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Effect of Corporate Governance Dimensions on Financial Performance of Savings and Credit Cooperative Societies in Nairobi County, Kenya

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Abstract

The study sought to examine the influence of corporate governance dimensions on SACCOs' financial performance in Nairobi County. Specifically, the study sought to determine the effect of board independence, board accountability, audit committee and financial disclosure on financial performance of SACCOS in Nairobi County. The study was anchored on agency, stewardship, and stakeholder theories. This research used descriptive survey design. The target population was the heads of finance and administration in all the 43 SACCOs in Nairobi County. The study applied census given that the target population was small. Secondary data on return on assets, total deposits, total assets and non-performing loans was collected from the annual reports of the SACCOs. Primary data was collected using semi-structured questionnaires. Quantitative data was then analyzed using inferential and descriptive statistics which comprised of mean, frequencies, standard deviation, and

percentages. The study found that board independence, board accountability and audit committee have a positive and significant effect on the financial performance of SACCOs in Nairobi County, while financial disclosure has a positive and insignificant effect on the financial performance of SACCOs in Nairobi County. The study recommends that SACCOs should select independent members of the boards to help the societies run honestly and efficiently since they are not under the influence of the management teams. In addition, SACCOs should make sure that the board of directors actively oversees and holds management accountable for financial decisions, risk management, and strategic planning. They should select the audit committee to monitor financial reporting, audit process, internal control system of the organization, and legal and regulatory conformity. They should also clearly define the roles and responsibilities of the audit committee in the SACCO's bylaws. Further, SACCOs should also establish a system for regular reporting to the board on financial performance, risk exposure, and compliance with financial policies and regulations.

Keywords: SACCOS, financial performance, governance

Introduction

According to Shafii, Samad & Yunanda (2019), savings and credit cooperatives have been characterized by financial malpractices such as fraud leading to their poor performance and at times collapse and hence the need for appropriate corporate governance. Different authors show mixed findings on the effect of corporate governance on the organizations' financial performance. In India, Thampoe and Alfred (2014) attributed the poor financial and operational performance of cooperatives to loss of assets, high non-performing loans, delayed payments as well as operational risks and failed internal processes, fraud, and mismanagement of funds. In Pakistan, Mayo (2020) indicates that there were malpractices and financial irregularities in some cooperatives and cases of promoters of some cooperatives decamping with depositors' money were rampant. In Bangladesh, Datta (2018) indicates that

corporate governance measured in terms of board audit committee, board meetings and board composition influenced financial performance positively. In addition, Aggarwal (2013) indicates that the role of external auditors, the number of board meetings, the financial expertise of directors, separation of chairman and CEO, and independence of board from management are all of vital importance. However, in Egypt, Shahwan (2015) found insignificant association between corporate governance practices and firms' financial performance. In addition, there was insignificant negative relationship between corporate governance practices and possibility of financial distress. Different countries are characterized by different macroeconomic environments, business environments and rules and regulations governing different types of organizations. As such, the findings of these studies are not generalizable to SACCOs in Kenya.

The corporate governance structure outlines the methods and rules for making decisions in corporate affairs as well as obligations and rights distribution among various stakeholders, including the board, managers, shareholders, and other stakeholders. For businesses to run effectively, increase access to finance, minimize risk, and safeguard stakeholders' interests, good corporate governance is required.

Board independence is the ability of the board members to make decisions independently, free from intervention or influence from outside forces such as politics, duress, personal gain, or conflicts of interest (Ayodeji & Okunad, 2019). The independence of a board of directors adds value to a company by increasing responsibility, offering self-governance judgment, expanding the board's and executive's business network connections, and moderating CEO power and the board chairman, which in many organizations is a sufficiently powerful position (Datta, 2018). Board accountability is taking ownership of all business operations and providing stakeholders with a balanced, fair, and clear evaluation of organization's status and future potentials (Mayo, 2020). Open, transparent, and honest

reporting can help an organization develop connections with stakeholders, such as customers, investors, and employees (Muhanguzi, 2019). Policies and guidelines provide guidance, uniformity, and accountability on an organization’s operation. Improved corporate governance, which can lessen the frequency and severity of financial crises and boost consumer confidence in business practices, can be achieved through increased accountability. A company's audit committee serves as a conduit between the board of directors and external auditors (Mmari & Thinyane, 2019). Audit committee members are supposed to approach business affairs with objectivity and impartiality. Financial disclosure refers to the action of promptly making all pertinent information about a company accessible to the public.

The goal of financial performance is to enable an organization's advancement by guaranteeing that ROC exceeds cost of capital while avoiding taking on significant financial risks. Different studies conducted on the SACCOs measured financial performance differently. For instance, Barus, Mutur and Kibati (2017) indicated that the financial performance measure among Savings and Credit Cooperatives was Return on Assets (ROA).

Literature review

The study was based on agency, stewardship, and stakeholder theories. Corporate governance focuses on strategies to align managers' and investors' objectives and make sure that businesses are governed in investors' best interests (Mayo, 2020). However, an agency problem occurs when the management of the savings and credit cooperatives (agents) seeks to serve their own interests instead of considering the interests of the members (principal). The stakeholder theory indicates that a firm should ensure that all stakeholders’ interests are covered. As indicated by the stewardship theory, it is within the interest of all stakeholders for the organization to perform well.

Agency Theory

The agency theory, propagated by Meckling and Jensen (1976), describes managers as agents and shareholders as principals because many decisions that affect the principal financially are made by the agents. When the priorities and interests of the agents and principals diverge, a principal-agent dilemma develops. To overcome their differing preferences for company activity and varied attitudes toward risk exposure, the principals and agents must be balanced.

Agency theory was employed to explain the effect of corporate governance on SACCOs' financial performance. One of the key problems with corporate governance is how to hold directors responsible for their actions. According to the theory, the main challenge is figuring out how principals (shareholders in corporate governance) can make sure that the agents (management) behave in the principals' interests instead of their own. To ensure that the interest of the shareholders is met, the organizations' management should ensure board independence and accountability. They should also ensure that the audit committee has enough experience and financial reporting is semiannual.

Stewardship Theory

Davis and Donaldson established the above theory (1991). According to this theory, directors serve as stewards and are willing to act in their company's best interests. They will also operate in a way that promotes organizational value instead of self-serving gains. Directors' personal needs are met as they work toward organizational goals. As stewards, directors are therefore concerned with upholding moral principles and "doing the right thing".

In line to this research, Stewardship theory was employed to explain the influence of corporate governance on SACCOs' financial performance. This theory suggests that the management should act in the company's best interests and in such a way that leads to organizational success. To facilitate the success of an organization, the top management

should ensure that the audit committee works towards ensuring the accountability of all persons within the organization and financial reporting is carried out frequently.

Stakeholder Theory

Edward Freeman founded the stakeholder theory in 1984. It states that a wide range of interested parties must be considered when defining a stakeholder. These include the company's employees, clients, suppliers, financiers, communities, governmental agencies, political parties, business associations, labor unions, and even rival companies, as all these groups have the potential to affect an organization's performance. According to this point of view, the workplace is an ecosystem of interrelated groups that should be considered and satisfied to maintain the organization's long-term health and prosperity (Zakhem & Palmer, 2020).

In this study, shareholder theory was used to evaluate the influence of board independence, board accountability, audit committee as well as financial disclosure on SACCOs' financial performance. The theory therefore emphasizes that an organization should endeavor to satisfy all its stakeholders. To satisfy their members' interests in maximization of dividends, the management of SACCOs should ensure enhanced accountability, availability of the audit committee and frequent financial reporting.

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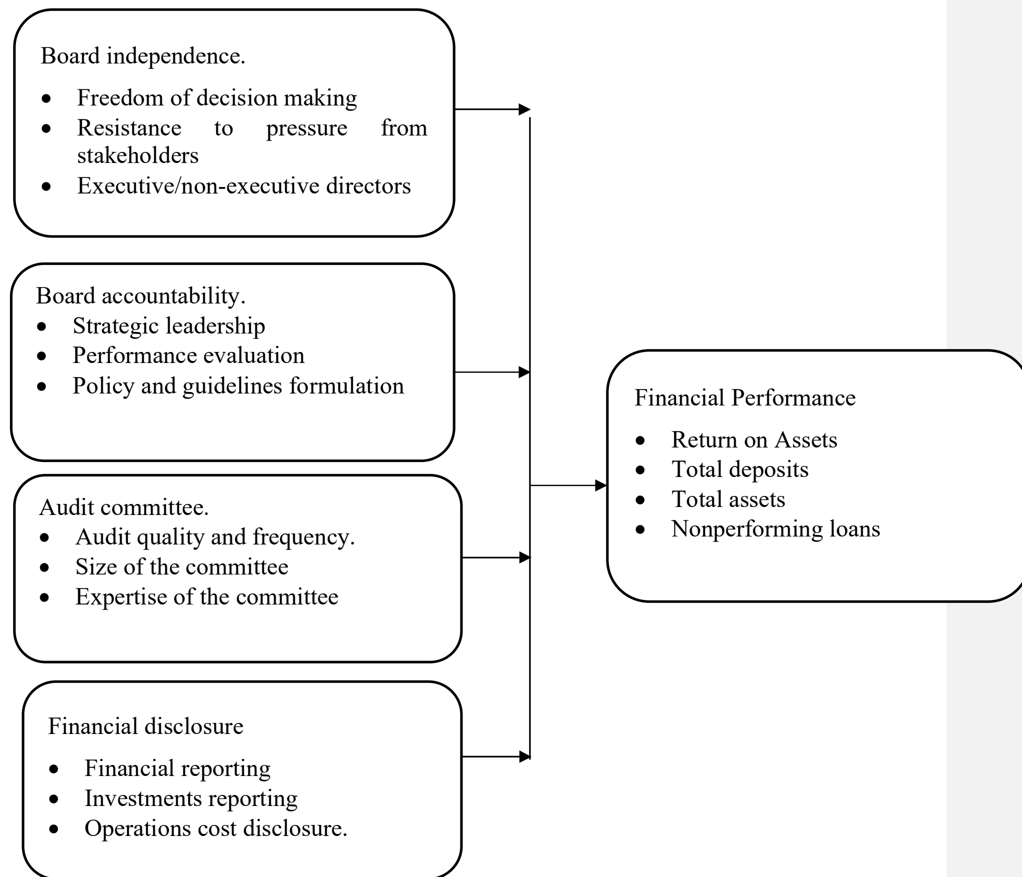
FIGURE 1

Conceptual Framework



Source: Researcher (2023)

Research Gap

In the recent one decade, SACCOs have been experiencing challenges in financial performance. The return on assets among SACCOs in Nairobi County in the year 2018 was 14.53%, which decreased to 14.13% in the year 2019, 13.82% in 2020 and 13.75% in 2021.

Non-performing loans among SACCOs in Nairobi County increased from 12.06% in 2018 to 12.79% in 2019, 13.63% in 2020 and 14.32% in 2021 (SASRA report, 2021). Incidences of fraud and embezzlement of members' savings has also been witnessed among SACCOs (SASRA report, 2018). In addition, the SASRA (2019) report shows that 11 percent of the SACCOs had been reported on complaints related to failure to pay dividends on time, suspected fraud, failure to hold annual general meetings, mismanagement of the organizations, irregular deductions of deposits and irregular account transactions. The poor performance of Saccos continues to frustrate Kenya's Vision 2030 goals of increasing financial inclusion. Since it is within the mandate of the Saccos' boards to ensure that the management adheres to regulations and operate within the interest of the Sacco members, it is important to understand how board independence, accountability, existence of audit committee and financial disclosure influence the performance of Saccos in Kenya.

Various studies have been conducted in Kenya on corporate governance dimensions and financial performance. For instance, Osedo, Mwanza and Ogendo (2020) examined the effect of corporate governance on financial performance of general insurance companies in Kenya; Miring'u and Muoria (2017) studied the effect of corporate governance on performance of commercial state corporations in Kenya, while Njuguna (2018) studied the role of corporate governance practices on financial performance of not-for-profit faith-based hospitals in Central Kenya. However, Osedo et al. (2020) focused on general insurance companies, Miring'u and Muoria (2017) focused on commercial state corporations while Njuguna (2018) focused on not-for-profit faith-based hospitals. This study therefore sought to find out the effect of corporate governance dimensions on financial performance of SACCOs in Nairobi County.

Methodology

In order to bring together diverse research components in a logical as well as cohesive way to successfully handle a research problem, a research approach provides a framework of techniques and methodologies used in the study (Stokes & Wall, 2017). The researcher used descriptive survey method, which enabled the use of mixed method approach combining quantitative and qualitative data. The study used a descriptive research design since it gives one the chance to combine qualitative as well as quantitative techniques of collecting data. The target population was the heads of finance and administration in all the 43 SACCOs in Nairobi County. Since the target population was small, this study conducted a census, which means the whole population was involved in the study. The study adopted both primary and secondary data. Secondary data on return on assets, total deposits, total assets and non-performing loans was collected from the annual reports of the SACCOs. Primary data was collected using semi-structured questionnaires. Likert scale and nominal scale were used in this study's structured questions. Data on the dependent and independent variables was gathered using five-point Likert scale.

Descriptive Statistics

The study sought to find out the effect of corporate governance dimensions on financial performance of SACCOs in Kenya. In particular, the study examined the effect of board independence, board accountability, audit committee and financial disclosure on financial performance of SACCOs in Kenya.

TABLE 1

Board Independence and Financial Performance

	Mean	**Std. Deviation**	**0**
Board of directors in the SACCO are free to exercise their duties effectively	4.231	0.427	0.101
The freedom of decision making by board of directors is limited	2.359	1.013	0.429
Am satisfied with the level of freedom of decision making exercised by board of directors	4.103	0.447	0.109
Board of directors is fully controlled by stakeholders	3.641	0.668	0.183
Board of directors are free from any pressure originating from the stakeholder	4	0	0
Am satisfied with the level of control exercised by stakeholders on board of directors	3.744	0.549	0.147
The proportion of non-executive members in the board of directors is very high	3.974	0.486	0.122
Non-executive members influence decision making of the board of directors	3.769	0.427	0.113
Am satisfied with percentage of non-executive members in the board of directors	3.846	0.489	0.127

Source: Researcher (2023)

The respondents agreed with a mean of 4.231 (SD=0.427) that the boards of directors in the SACCOs are free to exercise their duties effectively. Moreover, they agreed that they

are satisfied with the level of freedom of decision making exercised by boards of directors as shown by a mean of 4.103 (SD=0.447). Nonetheless, the respondents disagreed that the freedom of decision making by boards of directors is limited. This is shown by a mean of 2.359 (SD=1.013).

With a mean of 4.000 (SD=0.000), the respondents agreed that boards of directors are free from any pressure originating from the stakeholders. In addition, they agreed that they are satisfied with the level of control exercised by stakeholders on boards of directors. This is shown by a mean of 3.744 (SD=0.549). In addition, with mean of 3.641 (SD=0.668), the respondents agreed that the boards of directors are fully controlled by stakeholders.

With a mean of 3.974 (SD=0.486), the respondents agreed that the proportion of non-executive members in the boards of directors is very high. Moreover, the respondents agreed that they are satisfied with the percentage of non-executive members in the boards of directors. This is shown by a mean of 3.846 (SD=0.489). The respondents also agreed with a mean of 3.769 (SD=0.427) that non-executive members influence decision-making of the boards of directors.

TABLE 2

Board Accountability and Financial Performance

	Mean	**Std. Deviation**	**Coefficient of variation**
The board of directors ensures that organization's operations are in line with established laws of the land	4.564	0.502	0.11
Am satisfied with the level of strategic leadership exercised by the board of directors	4.128	0.339	0.082
The board of directors in the SACCO take responsibility of all the operations	3.923	0.48	0.122
Performance of the organization employees is assessed on a regular basis	4.462	0.6	0.134
The organization has established strategies to conduct performance evaluation	4.154	0.366	0.088
Am satisfied with the level of employee performance in the organization	4	0.324	0.081
Board accountability can be improved through policy formulation	4.308	0.468	0.109
Board accountability can be improved through guidelines formulation	4.256	0.442	0.104
The views of all stakeholders are put into consideration when formulating policies in the organization	3.949	0.223	0.056

Source: Researcher (2023)

The respondents agreed with a mean of 4.564 (SD=0.502) that the boards of directors ensure that organization's operations are in line with established laws of the land. In addition, the respondents agreed that they are satisfied with the level of strategic leadership exercised by the boards of directors as shown by a mean of 4.128 (SD=0.339). Moreover, the respondents agreed with mean of 3.923 (SD=0.480) that the boards of directors in the SACCO take responsibility of all the operations.

With a mean of 4.462 (SD=0.600), the respondents agreed that the performance of the organizations' employees is assessed on a regular basis. In addition, the respondents agreed that the organizations have established strategies to conduct performance evaluation. This is shown by a mean of 4.154 (SD=0.366). Moreover, the respondents agreed that they are satisfied with the level of employee performance in the organization as shown by a mean of 4.000 (SD=0.324).

The respondents agreed with a mean of 4.308 (SD=0.468) that boards' accountability can be improved through guidelines formulation. This is shown by a mean of 4.256 (SD=0.442). The respondents also agreed with a mean of 3.949 (SD=0.223), that the views of all stakeholders are put into consideration when formulating policies in the organization.

TABLE 3

Audit Committee and Financial Performance

	Mean	Std. Deviation	Coefficient of variation
The audit committee ensures quality audit reports every time an audit is conducted	4.308	0.468	0.109
Auditing in the organization is done frequently in a year	3.974	0.428	0.108
The organization always uses internal auditor in financial operations in the organization	4.051	0.223	0.055
Our organization always ensures inclusion of non-executive directors in the committee	4.128	0.339	0.082
Our organization makes sure that in the audit committee, most of the members are independent directors	4	0.459	0.115
The organizations ensures that the audit committee has the maximum number of staff as required by the organization by-laws	4.026	0.16	0.04
Audit committee always includes experts in the field of auditing	4.462	0.505	0.113
Members of the audit committee have enough experience to effectively perform their duties	4.205	0.409	0.097
Am satisfied with the level of training of the audit committee	4.154	0.587	0.141

Source: Researcher (2023

With a mean of 4.308 (SD=0.468), the respondents agreed that audit committees ensure quality audit reports every time an audit is conducted. Moreover, they agreed that the

organizations always use internal auditor in financial operations in the organizations. This is shown by a mean of 4.051 (SD=0.223). Moreover, with a mean of 3.974 (SD=0.428), the respondents agreed that auditing in the organizations is done frequently in a year.

The respondents agreed with a mean of 4.128 (SD=0.339) that the organizations always ensure inclusion of non-executive directors in the committee. Moreover, the respondents agreed that the organizations ensure that audit committee has the maximum number of staff as required by the organization by-laws as shown by a mean of 4.026 (SD=0.160). Furthermore, they agreed that the organizations make sure that in audit committees, most of the members are independent directors. This is shown by a mean of 4.000, SD=0.459).

With a mean of 4.462 (SD=0.505), the respondents agreed that audit committees always include experts in the field of auditing. Moreover, they agreed that members of the audit committees have enough experience to effectively perform their duties. This is shown by a mean of 4.205 (SD=0.409). Further, the respondents agreed that they are satisfied with the level of training of the audit committees as shown by a mean of 4.154 (SD=0.587).

TABLE 4

Financial Disclosure and Financial Performance

	Mean	**Std. Deviation**	**Coefficient of variation**
Financial reports in the organization present the actual financial position of the organization	4.359	0.486	0.111
Am satisfied with the process of providing access to financial information.	4.154	0.366	0.088
Financial reports for the institution adhere to the GAAP guidelines	4.051	0.223	0.055
Investors are always satisfied with the investment reports issued by the institution	4.41	0.498	0.113
Investment reports are not exaggerated in any way	3.846	0.904	0.235
Am satisfied with the level of investments reporting in the institution	3.949	0.223	0.056
The organization discloses the actual operations cost after every financial year	4.282	0.456	0.106
Operation costs are always lower that the total income	4.077	0.422	0.104
The operations cost has been increasing over years	4.154	0.366	0.088

Source: Researcher (2023-

The respondents agreed with mean of 4.359 (SD=0.486) that financial reports in the organizations present the actual financial position of the organizations. Moreover, the respondents agreed that they are satisfied with the process of providing access to financial information as shown by a mean of 4.154 (SD=0.366). In addition, with a mean of 4.051

(SD=0.223), the respondents agreed that financial reports for the institutions adhere to the GAAP guidelines.

With a mean of 4.410 (SD=0.498), the respondents agreed that investors are always satisfied with the investment reports issued by the institutions. In addition, they agreed that they are satisfied with the level of investments reporting in the institutions. This is shown by a mean of 3.949 (SD=0.223). The respondents also agreed that investment reports are not exaggerated in any way as shown by a mean of 3.846 (SD=0.904).

With a mean of 4.282 (SD=0.456), the respondents agreed that the organizations disclose the actual operations cost after every financial year. In addition, they agreed with a mean of 4.154 (SD=0.366) that the operations cost has been increasing over years. The respondents further agreed that operation costs are always lower than the total income. This is shown by a mean of 4.077 (SD=0.422).

TABLE 5

Correlation Coefficients

		Financial performance	**Board Independence**	**Board Accountability**	**Audit Committee**	**Financial Disclosure**
Financial performance	Pearson Correlation	1				
	Sig. (2-tailed)					
	N	39				
Board Independence	Pearson Correlation	.409**	1			
	Sig. (2-tailed)	0.01				
	N	39	39			
Board Accountability	Pearson Correlation	0.248	0.182	1		
	Sig. (2-tailed)	0.128	0.266			
	N	39	39	39		
Audit Committee	Pearson Correlation	.880**	0.252	0.091	1	
	Sig. (2-tailed)	0	0.122	0.583		
	N	39	39	39	39	
Financial Disclosure	Pearson Correlation	0.103	0.196	0.157	0.089	1

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

Source: Researcher (2023)

The study found that a positive and significant relationship exists between board independence and financial performance of SACCOs (r=0.409, p-value=0.010). P-value=0.010 was less than 0.05, thus the association was significant.

Furthermore, the findings demonstrated a positive and insignificant relationship between board accountability and financial performance of SACCOs (r=0.248, p-value =0.128). The relationship was found to be insignificant because the p-value=0.128 was more than 0.05.

The study also revealed a positive and significant association between the audit committee and financial performance of SACCOs (r=0.880, p-value =0.000). The p-value of 0.000 was less than 0.05 (significant level), indicating that the relationship was significant.

The study established that a positive and insignificant relationship exists between financial disclosure and financial performance of SACCOs (r=0.103, p-value =0.532). Since the p-value (0.532) was more than 0.05, the relation was considered to be insignificant.

TABLE 6

Model Summary

Model	**R**	**R Square**	**Adjusted R Square**	**Std. Error of the Estimate**
1	.916[a]	.839	.821	6.47458

a. Predictors: (Constant), Financial Disclosure, Audit Committee, Independence

Source: Researcher (2023)

As depicted in Table 6, R-squared for the relationship between corporate governance dimensions and financial performance of SACCOs was 0.839 which means that 83.9% of the variation of dependent variable (financial performance of SACCOs) could be explained by independent variables (board independence, board accountability, audit committee and financial disclosure).

TABLE 7

Analysis of Variance

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	7452.551	4	1863.138	44.445	.000[b]
	Residual	1425.286	34	41.920		
	Total	8877.836	38			

a. Dependent Variable: Total assets (in millions)

b. Predictors: (Constant), Board Independence, Board Accountability, Audit Committee, Financial Disclosure.

Source: Researcher (2023)

In this study, the ANOVA was performed to determine if the model was a good fit for the data. As shown in Table 7, the F-calculated was 44.445, and the F-critical from the F-distribution table was 2.65. Because the F-calculated was greater than F-critical and the p-value (0.000) was not more than the significance level (0.05), the model was considered to be a good fit for the data.

TABLE 8

Regression Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant) A	362.756	45.082		8.047	.000
	Board Independence	10.271	3.864	.196	2.659	.012
	Board Accountability	15.276	7.033	.153	2.172	.037
	Audit Committee	77.496	6.893	.809	11.242	.000
	Financial Disclosure	8.471	6.465	.094	1.310	.199

a. Dependent Variable: Total assets (Khs.000,000)

Source: Researcher (2023)

Regression equation was.

$Y = 362.756 + 10.271X_1 + 15.276X_2 + 77.496X_3 + 8.471X_4 + \varepsilon$

The study found that board independence had a positive and significant effect on the financial performance of SACCOs ($\beta 2=10.271$, p-value=0.012). The correlation was considered to be significant because the p-value=0.012 was less than 0.05 (significant level). This suggests that an increase in board independence will lead to a 10.271 increase in the financial performance of SACCOs.

The study findings indicated that board accountability had a positive and significant effect on financial performance of SACCOs ($\beta 3=15.276$, p-value=0.037). P-value (0.037) was not more than 0.05 (significant level) hence, the relationship was considered to be

significant. This denotes that increase in board accountability will lead to a 15.276 increase in the financial performance of SACCOs.

Furthermore, the study revealed that audit committee had a positive and significant effect on the financial performance of SACCOs (β1=77.496, p-value=0.000). Because the p-value of 0.000, was less than the significant level (0.05), the relationship was considered to be significant. This means that an enhancement in audit committee will lead to a 77.496 improvement in the financial performance of SACCOs.

The study also established that financial disclosure had an insignificant and positive effect on the financial performance of SACCOs (β4=8.471, p-value=0.199). Because the p-value (0.199) was more than 0.05, the relationship was found to be insignificant. This means that improving financial disclosure will result in a 8.471 decrease in the financial performance of SACCOs.

Conclusions

The study's findings were represented using both tables and figures. The study found that board independence has a positive and significant effect on the financial performance of SACCOs in Nairobi County. In addition, board accountability has a positive and significant effect on the financial performance of SACCOs in Nairobi County. The study also found that the audit committee has a positive and significant effect on the financial performance of SACCOs in Nairobi County. The study established that financial disclosure has a positive and insignificant effect on the financial performance of SACCOs in Nairobi County.

Recommendations

The study recommends that SACCOs should select independent members of the boards to help the societies run honestly and efficiently since they are not under the influence of the management teams. In addition, SACCOs should make sure that the board of directors

actively oversees and holds management accountable for financial decisions, risk management, and strategic planning. They should select the audit committee to monitor financial reporting, audit process, internal control system of the organization, and legal and regulatory conformity. They should also clearly define the roles and responsibilities of the audit committee in the SACCO's bylaws. Further, SACCOs should also establish a system for regular reporting to the board on financial performance, risk exposure, and compliance with financial policies and regulations.

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