Total Assets	Max 20%	12%	7%	5%	7%	8%	9%	7%	6%	5%	7%	8%	7%	13%	8%	10%	9%	5%	6%	7%	8%	1%	4%	3%	2%	14%	10%	13%	13%
E3 Financial investments/Total Assets	Max 10%	0%	1%	1%	1%	0%	0%	0%	0%	1%	1%	1%	1%	0%	0%	0%	0%	9%	7%	8%	75	2%	1%	1%	1%	0%	0%	0%	0%
E4 Non - financial investments/Total Assets	0%	0%	0%	0%	0%	3%	3%	4%	4%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
E5 Savings Deposits /Total Assets	70-80%	80%	80%	82%	80%	83%	84%	87%	87%	76%	76%	76%	76%	85%	86%	87%	86%	88%	80%	79%	78%	74%	75%	75%	73%	82%	82%	80%	81%
E6 External credit /Total Assets	Max 5%	0%	0%	1%	1%	3%	4%	0%	0%	1%	2%	2%	2%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
E7 Member Share Capital/Total Assets	10-20%	2%	2%	1%	0%	5%	2%	2%	2%	15%	14%	14%	13%	10%	6%	4%	6%	5%	5%	5%	5%	17%	17%	17%	17%	6%	6%	5%	4%
E8 Institutional capital /Total Assets	Min 10%	7%	6%	5%	5%	4%	4%	5%	ss	15%	13%	13%	13%	6%	2%	2%	2%	2%	1%	1%	1%	15%	16%	16%	15%	3%	3%	2%	2%
E9 Net Institutional Capital/Total Assets	Min 10%	7%	6%	5%	5%	4%	4%	5%	5%	15%	13%	11%	10%	6%	2%	2%	2%	2%	1%	1%	1%	15%	16%	16%	15%	3%	3%	2%	2%
Source: Worked out from Audited Accounts of the SACCOS																													

		SACCOS	1				2				3				4				5				6			
	A= ASSET QUALITY																									
A1	Total Loan Delinquency/ Gross Loan Portfolio	5%	1%	1%	1%	1%	1%	1%	1%	0%	5%	2%	0%	0%	2%	2%	2%	2%	4%	4%	0%	0%	5%	4%	3%	3%
A2	Non -Earning Asset /Total Assets(cash+AR+FA& AP)	5%	19%	18%	18%	18%	22%	28%	25%	12%	30%	26%	18%	18%	5%	12%	11%	13%	19%	12%	15%	23%	-3%	-28%		
A3	Net Institutional & Transitory capital+Non interest -Bearings liabilities/Non Earning As	>200	-20%	-32%	-30%	-30%	18%	13%	2%	5%	14%	18%	46%	61%	133%	75%	74%	69%	6%	-45%	-47%	-167%	-428%	-33%		
Source: Worked out from Audited Accounts of the SACCOS																										

		SACCOS	7				8				9				10				11				12				13			
	A= ASSET QUALITY																													
A1	Total Loan Delinquency/ Gross Loan Portfolio	5%	0.1%	1.0%	1%		1%	1%	1%	1%	1%	1%	1%	1%	7%	10%	9%	9%	1%	1%	1%	1%	1%	1%	1%	1%	3%	4%	6%	6%
A2	Non -Earning Asset /Total Assets(cash+AR+FA& AP)	5%	4%	-1%	-2%		24%	19%	16%	16%	3%	4%	4%	4%	16%	10%	12%	10%	6%	6%	6%	6%	16%	19%	17%	16%	3%	-1%	2%	3%
A3	Net Institutional & Transitory capital+Non interest -Bearings liabilities/Non Earning As	>200	181%	-559%	-179%		18%	21%	32%	29%	33%	35%	67%	68%	63%	41%	25%	25%	47%	36%	35%	35%	105%	86%	107%	110%	98%	-222%	85%	51%
Source: Worked out from Audited Accounts of the SACCOS																														

		SACCOS	1				2				3				4				5				6			
	R= RATES OF RETURN & COSTS																									
R1	Net Loan Income /Average Net loan Portofolio	E/Rate(10%)	16%	14%	15%	13%	20%	14%	12%		17%	16%	17%	17%	15%	13%	12%	12%	13%	13%	13%	14%	8%	8%	8%	8%
R2	Total Liquid Investment Income /Average Liquid Investments	M/Rates	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
R3	Total Financial Investment Income/Average Financial Investments	M/Rates	2%	2%	2%	2%	10%	6%	3%	0%	30%	37%	30%	30%	14%	23%	27%	24%	37%	28%	18%	11%	12%	11%	10%	11%
R4	Total Non - Financial Investment Income /Average Non-Financial Investments	Greater R1	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
R5	Total Interest Cost on Savings Deposits/Average Savings Deposit	M/Rates	1%	1%	1%	1%	3%	0%	3%	3%	5%	6%	3%	3%	5%	6%	4%	4%	0%	0%	0%	0%	0%	0%	0%	0%
R6	Total Interest Cost on External credit /Average External credit	M/Rates	16%	15%	14%	15%	15%	20%	8%	0%	21%	18%	22%	21%	14%	9%	3%	3%	22%	22%	22%	22%	22%	21%	22%	22%
R7	Total Interest(Dividend) Cost on shares /Average Member shares	M/Rates > R5	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
R8	Total Gross Income Margin/Average Total Asset	10%	7%	7%	8%	8%	8%	7%	8%	6%	10%	10%	7%	7%	11%	10%	8%	7%	16%	15%	15%	15%	4%	4%	4%	4%
R9	Total Opertaing Expenses/Avg. Total Assets	<5%	5%	5%	6%	7%	7%	7%	8%	8%	10%	9%	8%	8%	9%	9%	8%	8%	14%	18%	16%	15%	4%	3%	3%	3%
R10	Total Loan Loss Provision Expense /Average Total Asset	100 & 35%	0%	0%	0%	0%	1%	0%	0%	0%	4%	2%	0%	0%	2%	2%	2%	2%	3%	0%	0%	0%	0%	0%	0%	0%
R11	Non- Recurring Income or Expense/ Average Total Asssts	Minimized	0	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
R12	Net Income/Average Total Assets (ROA)	10%	1%	1%	1%	1%	6%	6%	6%	6%	0%	0%	0%	0%	2%	1%	1%	1%	4%	1%	6%	1%	1%	1%	1%	1%

		SACCOS	7				8				9				10				11				12				13			
	R= RATES OF RETURN & COSTS																													
R1	Net Loan Income /Average Net loan Portofolio	E/Rate(10%)	5%	5%	4%	4%	7%	4%	4%	1%	18%	16%	13%	14%	13%	13%	13%	13%	14%	14%	14%	14%	14%	12%	15%	11%	16%	16%	14%	14%
R2	Total Liquid Investment Income /Average Liquid Investments	M/Rates	2%	1%	1%	1%	4%	3%	3%	4%	0%	0%	0%	0%	8%	2%	2%	2%	5%	5%	4%	4%	2%	2%	2%	2%	7%	4%	4%	3%
R3	Total Financial Investment Income/Average Financial Investments	M/Rates	75%	169%	0%		15%	12%	24%	16%	4%	4%	4%	4%	330%	213%	215%	208%	5%	5%	4%	4%	26%	20%	18%	19%	0%	0%	0%	0%
R4	Total Non - Financial Investment Income /Average Non-Financial Investments	Greater R1	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	88%	17%	16%	15%	15%	12%	16%	10%	16%	14%	15%	15%
R5	Total Interest Cost on Savings Deposits/Average Savings Deposit	M/Rates	10%	10%	10%	10%	5%	6%	6%	6%	12%	9%	9%	9%	3%	7%	6%	6%	10%	10%	10%	9%	0%	0%	0%	0%	14%	13%	13%	12%
R6	Total Interest Cost on External credit /Average External credit	M/Rates	14%	21%	21%	21%	24%	16%	0%	0%	11%	19%	19%	19%	0%	0%	0%	0%	10%	10%	10%	9%	0%	0%	0%	0%	0%	0%	0%	0%
R7	Total Interest(Dividend) Cost on shares /Average Member shares	M/Rates > R5	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	10%	23%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
R8	Total Gross Income Margin/Average Total Asset	10%	5%	5%	5%	5%	6%	4%	4%	4%	5%	5%	5%	5%	12%	11%	9%	9%	5%	5%	6%	5%	7%	5%	6%	7%	4%	4%	4%	4%
R9	Total Opertaing Expenses/Avg. Total Assets	<5%	3%	3%	4%	4%	4%	4%	3%	3%	4%	3%	3%	3%	7%	10%	8%	8%	3%	3%	4%	3%	4%	3%	5%	3%	3%	3%	3%	3%
R10	Total Loan Loss Provision Expense /Average Total Asset	100 & 35%	0%	0%	0%	0%	1%	0%	0%	0%	1%	0%	0%	0%	3%	3%	0%	0%	1%	1%	2%	1%	1%	1%	1%	1%	1%	1%	1%	4%
R11	Non- Recurring Income or Expense/ Average Total Asssts	Minimized	0%	0%	2%	2%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
R12	Net Income/Average Total Assets (ROA)	10%	2%	2%	0.4%	0.4%	2%	0%	1%	1%	2%	3%	3%	3%	5%	2%	2%	2%	2%	3%	2%	2%	2%	3%	2%	2%	1%	1%	1%	1%

Source: Worked out from Audited Accounts of the SACCOS

		SACCOS	1				2				3				4				5				6			
	L= LIQUIDITY																									
L1	S.T Investments+Liquid Assets- S. T payables/Total savings deposit	Min 15%	25%	26%	25%	25%	75%	115%	109%	114%	28%	23%	14%	10%	8%	15%	7%	9%	17%	6%	6%	9%	6%	-3%	2%	2%
L2	Liquidity Reserves /Total Savings Deposits (cash+AR+Inv)	10%	17%	14%	15%	14%	38%	45%	46%	18%	38%	31%	20%	19%	10%	15%	16%	17%	43%	30%	28%	24%	21%	7%	8%	8%
L3	Non- earning Liquid Assets/Total Assets	<1%	2%	2%	2%	2%	2%	3%	4%	3%	4%	5%	5%	6%	1%	1%	1%	1%	7%	9%	11%	11%	3%	3%	3%	3%
Source: Worked out from Audited Accounts of the SACCOS																										

		SACCOS	7				8				9				10				11				12				13			
	L= LIQUIDITY																													
L1	S.T Investments+Liquid Assets- S. T payables/Total savings deposit	Min 15%	5%	-2%	-5%	-5%	24%	18%	14%	13%	16%	10%	10%	9%	19%	11%	13%	11%	20%	25%	23%	20%	4.03%	5.43%	3%	3%	16%	12%	16%	16%
L2	Liquidity Reserves /Total Savings Deposits (cash+AR+Inv)	10%	17%	10%	8%	8%	10%	10%	8%	7%	15%	16%	15%	15%	21%	12%	15%	14%	7%	8%	7%	6%	2%	5%	4%	4%	17%	12%	16%	16%
L3	Non- earning Liquid Assets/Total Assets	<1%	0%	1%	1%	0%	5%	5%	5%	6%	1%	1%	1%	1%	1%	1%	1%	1%	0%	0%	0%	0%	13%	16%	12%	12%	0%	0%	0%	0%
Source: Worked out from Audited Accounts of the SACCOS																														