

**EFFECT OF REGULATORY CONTROLS ON INTEREST RATES OF DEPOSIT
TAKING SAVINGS AND CREDIT CO-OPERATIVE SOCIETIES IN NAIROBI
COUNTY**

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DECLARATION

Student's Declaration

I declare that this project is my original work and has never been submitted for a degree in any other University or college for examination/academic purposes.

Signature Date:.....

Cornelius Mukoyani Waswa

D61/68242/2011

Supervisor's Declaration

This research project has been submitted for examination with my approval as the university supervisor.

Signature Date:.....

Cyrus Iraya

AKNOWLEDGEMENT

First, I acknowledge my God in heaven whose purpose established in eternity continues to unfold in my life. His presence, wisdom and comfort have been my inspiration.

I salute my dearest wife Jane Katunge who has sacrificially stood with me at all times to ensure I exploit all the potential and opportunities available in this life.

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To all my lecturers, friends and classmates who encouraged me in this endeavour, Bravo!
May our good Lord richly bless you.

DEDICATION

To my dearest wife Katunge Jane,son Sifa Brian and daughters Mumbua Joy and Nasiaki
Shallom for their endless encouragement and sacrifice for me while undertaking this
study.

To my Dad Christopher Mukoyani and my late Mom Ednah Nasiaki for being a source
of inspiration,joy and support in my pursuit for better life.

ABSTRACT

This study was undertaken to assess the effects of regulatory controls on interest rates of deposit taking Savings and Credit Co-operative Societies (SACCOs) in Nairobi County. Its objective was to establish the impact of SACCO Societies Regulatory Authority (SASRA) regulations on interest rates levels charged by SACCOs in Nairobi County. A descriptive research design was used to collect data on a population of 34 Saccos that operate Front Office Services Activity (FOSAs) licensed by SASRA. Primary data was collected by use of questionnaire instrument while annual financial reports and Sasra reports provided the secondary data. This data was processed by Statistical Package for Social Scineces (SPSS) and analysed using analysis of variance (ANOVA) technique. The research findings reveal that the regulatory controls inception led to a slight increase in interest rates on Sacco loans /credit. This was as a result of increased compliance costs. The study observes that implementation of regulations in phases shall cushion Saccos on operational costs and profitability variations. The Sasra regulations are not punitive as such but likey to give positive impact on Sacco subsector performance in the long run.

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LIST OF ABBREVIATIONS

ANOVA	Analysis of Variance
ASCA	Accumulating Savings & Credit Association
ACCOSCA	African Confederation of Co-operative Savings & Credit Associations
BOSA	Back Office Services Activity
CBK	Central Bank of Kenya
CCS	Co-operative Credit Scheme
FOSA	Front Office Services Activity
GDP	Gross Domestic Product
GOK	Government of Kenya
ICA	International Co-operative Alliance
KUSCCO	Kenya Union of Savings and Credit Cooperatives
MFI	Micro Finance Institutions
MoCDM	Ministry of Co-operative Development and Marketing
SACCOs	Savings & Credit Co-operative Societies
SASRA	Sacco Societies Regulatory Authority
SHG-PACs	Self Help Groups – Primary Agricultural Cooperative Societies.
SPSS	Statistical Package for Social Scientists
WOCCU	World Credit Council of Credit Unions

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Keynes (1936) theory, postulates arguments that interest rates affect the demand for and supply of money. Shaw (1973) argues from the classical theory where the equilibrium savings and investment is defined by interest rates if inflation policy reduces real rates of interest and makes savings appear cheap, so cheap that they must be vigorously rationed. The result will be excess demand for savings. A rise in real interest rates increases the flow of savings, reduces the excess demand. Rates of return on holding money also increase investment levels.

Darrant & Dicken (1999) argue that interest rate environment is fundamental to the performance and returns of any given investment. The central bank of Kenya's management of the country's monetary policy has a strong bearing on the performance of every sector including co-operative societies. Economic theory postulates that the base is the interest rate set by banks too determine the interest rates.

In Kenya, the base rate is the rate at which the central bank of Kenya lends to other financial institutions. Banks and other financial intermediaries usually follow the lead of the CBK by adopting the base rate. This, in turn affects the price at which funds are made available to institutions like cooperatives and individuals and hence affect performance of co-operative societies in Kenya. The role of co-operative has changed over time from member welfare to profit seeking. Saccos in Kenya have invested heavily

in physical assets. They have also borrowed funds from the financial markets to meet their loan obligation to members (Mudipo, 2005).

Savings and Credit Co-operatives are community membership-based financial institutions that are formed and owned by their members in promotion of their economic interests (Ahimbisibwe, 2007). A cooperative society can run two activities namely; BOSA and FOSA. Back office savings activity (BOSA) is where the SACCO operates their services such as loans and repayments but do not have banking hall services. Such SACCOs do not offer direct access to cash and clients either wait or get referred to the main banks. A Front Office Services Activity (FOSA) on the other hand operates banking hall and hence offers banking hall services (SACCO briefs, 2011). The term deposit-taking is used because these Sacco's have a banking facility as well as banking hall. Here members not only save the salary they earn but also save from their other diverse sources of income. From the legal point of view non deposit taking Sacco's are those ones without FOSAs.

1.1.1 Regulatory Control

The term 'regulation' has no standard definition both in legal and economic fields. Regulation could be taken to mean the employment of legal instruments for the implementation of social-economic policy objectives (Hertog, 1999). A feature of legal instruments is that individuals and /or organizations can be compelled by the government to comply with prescribed behavior under penalty or sanctions. Corporations can be forced, for instance, to observe certain prices, to supply certain goods and to stay out of

particular markets. Sanctions can include; fines, imprisonment or an order to make specific arrangements or closing down the business (Hertog, 1999).

There is often a distinction between economic and social regulations (Viscusi, Venon and Hannington, 1996). Economic regulations consists of two types of regulations; structural and conduct (Kay and Vickers, 1990). 'Structural' is used in regulating market structure, for instance restriction on entry and exit rules. Conduct regulation is used for regulating behavior in the market. This may include price control, rules against advertising and monitoring quality standards. Social regulation comprises regulation in the areas of environment, labour conditions (occupational health and safety) and consumer protection.

Globally the degree of formal legislation and regulation of Saccos varies widely. In some countries Saccos are subject to external legislation outlining their scope, function and powers and should operate in highly regulated environment. Yet in most countries, legislation and regulations have not been developed specifically for Saccos or if they exist they are often weak and ineffective. These deficiencies are concerning because the lack of enabling regulations affect the safety and smooth running of the Saccos. If saccos are to grow to provide quality member products and services, adequate regulations is imperative.

The World Council of Credit Unions Inc (WOCCU) has developed the regulation Content Guide (Guide). This Guide is based on regulations from numerous countries, experience and documented practices. It also incorporates many of the prudential rates in

WOCCU'S International Credit Union Principles for Safety and Soundness and builds upon them into a robust regulatory framework. To the best knowledge of the Guide's developers this is the first of its kind to be developed and distributed for credit union specific legislation. The Guide is designed to develop as a common piece to WOCCU's Model Law for Sacco's. The guide is divided into six main sections; the prudential and operational regulations, the administrative regulations. enforcement regulations, general accounting and audit regulations, deposit insurance and consumer protection regulations and each main section is again subdivided into a series of regulations.

Many countries in Africa have focused attention on the legislation of micro finance and non banking financial institutions. Some have adopted prudential standards specific to Saccos while others use existing banking laws to regulate Saccos. Kenya's Regulatory Authority is among the only few in Africa, others being in South Africa, Malawi and Rwanda (Ademba, 2011).

Until recently, Saccos have been able to retain their membership and attract new members through natural affiliation stemming from common bond among members. With increased competition from other financial service providers and other factors like retrenchment Sacco membership has been on decline. This prompted Saccos to come up with strategies and products to assist them cope with these challenges. One of the new products for Saccos was establishment of Front Office Services Activity (FOSA) from early 2001. This was due to commercial banks withdrawing their services in rural areas (Okundi,2011).

These new development led to a myriad of challenges in the Sacco sector similar to those of the Co-operatives movement. These include weak governance, low uptake of information technology and low level of professional skill development in both senior and junior staff. The sub sector was further rocked with financial impropriety and liquidity hitches. This coupled with strong competition from mainstream commercial banks led to loss of confidence and withdrawal of savings from membership.

It was against this background that amendment was made to the Cooperation Society Act 1997 to culminate into the Cooperative Societies (Amendment Act,2004). This led into enactment of Sacco Society's Regulatory Authority (SASRA) to operationalize the Act. This authority has the power to license, regulate and supervise Saccos, carry out inspections of Sacco's, control ownership and governance of Saccos and manage a Deposit Guarantee Fund for Saccos, among other responsibilities (Mbui,2010).The need to regulate Saccos cannot be underestimated considering the fact that Kenya has 70% of all the co-operatives in Africa. Out of the total \$4.8 billion Co-operative assets in Africa, \$3.8 billion are in Kenya (Ademba,2011).

1.1.2 Interest Rates

Interest rate is the 'rent' paid on borrowed money. Lenders receive interest as compensation for foregoing the use of their funds now. The original amount rent is called the principal and percentage of principal which is payable over a period of time is the interest.(Ivey, 2002; Heaton, 2002).

In money monetary using economies, money creates claims because it is an asset, a store of value as well as a means of exchange. Therefore, those who lend money expect to be compensated for handing over their claims for the period of the loan to those who borrow money. The compensation is the interest rate expressed as a rate percent per annum. This is because it is a convenient way of calculating and comparing the cost of borrowing money.

The commonly used definition of interest rate is that it's a price at which money is lend and borrowed. Therefore interest rate can be defined as the price lenders expect and borrowers pay for exchanging current claim for greater future claims to goods and services. Interest rate presents cost of money (Kimutai, 2003). The interest rate for this study is the lending rate that Sacco's charge for loans advanced to their clients (members).Charging prices high enough to cover cost is an essential practice for any business enterprise that intends to continue its operations into the foreseeable future. Interest rates therefore must cover operational and financial costs and growth. To achieve the objectives of a sustainable, healthy growing Sacco sector and increase its membership, especially the poor in rural areas, then the level of interest rate on loans must be critically examined.

Interest rate on loans is the main source of income for Saccos. The SASRA rules encourage Sacco's to maximize returns on their assets. One of the principal assets is the loan portfolio. The returns from these assets,determined mainly by interest charged is

used to meet Sacco recurrent costs. The key factors that determine interest rates are; cost of funds, the operating expenses, default risks and level of profits needed to expand the capital base and funds expected for future growth (Waruiru, 2012)

According to Mbogo (2010), the cost of running deposit taking Saccos is set to go up significantly with the new set of SASRA regulations. This effectively threatens the low interest regime that has for decades given the co-operative movement an edge over commercial banks in the lending market. The regulation covering 220 deposit taking Saccos, also known as FOSAs with an estimated membership of five million and assets worth ksh. 150 billion, demands that societies converting to deposit taking platform meet new requirements. These include investing in new banking halls, installation of sophisticated security equipment including armed security personnel from Administration police and provide security guards. This will subsequently increase the operational costs of SACCOs.

“SACCOs must now start thinking business, not just welfare of members”, said Peter Njunguna, the Chief Supervisory Manager of SASRA at ACCOSCA workshop in Nairobi, June 2011. The Sasra manager said that the challenge is to ensure SACCO’s bring the cost of operations to a minimum within the four year window to comply with regulations.

1.1.3 Regulation and Interest Rate

Darrant and Dickens (1999) argue that interest rate environment is fundamental to the performance and returns of any given investment. Ackley (1961) suggest that

macroeconomic theory implies that it is through interest rates that monetary policy actions are transmitted to the economy. Smith (1970) indicate that studies on the determinants of output movements of economic entities including Co-operatives conducted since 1980's found that when interest rates are considered the monetary aggregates lose most of their explanatory power suggesting that interest rates have a crucial bearing on asset and future performance of organizations. This interest rate environment has a probable bearing on the performance of co-operatives in Kenya since the rates will determine the level of savings and hence investment levels.

Hall and Watkins (1934) explain that as early as 1844, the co-operative sector was pioneered by low income earners who worked for the cotton mills in North England. The major objectives of co-operative was perceived as a resource mobilization and welfare to members needs. The major concern of members was that of accessing cheap credit. An inherent structural weakness of this credit motivation co-operative sector is its unlimited power to generate savings because they (have to) pay low interest rates on deposits that are obtainable on alternative forms of investment.

When co-operatives resort to external source of funding, be it in the form of borrowing from local commercial banks or a special financial facility provided by the government through central bank or grants, loans from foreign donor institutions, they effectively abandon their principal principle of self-help and behave like any other commercial enterprise for profit maximization. In this regard interest rates charged on lending to members become critical in co-operative sector performance and sustainability. Although self help is the underpinning principle to the modern co-operative sector operations, the

sector has changed drastically since modern co-operative does not have membership from low income-earners only. However their objectives have broadened to include profit seeking (affecting interest rates) and to generally operate like any other commercial enterprises.

Up-to the year 2002, big commercial banks used to serve the rural areas. These institutions withdrew services in rural areas and hence created the need for FOSA establishments. From the 1990s micro finance institutions emerged and boomed giving commercial banks a stiff challenge (Okundi, 2011).

According to Mbogo (2010), the cost of running deposit taking Saccos is set to go up significantly with these new regulations. This in effect threatens the low interest regime that has for decades given the co-operative movement an edge over commercial banks and other micro finance institutions in the lending market. The regulations demand that Saccos invest in new banking halls and install sophisticated security equipment, hire professional staff, meet specific capital and liquidity requirements and submit regular reports to SASRA, among others.

Sacco societies depend mainly on funds collected from the members in terms of savings and use them to lend to the same members (Maina, 2005). This source of funding is cheaper than external funds that Saccos may use from time to time depending on the level of outstanding loans. The financial institutions that offer credit facilities to Saccos among other borrowers have profit as their motive. They receive deposits from the general public and corporate bodies and use these deposits to lend others. Thus they have to lend the funds at higher rates so as to make their profit.

But now with new legal environment, a clientele that has options in terms of credit facilities and open bonds for membership in any Sacco, deposit taking Saccos must lookfor ways to raise funds to keep themselves in business. One of the most likely avenue for this is variation of interests rate so as to meet regulatory requirements and meet their operational costs.

1.1.4 Saccos in Nairobi County

Most co-operative societies in Nairobi County are Savings and Credit Co-operatives commonly referred to as Urban Saccos. They offer various products to their members such as development/normal, emergency, college/school fees loans, special loans and front office services. In the current liberalized economic environment, co-operative societies are expected to operate like any other profitable business venture with a focus on maximization of shareholders returns. It is also notable that with the opening up of common bonds in most co-operative societies members are free to join societies that will offer what they perceive as more competitive and superior products as well as a competitive return on their investments (Mudipo, 2005).

The traditional savings and credit service that has been practiced by SACCOs over the years has led to many cooperatives experiencing low liquidity problems especially because members are not allowed to withdraw their savings at will. However, members can borrow as much as three/four times their total deposit with the society. This has compelled Saccos to seek other ways to improve their liquidity position. A number of Saccos have diversified and introduced FOSA's where they offer products and services as

payment of salaries, salary advance, bankers' cheques, safe keeping of documents and ATM services. The result is that FOSAs have begun to be very popular with SACCOs as members have access to their savings right away. Saccos that introduced FOSA services experienced rapid asset growth (Jesus, 2006). When financial institutions withdrew their banking services from rural areas and due to employers' failure to remit members recoveries to SACCOs, it became necessary for Saccos to start FOSAs to serve their members. Through retained savings the Sacco can access funds for onward-lending to its members, (Wanyama 2009).

The Co-operative Societies (Amendment) Act of 2004 (Republic of Kenya, 2004a) is the current basic legislation that guides the formation and management of Co-operatives in Kenya. It has its origins in Co-operative Societies Act, Cap 490 of 1966, which was revised in 1997 into the Co-operative Societies Act Chapter 12 of 1997 (Republic of Kenya 1997b). The reforms contained in the revised Act sought to reduce the strict state supervision of the co-operatives to support the liberalization of co-operative enterprise. The legislation stipulates that the roles to be undertaken by government include: a) creating the policy and legal framework for development of co-operatives, b) improving the growth and development of co-operatives by providing the requisite services for their organization, registration, operation, advancement and dissolution c) developing partnerships with co-operations through consultative processes that are focused on policy, legislation and regulation.

In addition to this legislation there is the SACCO Societies Act of 2008 (Republic of Kenya 2008b) that provides for the licensing, regulations, supervision and promotion of

Savings and Credit Co-operatives (SACCOs) by the SACCO Societies Regulatory Authority (SASRA). Thus this Act provides for the establishment of the Saccos Societies Regulating Authority whose functions will include licensing SACCOs to carry out report-taking business as well as regulating and supervising SACCOs.

Similar to other deposit-taking financial institutions in Kenya, FOSA SACCOs have to comply with a wide range of regulatory provisions in their day- to-day operations. There are governance rules that must be followed by FOSA SACCOs. At a minimum, the Board of Directors (elected at the Annual General Meeting) have to establish an audit and credit committee. It will also be their responsibility to establish appropriate policies on credit management, human resource, savings, liquidity, information preservation, dividend and risk management.

A major shift on governance is that directors and senior management are subject to vetting (fit and proper test) by SASRA. The separation of the responsibilities of the board and the management has been clearly outlined in the Regulations to ensure transparency and accountability in the running of the SACCO. The Deposit-taking SACCOs are also expected to comply with prudential regulations which include clear standards regarding, among others, capital, liquidity, the extent of external borrowing, asset categorization and provisioning, maximum loan size and insider lending. There are various reporting requirements for Saccos: monthly (capital adequacy, liquidity and deposit), quarterly (risk classification of assets and loss provisioning, investment reforms, financial performance) and annual (audited financial statements) reporting requirement to SASRA.

SASRA has the authority to inspect the premises and the records of a Sacco and to prescribe enforcement actions in case of deficiencies including the appointment of a statutory manager. Non-compliance with legal requirements carries clearly specified penalties and includes removal from office of directors and other responsible officers.

Saccos have to establish deposit insurance schemes. Once licensed, member deposits will be protected in the event of collapse of a Sacco. SASRA will in the future set up a Deposit Guarantee Fund and Saccos will be expected to contribute to this.

Opening, closing and relocating branches and other places of business require prior approval by SASRA. Sacco shall continue to operate according to co-operative principles and deal with members only. Serving members only is the reason why interest and other income earned from loans to members is exempt from income tax. Saccos will have to pay a levy (published in the Gazette notice), which shall be used to finance the operations of SASRA.

According to SASRA records as at March 31st, 2013, there are only 34 licensed deposit taking Saccos in Nairobi County. Using stratified random sampling the researcher will establish how the new regulatory regime has impacted on levels of interest rates charges by Saccos on the products to members.

1.2 Research Problem

Sacco societies depend mainly on funds collected from their members in terms of savings and use them to loan to the same members (Maina, 2005). This source of funding for co-operatives is cheaper than the external fund that Saccos may use from time to time depending on the level of outstanding loans. The financial institutions that offer credit facilities to Saccos among other borrowers have profit as their motive. They receive deposits from the general public and corporate bodies and use these deposit to loan to others. Thus they have to lend the funds at high rates so as to make their profit. Since Saccos collect savings/deposits from the members directly they are able to mobilize these savings and lend to their members at cheaper rate.

The traditional savings and credit service that has been practiced by Saccos over the years has led to many co-operatives experiencing low liquidity problems. This is especially because members are not allowed to withdraw their savings at will albeit can borrow as much as three/four times their deposits with the society. This has compelled Saccos to seek other ways to improve the liquidity position. A number of Saccos have diversified and introduced FOSA where new products and services are available to members at reasonable rates.

According to Mbogo (2010), the cost of running deposit taking (FOSA operating) Saccos is set to go up significantly with the new SASRA regulations. This consequently threatens low interest regime that has characterized SACCOs competitive advantage over other lenders in the market. The regulation covering 220 deposit taking SACCOS (those operating front office services) demands that those societies in this category meet specific

compliance requirements within the next four years commencing November 2011. This will tamper with Saccos liquidity position due to increased operational costs.

‘Saccos must now start thinking business not just welfare of members’, said Peter Njuguna the chief supervisory manager of SASRA at ACCOSCA workshop in June 2011, Nairobi.

Oyoo (2002) in his study on evaluation of financial performance of SACCOs in Nairobi before and after deregulation concludes that performance of Saccos in the two eras was not significantly different although profitability ratios were favorable before deregulation. This means regulations were more productive for Saccos. He also observes that there was a notable increase in expenses after deregulation. However, his study fails to check the interest rates variations in the two eras.

Bett(2006) studied the effect of lending interest rates on profitability of SACCOs in Kenya. He used the empirical cross sectional survey design in data collection. In conclusion he notes the positive correlation between lending interest rates and profits of Saccos as revealed by a positive multiple correlation coefficients. This means that interest rates levels play a major role in profitability levels of Saccos.

Ngaira (2011) looked at the impact of sacco regulatory guidelines on Sacco Operations in Kenya with emphasis on Deposit-taking Saccos in Nairobi. She concludes that one of the main issues affecting compliance with SASRA regulations is low liquidity levels in Saccos. She notes that some SACCOs are likely to be liquidated or merged for failure to

comply with the rules. Her study, however looks at all variables in general not interest rate in particular as per this current study.

Thus the effect of regulatory controls on interest rates of Saccos with FOSA has not been looked at in any previous research known to the researcher .This study therefore seeks to fill this gap by seeking to establish the degree of influence of regulatory controls on interest rates in deposit-taking Saccos. The researcher's question therefore is; what is the effect of regulation controls on interest rates of deposit-taking SACCOs in Nairobi County?

1.3 Objectives of the Study

This study establishes the effect of SASRA regulations on interest rates charged by Saccos in Nairobi County.

1.4 Value of the Study

This study provides additional knowledge to existing theories in relationship between regulatory controls and interest rate levels. The study is vital material for the practitioners in the co-operative movement as they endeavor to instill better business practices and maximize returns to the shareholders. Further, the academicians will find this research a stepping stone for further studies and a source of relevant information into the operations of Savings and Credit Co-operative Societies in Kenya.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter consists of a review of the theories that have been advanced in regulation, discussion of studies done both locally and internationally on the impact of regulation on interest rates, the regulatory framework of Saccos in Nairobi County as well factors that affect determination of interest rates in Saccos.

2.2 Theoretical Framework

This section makes a distinction among the theories of regulation. The core of the diverse theories is discussed as well critiques of the same.

2.2.1 Public Interest Theories of Regulations

These theories account for regulation from the point of view of aiming for public interest. Public interest is discussed as the best possible allocation of resources for individual and collective goods. In western economics the allocation of scarce resources for individual and collective use is to a significant extent coordinated by the market mechanism. In theory, it can even be demonstrated that under certain circumstances, the allocation of resources by the means of markets mechanism is optimal (Arrow,1985). Because these conditions are frequently not adhered to in practice, the allocation of resources is not optimal and a demand for methods of improving the allocation arises (Bator, 1958). One of the methods of achieving efficiency in the allocation of resources is government regulation (Arrow,1970; Shubik,1970). According to public interest theory, government

regulation is the instrument for overcoming the demerits of imperfect competition, unbalanced market operation, mixing markets and undesirable market results.

In the first place, regulation can improve the allocation by facilitating, maintaining, or initiating market operation. The exchange of goods and production factors in markets assumes the defined allocation and assertion of individual property rights and freedom to contract (Pejovich,1979). The guarantee of property rights and any necessary enforcement of contract compliance can be more efficiently organized collectively than individually. Further, the costs of market transactions are reduced by property and contract law. The freedom to contract can, however be used to achieve cooperation between parties opposed to market operation. Agreements between producers give rise to prices deviating from marginal costs and an inefficient quantity of goods is put on the market.

Anti-monopoly legislation is aimed at maintaining the market operation through monitoring the creation of positions of economic power and by prohibiting competition, limiting agreements or punishing the misuse thereof. This theory that regulation can be explained as an answer to market failures has been criticized in several ways:

First, criticism is directed at the theory of market failure underlying the explanation of government regulation (Cowen, 1988). In practice, it appears that the market mechanism itself is often able to compensate for any inefficiency. Therefore, regulation is uncalled for. Similarly, the original theory assumes that government regulation is effective and can

be implemented without great costs (Posner,1974). The transaction costs and information costs which underlie market failure are assumed to be absent in the case of government regulation. This assumption has been criticized in both empirical and theoretical research. Public interest theory usually assumes that regulation can be accounted for as aiming for economic efficiency. Interpreted this way, the theory is unable to explain why on occasions other objectives such as procedural fairness or redistribution are aimed for at the expense of economic efficiency (Joskow and Noll, 1981, P.36).Finally, it has been observed that public interest theory is incomplete. The theory does not indicate how a given view of the public interest translates into legislative actions that maximize economic welfare (Posner, 1974).

2.2.2 Sophisticated Public Interest Theory

Criticism of the public interest theory led to a more serious public interest theory, (Noll,1983, 1989a). According to the naïve public interest theory, regulation can be accounted for by market failure under performance to the conditions of the Coase theorem. This implies the assumption of the absence of transaction costs and freely available, conveniently processed information in the political process. By letting go of these assumptions, a more sophisticated version of the public interest theory arises. Is it possible to see regulation as an answer to market failure when account is taken of transaction of information costs? In the presence of transaction costs, regulation can form a more efficient solution to market failure than private negotiations between parties involved. Costs of organization can also be avoided when, for instance, in the case of environmental pollution, politicians bundle the preferences of those negatively affected.

In the case of flawed information political entrepreneurs can detect the causes of market failure and report them to these involved.

Regulation may be more efficient in this case because the government can obtain information less expensively. Similarly, the government can enforce provision of information about accidents while at the same time information can be a byproduct of other government activities. This sophisticated version of public interest theory does not therefore require regulation to be perfect. It does, however, assume that market failure exists, that regulation is the most expensive means of combating it and that regulation does not continue to exist once the costs exceed the benefits. This theory also assumes that politicians support open decision – making processes and spread information widely about the effects of market results and regulation. According to this theory then, regulation can be accounted for as the efficient solution to market failure. It does not however, solve some of the problems beforehand.

2.2.3 Private Interest Theories of Regulation

After public interest theory fell into disrepute through empirical and theoretical research, the capture theory was developed mainly by political scientists (Posner, 1974). This theory assumes that in the course of firms, regulation will come to serve the interests of the branch of industry involved. For instance, it is assumed that legislators subject for branch to additional regulation by an agency if misuse of the economic position of power is detected. In the course of time, the political priorities arrive at the agenda and the monitoring of the regulatory agency by legislators is relaxed.

The agency will tend to avoid conflicts with the regulated company because it is dependent on this company for its information. Furthermore, there are career opportunities for the regulators in the regulated companies. This leads, with time, to the regulated agency coming to represent the interests of the branch.

2.2.4 The Chicago Theory of Regulation

In 1971 a start was made on the development of a theory of regulation called by some 'The Economic Theory of Regulation' (Posner, 1974), and by others the Chicago Theory of Government (Noll, 1989a). The theory of economic Regulation by Stigler (1971) appeared in that year. His central proposition was that as a rule regulation is required by the industry and is designed and operated primarily for its benefit. The benefits of regulations for a branch of industry is obvious. The government can grant subsidies or ban entry of competitions to the branch directly so that the level of prices rises. In the second place, the government can maintain minimum prices so easily than a cartel. Thirdly, the government can approve the use of substitutes and support complements, for example the subsidizing of airports for the benefit of airlines. A demand will therefore arise on the one hand for government regulation.

The political decision-making process on the other hand makes it possible for branches of industry to exploit politics for its own ends. For this proposition, Stigler makes use of the insights of Downs (1957) and Oslon (1965). In the political decision-making process, interest groups will exercise political influence, as opposed to individuals. Individuals will not participate because forming an opinion about political questions is expensive in terms of time, energy and money, while benefits in terms of political influence will be

negligible. A representative democracy would more readily honour the strongly felt preferences of majorities and minorities than the less passionately expensive preferences.

2.2.5 Interest Rates Theories

Traditional theories define the interest rate as the price of savings determined by demand and supply of loanable funds. It is the rate at which savings are equal to investment assuming the existence of a capital market. The loanable funds theory argues that interest rate is determined by non-monetary factors. It assigns no role to quantity of money or level of income on savings, or to institutional factors such as Commercial Banks and the Government.

The liquidity theory, on the contrary looks at interest rate as the token paid for abstinence and inconveniences experienced for having to part with an asset whose liquidity is very high. It is a price that equilibrates the desire to hold wealth in the form of cash with the available quantity of cash, and not a reward of savings. Interest rate is a function of income. Its primary role is to help mobilize financial resources and ensure the efficient utilization of resources or the promotion of economic growth and development.

From the traditional theory, nominal interest rates adjust fully to the expected rate of inflation leaving interest rates unchanged. Irving Fisher, in his findings held the same sentiments and he believed that there is a positive relationship between expected future price increases and nominal interest rates. An increase in price increases the nominal value of trade, resulting in an increase in demand for money and leading to an increase in

nominal interest rate. This theory is controversial, however, especially when it is interpreted as suggesting a constant real investment rate.

Ngugi and Kerubo (1989) applying the traditional theory shows that positive real interest rate are achieved when inflation is moving down, and when they move up the prospects of keeping them are narrow. Their study further argues that the spread between lending and deposit rates widened with liberalization, while short term rates increases at faster rate compared with long term rates resulting in a negatively sloped yield curve. Fredrick (1986) while noting that interest rate is the price lenders charge on borrowed funds ,further contends that the forces of demand and supply in the market would attain the market equilibrium interest rate. This position is in conformity with the classical economic theory: the supply side of this money market represents the supply of loanable funds while the demand side will represent the demand for loanable funds. Therefore the interest determination is at the equilibrium point of intersection of the supply and demand curves.

The factors that determine rates of interest for co-operative societies include the cost of funds, saving level, operating expenses, risk of default and targeted profit and regulatory policy.

2.3 Empirical Literature

Ahimbisibwe (2007) set out to investigate whether Saccos in Uganda have an effect on members' saving culture. The study used a sample of 57 members,3 board members and

3 management staff randomly selected from the three counties made up of fifteen sub-counties. Data was collected by use of questionnaire instrument and interviews, observation and focus group discussion. Results were computed and analyzed using Pearson Chi-square tests and linear regression model in SPSS which attempted to test the relationship and impact of the variables of saving culture. The findings by Ahimbisibwe (2007) indicated that SACCOs positively influence saving culture.

Misra (2008) conducted a study on the linkage of the primary agricultural credit society in India and concluded that models linking community based associations with financial institutions have tremendous potential to expand outreach in remote areas. Associations in many forms (Accumulating Savings and Credit Association – ASCAS, Self –Help Groups, savings and credit associations, even farmer or fisher associations) already have strong presence in rural areas. They provide convenient and flexible access for members in the light of few or no alternatives. Linkages can provide these associations with additional value such as access to large loans, a safe place for savings and the potential for a broader range of skills including graduation to individual member services. The author also argued that the regulation and supervision of the SHG-PACS (Self –Help Groups, Primary Agricultural Co-operative Societies) linkage system suffers from multiple layer of inadequacy. The Cooperative Credit Scheme (CCS) itself “is said to suffer the problem of dual control. It also suffers from a subject of rules and no regulation. It suffers from too many supervisors and no supervision. It has too many owners and no ownership.” (Price, Waterhouse Coopers, 2006)

The CCS is regulated by both state laws as cooperative societies and bank law for banking business. However PACS are not regulated by the Banking Regulation Act thus leaving them under the regulatory purview of the state, which in cases such as the current. PACS is also partial owner of the co-operatives. Reforms are now on the anvil for the CCS and this is possibly an ideal time to see how a stronger space can be curved out for SGS's the overall system.

Wanyama et al (2009) conducted a study on how African Cooperatives had fared after the liberalization. The authors attempted to obtain qualitative insights into the strengths and weaknesses of the cooperative movement in the countries with a view of assessing the real and potential impact of cooperatives in reduction of poverty through creation of employment, generation of economic activities, enhancement of social protection and improvement of the voice and representation of vulnerable groups in society. The researchers, one in each of the eleven countries, first of all used qualitative rapid assessment methodology to collect data at the national level using semi- structured interviews with leaders and members in selected cooperative societies at the local level with a view to generating case studies to illuminate on the findings from the national level. The eleven countries are Ethiopia, Egypt, Kenya, Uganda, Rwanda, South Africa, Nigeria, Ghana, Niger, Senegal and Cape Verde. These results by Wanyama et al(2009) indicated that cooperatives in the 11 African countries have survived market forces and continued to grow in number and membership. In addition the authors concluded that cooperatives in Africa are re-examining the organizational forms and diversifying their activities in response to members' interest and needs.

Crafts (2006) noted that regulation can result in resources being directed towards compliance rather than the creation of output. Secondly, regulations can impose constraints on the choice of production techniques (for instance, by preventing the use of inputs) or lead to a misallocation of resources. While the former effect will result in a reduction in the level of productivity as the output from factor inputs reduces, the latter effect can actually reduce the longer term growth rate of productivity through reductions to the level of technological progress.

However, Crafts (2006) suggests that the direct impact of compliance costs, while important, is likely to only have a relatively small impact on productivity when compared to other channels, illustrating this with an estimate that if administration costs doubled from 1.5 percent of GDP to 3 percent of GDP, this could possibly lead to a 1.5 percent per year reduction in productivity growth. This impact should not be underestimated, particularly in the case of smaller firms which are limited in their capacity to absorb such costs, as a result of a lack of management time to deal with compliance and an inability to exploit the same economies of scale as larger firms. Crafts (2006) however, notes that there is currently limited evidence on the costs of regulation, hence inhibiting the ability to make international comparisons and to quantify accurately the impact of productivity in the UK. Crafts (2006) focuses on the negative impacts arising when regulations create barrier to entry (he gives the examples of compliance costs or licensing). These barriers can constraint the intensity of competition and can also discourage the formation of firms as new firms found it harder to enter existing markets and compete with incumbent firms.

This diminishing of competitive pressures can then reduce firm's incentives to innovate or to imitate (impending technological diffusion).

Aghion et al (2006) in a micro level study investigated the impact of technologically advanced entry (through foreign firm entry rate) on innovation in incumbent firms. They used manufacturing plant data for the UK (from the Annual Respondents Database) and for the US (NBER manufacturing productivity database) over the 1987-1993 period. They found that the significance of entry barriers varies from sector to sector depending on the level of technology, and suggest that incentives to innovative are sharper when firms are in sectors which are closer to the technology frontier. This implies that tackling barriers to entry created by regulation, will be a necessary but not a sufficient condition for securing productivity improvements.

Standard regulations provide a key enabling mechanism for the wide spread diffusion of major technologies, and hence are productivity enhancing. Temple et al (2005) found that the growth in standards of measure by the BSI catalogue accounted for 13 percent of labour productivity growth in the post-war period. Common standards across countries such as European Union, EU can be important in facilitating innovation, notably in major technology based innovation, where the role of scale is important. Also regulation can play a further role in facilitating innovation through providing a shared framework for interoperability where developments require network economies. (For instance, EU Telecoms regulation).

2.4 Summary of Literature Review

The area of regulation and interest rates has received great scholarly attention. Some studies such as Temple et al (2005) suggest that strict regulation hinders the adoption of existing technologies through reduced competitive pressures and spill overs and hence negatively affecting performance. Berr(2008), on the contrary, argues that while there is much discussion of the negative impacts of regulation, some regulation can have a positive indirect impact on productivity.

Bett (2007) set out to investigate the relationship between lending interest rates and profitability of Saccos in Kenya. He established that there was a significant relationship between lending interest rates and profits of Savings, Credit and Cooperative Societies in Kenya. His study however, was general and not focused on deposit -taking Saccos only.

Wamalwa (2012) studied the effect of regulation on financial performance of Savings and Credit Cooperative Societies (Saccos) offering Front Office Service Activity (FOSA) in Kenya. He observed that it was not possible to conclude that all regulatory clauses have impacted performance of Saccos positively. He asserted that while governance, prudential and reporting regulations had impacted performance positively there was need to enforce other regulations by SASRA to realize the desired results.

The above studies indicate that there exists divergent opinion as to how co-operative societies have performed under different regulation regimes. A study on the impact of regulations on interest rates of Saccos with FOSAs would hence bridge this knowledge gap.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter entails a description of the methodology used in the study. It was organized in four parts; the research design, population, data collection techniques and data analysis technique.

3.2 Researcher Design

Descriptive research design was used in this study. Saunders, Lewis and Thornbill (2000), argue that descriptive method is used to identify and obtain information on the characteristics of a particular issue and data collected are quantitative and statistical techniques are used to summarize the information. Descriptive design was used to enable the researcher collect comprehensive data on the population under study and thus provide relevant and specific information. Zikmund (2003) asserts that the major purpose of using descriptive research is to provide information on characteristics of population or phenomenon.

3.3 Population

A population refers to an entire group of individuals, events or objects having common observable characteristics (Mugenda and Mugenda, 2003). The population was for all the 34 Saccos that operate front office services activity (FOSAs) licensed by SASRA to offer deposit taking services.

3.4 Data Collection Technique

The data instrument used was a questionnaire and other secondary data like Annual Audited Financial Accounts and Sasra reports. A questionnaire is a list of research or survey questions asked to respondents and designed to extract specific information. Each item in the questionnaire was used to address a specific objective, research questions or hypothesis. The researcher shall use closed questions (Copper and Schindler, 2007).

3.5 Data Analysis Technique

The data analysis included an Analysis of the Variance (ANOVA) of interest rates for period before and after operationalization of the regulatory controls. The data processing was conducted using statistical package for social sciences (SPSS). The data is presented using frequency tables. Mugenda (2008) defines SPSS as a computer package used to analyze data including descriptive statistics to generate frequencies, percentage tables and graphs as well as inferential and multivariable statistical analysis. To analyze quantitative data, frequency distribution and percentages were used.

To achieve the study objective a regression equation was used to check the relationship between regulation controls and the interest rates. This is based on studies in literature review that allude to a relationship between the two factors (variables)

$$y = \beta_0 + \beta_1x_1 + \beta_2x_2 + \beta_3x_3 + \varepsilon$$

Where y = Rate of interest per annum charged on loans advanced by a given SACCO.

$\beta_0, \beta_1, \beta_2, \beta_3$ = regression coefficient factors (change in y by each change in x)

X_1 = governance controls measured by costs incurred per annum to comply with the requirements.

X_2 = prudential controls measured by costs incurred annually to comply with the guidelines.

X_3 = Reporting controls measured by costs incurred annually to comply with those guidelines.

ε = error term (assumed to have zero mean and constant variance)

The measurement of effect of regulatory controls was done by analyses of variance (ANOVA) in interest rates of SACCOs before and after institutionalization of SASRA regulations.

The model covers a period of five years (2008-2012); three years prior and two years after effecting the regulatory controls.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

In this chapter, the researcher reports on the main results obtained by analysis of data and presentation of results of the questionnaire data. The findings/results are to establish the effects of regulatory controls on interest rates of deposit taking savings and credit co-operative societies in Nairobi county. The findings were to assess if there was any effect on interest rates charged by the SACCOs as a result of the SASRA regulations. Data generated from this research was quantitative. Quantitative data was presented in form of frequencies, means, modes and percentages. Presentation was done using tables, charts and graphs for easy yet effective communication.

4.2 Response Rate

The researcher distributed 34 self-administered questionnaires to the census Sacco respondents out of the total population of 34 Saccos within Nairobi County. The respondents were drawn from the departments of administration, credit and savings within the Saccos of which the study is based on. Out of 34 questionnaires 32 were returned but 2 questionnaires were rejected for incomplete information. Thus 30 questionnaires were subject to analysis. This represents a 88.24% response rate which the researcher found sufficient to proceed with data analysis. The high response rate is attributed to the fact that the researcher personally administered the questionnaires to the respondents at the various Saccos within Nairobi County.

4.2.1 Effect of Governance Regulations on Saccos Compliance Costs

The researcher sought to establish/assess the impact of governance regulations on the annual operating costs of Saccos within Nairobi county in the past five years. These costs includes election of independent board of directors, establishment and running of audit and credit committees, establishment of operational policies and Fosa's costs of security systems and information processing software. The responses summary are recorded in the table below.

Table 4.1: Effect of Governance Regulations on Saccos Operational Costs

	Mean	Std. Deviation	N
V1	8.00	4.472	15
2008A4	3.73	1.534	15
2009A4	3.93	1.486	15
2010A4	4.07	1.486	15
2011A4	4.07	1.335	15
2012A4	4.07	1.335	15

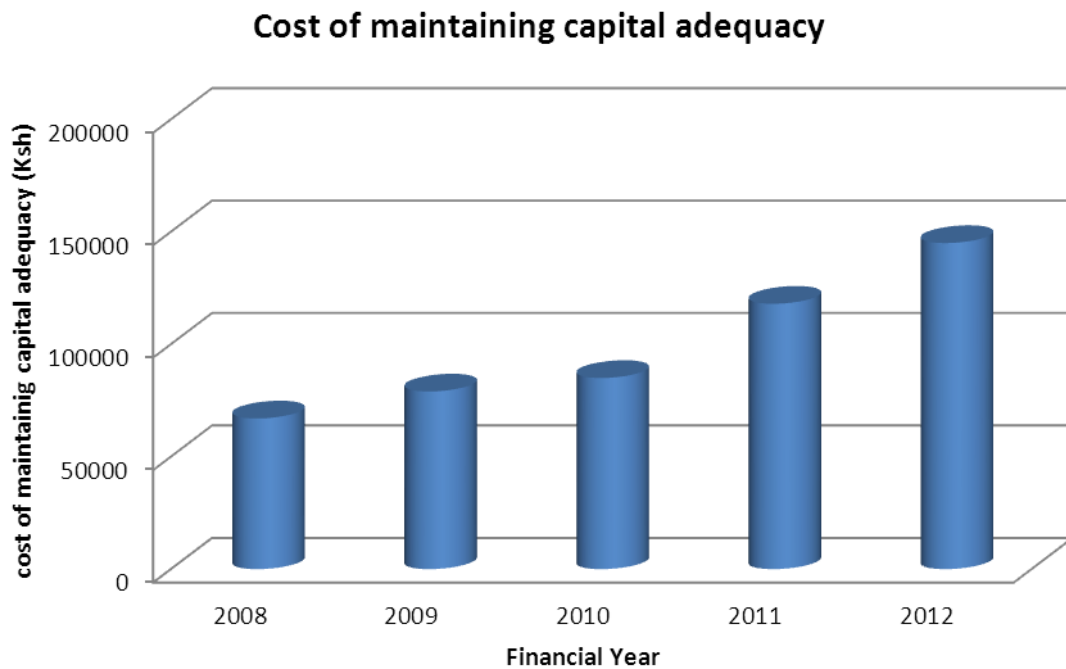
Source: Research findings (2013)

From the table above, the average estimated cost of governance in Saccos was 3.73, 3.93, 4.07, 4.07 and 4.07 for the five years from 2008 to 2012 respectively indicating that the cost was between 100,001 to 200,000 in 2008 to 2009 and suddenly increasing to a cost above Ksh.200,000 in the rest study. This implies that governance regulations on operations costs was contributing factor to the sudden rise of operation cost and this is affirmed by the anova output where the significance level is 0.17, which is more than the threshold of 0.05%. This means that the governance regulations had an impact on the cost of Saccos operations.

4.2.2 Effect of Prudential regulations on operational costs

The study sought to establish the costs related to prudential compliance regulations of Saccos within Nairobi county in the past five years. The responses are recorded in the figure below.

Figure 4.1: Costs of prudential Regulations



Source: Research findings (2013)

From the findings above we observe that prudential regulations costs rose gradually between 2008 and 2010. Thereafter there was a steep rise. This shows costs of complying with this type of regulations greatly affected operational costs of Saccos in Nairobi County.

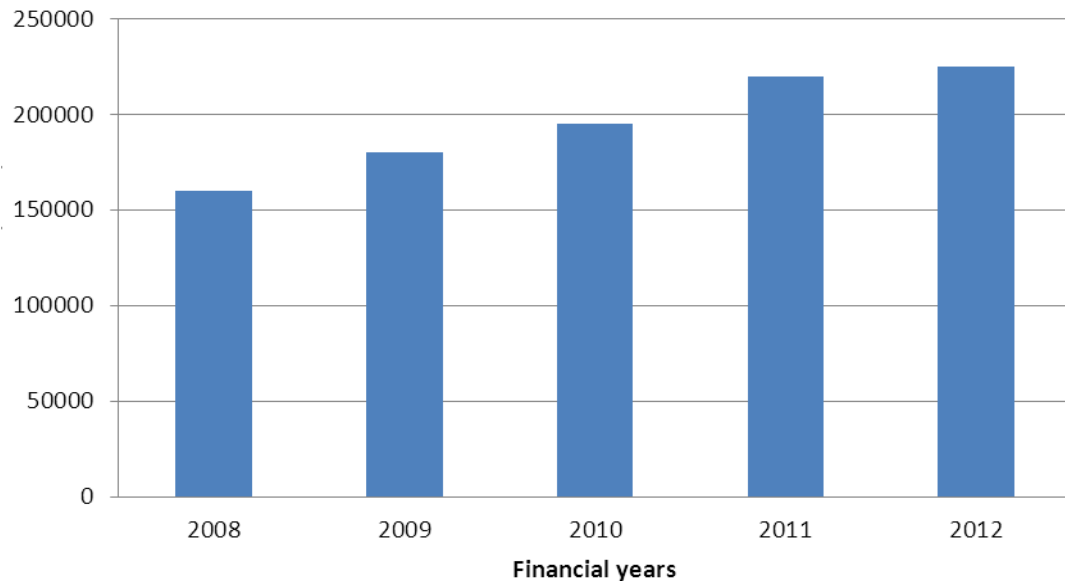
4.2.3 Impact of reporting regulations on operational costs

The researcher sought to establish the annual cost on monthly reports on capital adequacy, liquidity and deposits, quarterly reports on risk classification of assets, loss

provisioning, investments returns and financial performance and annual reports on audited financial statements in Saccos within Nairobi county in the past five years. The responses are recorded in the figure below.

The results indicate a steady increase in annual costs on reporting regulations. The findings reveal a higher rise from kshs 180,000 to kshs 220,000 between the years 2010 and 2011 respectively. This implies reporting regulations had an impact on Saccos operating costs during the period under study.

Figure 4. 2: Impact of reporting regulations on operational costs



Source: Research findings (2013)

4.3 Regulatory effects on interest rates

The researcher classified credits into three categories for ease and specific analysis purposes.

4.3.1 Short term credit/Loans

The researcher sought to establish the regulatory effects on the interest rates of short term credits/loans in Saccos. The responses are recorded in the table below.

Table 4.2: Short term credit/Loans

Descriptive Statistics

Year / Credit type	Mean	Std. Deviation	N
V1	8.00	4.472	15
2008A1	13.667	2.4689	15
2009A1	13.667	2.4689	15
2010A1	13.800	2.4260	15
2011A1	14.267	2.5486	15
2012A1	14.467	2.6421	15

Model Summary^b

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.551 ^a	.303	.113	4.211

Source: Research findings (2013)

From the descriptive statistics table above, the average interest rates for short term loans for the past five financial years from 2008 to 2012 was 13.667, 13.667, 13.800, 14.267 and 14.467 respectively. This indicates that there was an increase in interest rates in most of the Saccos on short term loans/credit. This increase was gradual throughout the study period. From the regression analysis model summary table above, there is a moderate positive correlation of 0.551 between the interest rates charged by the Saccos and the

regulatory effects. This indicates that Saccos adjusted upwards their interests on short term loans in order to cushion themselves of the regulatory effects. Thus the interest rates on short term loans to some extent rely on the current regulations that are governing the Saccos.

4.3.2 Medium term Credit/Loans

The researcher sought to establish the regulatory effects on the interest rates of middle term credits/loans in Saccos in the last five years. The responses are recorded in the tables below.

Table 4.3: Medium term Credit/Loans

Descriptive Statistics

Year / Credit type	Mean	Std. Deviation	N
V1	8.00	4.472	15
2008A2	13.480	2.1160	15
2009A2	13.480	2.1160	15
2010A2	13.613	2.0788	15
2011A2	14.080	2.2622	15
2012A2	14.280	2.3839	15

Model Summary^b

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.400 ^a	.160	-.069	4.624

Source: Research findings (2013)

From the descriptive statistics table above, the average interest rates for medium term loans (maturity is 13 to 24 months) for the past five financial years from 2008 to 2012

was 13.480, 13.480, 13.613, 14.080 and 14.280 respectively. This indicates that there was a slight increase in interest rates in most of the Saccos on medium term loans/credit. From the regression analysis model summary table above, there is a slight positive correlation of 0.400 between the interest rates charged by the Saccos and the regulatory effects. This indicates that though the interest rates of medium term loans increased the effect was slightly as a result of regulatory effects. Saccos slightly increased their interests on medium term loans in order to cushion themselves of the regulatory effects and other factors.

4.3.3 Long term credit/Loan

The study sought to establish the regulatory effects on the interest rates of long term credits/loans in Saccos within Nairobi county for the past five years. The responses are recorded in the tables below.

Table 4.4: Long term credit/Loan

Year / Credit type	Mean	Std. Deviation	N
V1	8.00	4.472	15
2008A3	13.547	2.1155	15
2009A3	13.547	2.1155	15
2010A3	13.847	2.0553	15
2011A3	14.247	2.2453	15
2012A3	14.513	2.3228	15

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.366 ^a	.134	-.212	4.924

Source: Research findings (2013)

From the descriptive statistics table above, the average interest rates for long term loans (whose maturity is above 24 months) for the past five financial years from 2008 to 2012

was 13.547, 13.547, 13.847, 14.247 and 14.513 respectively. This indicates that there was a slight increase in interest rates in most of the Saccos on long term loans/credit. From the regression analysis model summary table above, there is a slight positive correlation of 0.366 between the interest rates charged by the Saccos and the regulatory effects. This indicates that increase of long term loans interest rates was not entirely as a result of regulatory effects and that the regulatory effects had slight impact on the increase of these rates.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

In this chapter, the researcher presents a summary of the major findings from the results of the study and the conclusions made from them. It also presents the recommendations made by the researcher. This was done in respect to the stipulated objectives in a bid to answer the research questions.

5.2 Summary of Findings

The researcher identified three (3) major SASRA regulations which include governance regulations, prudential regulations and reporting regulations. The findings indicated that all the three SASRA regulations identified had a notable impact on the operational costs of the Saccos within the study period.

Findings indicated that prudential regulations had an impact on the cost of maintaining capital adequacy in Saccos with the average estimated cost of maintaining capital adequacy rising from 2.47 to 3.33. Also prudential regulations saw the average estimated cost of adhering to external borrowing rise from 2.47 to 3.07. Findings further indicated that prudential regulations somewhat was a contributing factor in the rise of operation cost of Asset categorization and provisioning requirements in Saccos though at a less proportion as the increase was very minimal from 3.07 to 3.33. Findings showed that prudential regulations had an impact on two other operational costs which were cost of observing maximum loan size requirements and cost related to insider lending. Both operational costs had their significance level way above the threshold of 0.05% indicating

that prudential regulations on the two operations costs was contributing factor the rise of costs related to insider lending and cost of observing maximum loan size requirements.

Findings further indicated that reporting regulations had an impact on three operational costs in Saccos. These operational costs were annual cost on capital adequacy, liquidity and deposits, cost of quarterly Reports on risks, classification of assets, loss provisioning, investment returns and financial performance and the cost of Annual reports on audited financial statements. These operational costs rose on the amount spent on them hence pushing the Saccos to increase the interest rates on their loans in order to cushion themselves from the effects.

Thirdly, the study sought to determine the effects of regulatory controls on interest rates of Saccos within Nairobi county. The finding indicated that average interest rates for short term loans for the past five financial years from 2008 to 2012 rose from 13.667 to 14.467. This implied that there was an increase in interest rates in most of the Saccos on short term loans/credit. This increase was gradual throughout the study period. Findings indicated that there was a moderate positive correlation of 0.551 between the interest rates charged by the Saccos and the regulatory effects. This forced Saccos to adjust upwards their interests on short term loans in order to cushion themselves of the regulatory effects. Thus the interest rates on short term loans are to some extent rely on the current regulations that are governing the Saccos.

The average interest rates for medium term loans whose maturity is between 13 to 24 months also had a slight rise from 13.480 to 14.280. This implied that there was a slight increase in interest rates in most of the Saccos on medium term loans/credit. The

researcher found out that there was a slight positive correlation of 0.400 between the interest rates charged by the Saccos and the regulatory effects. This indicated that though the interest rates of medium term loans increased slightly as a result of regulatory effects. Saccos slightly increased their interests on medium term loans in order to cushion themselves of the regulatory effects and other factors.

Findings showed that the average interest rates for long term loans whose maturity is above 24 months for the past five financial years rose with almost 1% from an average of 13.547% to 14.513% per annum. This indicated that there was a slight increase in interest rates in most of the Saccos on long term loans/credit. Findings showed that there was a slight positive correlation of 0.366 between the interest rates charged by the Saccos and the regulatory effects. This indicates that increase of long term loans interest rates was not entirely as a result of regulatory effects and that the regulatory effects had slight impact on the increase of the long term loans interest rates.

5.3 Conclusions and Recommendations

To show the effects of regulatory controls on interest rates of Saccos within Nairobi county, the researcher found out that indeed the SASRA regulations had a negative impact on interest rates of Saccos. The researcher identified three major SASRA regulations which are Governance, Prudential and Reporting regulations.

The researcher identified various operational costs that would be affected by the three major SASRA regulations. Increase in these operational costs had a great impact on the interest rates on loans/credits from the various Saccos within Nairobi county. The

researcher established that average interest rates for short term loans rose from 13.667% to 14.467%. This implied that there was an increase in interest rates in most of the Saccos on short term loans/credit. This increase was gradual throughout the study period. Findings indicated that there was a moderate positive correlation of 0.551 between the interest rates charged by the Saccos and the regulatory effects. This forced Saccos to adjust upwards their interests on short term loans in order to cushion themselves of the regulatory effects. Thus the interest rates on short term loans are to some extent rely on the current regulations that are governing the Saccos. Further the average interest rates for medium term loans whose maturity is between 13 to 24 months also had a slight rise from 13.480% to 14.280% per annum. This implied that there was a slight increase in interest rates in most of the Saccos on medium term loans/credit. The researcher found out that there was a slight positive correlation of 0.400 between the interest rates charged by the Saccos and the regulatory effects. This indicated that though the interest rates of medium term loans increased slightly as a result of regulatory effects. Saccos slightly increased their interests on medium term loans in order to cushion themselves of the regulatory effects and other factors. Findings showed that the average interest rates for long term loans whose maturity is above 24 months for the past five financial years rose with almost 1% from an average of 13.547% to 14.513% per annum. This indicated that there was a slight increase in interest rates in most of the Saccos on long term loans/credit. Findings showed that there was a slight positive correlation of 0.366 between the interest rates charged by the Saccos and the regulatory effects. This indicates that increase of long term loans interest rates was not entirely as a result of regulatory

effects and that the regulatory effects had slight impact on the increase of the long term loans interest rates.

The study recommends that managers implement the regulations in phases so as to maintain new liquidity levels for credit advancement. Saccos should ensure they observe prudential regulations on capital adequacy and extent of external borrowing so as to keep interest rates at manageable levels for their clients. The Sacco managers should put in stringent measures to manager credit risk since this could affect their profitability levels. This is as a result of increased interest rates.

5.4 Limitations of the Study

The study was limited to the extent of respondents honesty. The accuracy of responses is an inherent limitation in many studies and this study was no exception. The study did not address all other factors that affect interest rates and also covered only Saccos in Nairobi County.

The results also have a limited application as far as sectoral differences are concerned. The results may not apply to the manufacturing or the banking sector because the regulations are different and the industry environment is different in those sectors.

The study did not establish the specific sources of funds used for lending by the Saccos. Internal sources could attract less interest charges compared to borrowed funds.

5.5 Suggestions for Further Studies

The researcher suggests that more studies should be carried on the other factors that influence the change of interest rates in Saccos and also more studies should be done to find out if the regulatory effects have the same impact on interest rates in Saccos outside Nairobi county.

It is suggested that further areas of study should be done to investigate other factors that contribute to different levels of Sacco interest rate. Such study would focus on capital adequacy, liquidity and operating efficiency.

Further, a study could be done to investigate whether increase in interest rate affected the loan uptake and the asset quality. Hence this would reveal the effect of such interest rates on non performing loans.

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APPENDICES

Appendix I: Research Questionnaire

This questionnaire is meant to assess the effect of regulatory controls on interest rates of deposit taking Savings and Credit Cooperative Societies in Nairobi County.

Section A

This section is concerned with assessing the impact of governance regulations on operational costs per annum of Saccos in Nairobi County. Please indicate as appropriate

- 1 – for cost below Kshs 50,000
- 2 – for cost between Kshs 50,001 to 100,000
- 3 – for cost between Kshs 100,001 to 200,000
- 4 – for cost between Kshs 200,001 to 400,000
- 5 – above Kshs. 400,000

Operational costs (kshs)

Item	2008	2009	2010	2011	2012
1. Election of independent board of directors					
2. Establishment and running of audit and credit committees.					
3. Establishment of policies (credit management, human resource, savings, liquidity, information presentation and risk management)					
4. Fosa's costs of security systems and information processing software					
Average scores					

Section B

This section is concerned with assessing the impact of prudential regulations on operational costs per annum of Saccos in Nairobi County Please indicate as appropriate

1 – for cost below Kshs 50,000

2 – for cost between Kshs 50,001 to 100,000

3 – for cost between Kshs 100,001 to 200,000

4 – for cost between Kshs 200,001 to 400,000

5 – above Kshs. 400,000

Operational costs (kshs)

Item	2008	2009	2010	2011	2012
1. Maintaining capital adequacy					
2. Adhering to extent of external borrowing					
3. Asset categorization and provisioning requirements					
4. Observing maximum loan size requirements					
5. Costs related to insider lending					
Average scores					

Section C

This section is concerned with assessing the impact of reporting regulations on operational costs per annum of Saccos in Nairobi County

Please indicate as appropriate

- 1 – for cost below Kshs 50,000
- 2 – for cost between Kshs 50,001 to 100,000
- 3 – for cost between Kshs 100,001 to 200,000
- 4 – for cost between Kshs 200,001 to 400,000
- 5 – above Kshs. 400,000

Operational costs (kshs)

Item	2008	2009	2010	2011	2012
1. Monthly cost on capital adequacy, liquidity and deposits					
2. Quarterly reports on risk classification of assets, loss provisioning, investment returns and financial performance					
3. Annual reports on audited financial statements					
Average scores					

Section D: Regulatory effects on interest rate charged by Sacco on loans to members.

Item	Year	Interest rate % per annum
a) Short term credit/loans (maturity below 12 months)	2008 2009 2010 2011 2012	
b) Medium term credit/loans (maturity between 13-24 months)	2008 2009 2010 2011 2012	
c) Long term credit/loans (maturity above 24 months)	2008 2009 2010 2011 2012	

Appendix II: List of Saccos

1. AFYA SACCO SOCIETY LTD
2. AIRPORTS SACCO SOCIETY LTD
3. ASILI SACCO SOCIETY LTD
4. CHAI SACCO SOCIETY LTD
5. CHUNA SACCO SOCIETY LTD
6. COMOCO SACCO SOCIETY LTD
7. FUNDILIMA SACCO SOCIETY LTD
8. HARAMBEE SACCO SOCIETY LTD
9. HAZINA SACCO SOCIETY LTD
10. JAMII SACCO SOCIETY LTD
11. KENPIPE SACCO SOCIETY LTD
12. KENVERSITY SACCO SOCIETY LTD
13. KENYA BANKERS SACCO SOCIETY LTD
14. KENYA POLICE STAFF SACCO SOCIETY LTD
15. KINGDOM SACCO SOCIETY LTD
16. MAGEREZA SACCO SOCIETY LTD
17. MAISHA BORA SACCO SOCIETY LTD
18. MWALIMU NATIONAL SACCO SOCIETY LTD
19. MWITO SACCO SOCIETY LTD
20. NACICO SACCO SOCIETY LTD
21. NAFKA SACCO SOCIETY LTD

22. NAKU SACCO SOCIETY LTD
23. NASSEFU SACCO SOCIETY LTD
24. NATION SACCO SOCIETY LTD
25. ORTHODOX DEVELOPMENT SACCO SOCIETY LTD
26. SAFARICOM SACCO SOCIETY LTD
27. SHERIA SACCO SOCIETY LTD
28. STIMA SACCO SOCIETY LTD
29. UKULIMA SACO SOCIETY LTD
30. UNITED NATIONS SACCO SOCIETY LTD
31. WANAANGA SACCO SOCIETY LTD
32. WANANDEGE SACCO SOCIETY LTD
33. WAUMINI SACCO SOCIETY LTD
34. UKRISTO NA UFANISI WA ANGLICANA SACCO SOCIETY LTD