

**RISK MANAGEMENT SYSTEMS IN SAVINGS AND CREDIT
CO-OPERATIVES WITHIN NAIROBI COUNTY, KENYA**

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DECLARATION

This research project is my original work and has not been presented for the award of degree in this or any other university.

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DEDICATION

I dedicate this work to my son Wigglesworth and daughter Cindy for being of great understanding and help in expressing their support for me especially during the difficult moment I was going through in the family while pursuing this course. Their continuous affirmations and support became a source of strength and believe that, it is possible. With this document I wish to tell you; God has finally answered your prayers.

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LIST OF ACRONYMS

ACCOSCA : Africa Confederation of Co-Operative Savings and Credit Association

ACCU : Asian Confederation of Credit Union Association

BC : British Columbia

BOSA : Back Office Savings Activities

CRR : Composite Risk Rating

DT : Deposit Taking

FOSA : Front Office Savings Activities

ICA : International Co-Operative Alliance

KUSCCO : Kenya Union of Savings and Credit Co-Operatives

NDT : Non Deposit Taking

RBS : Risk Based Supervision

RCA : Rwanda Co-Operative Alliance

SACCO : Savings and Credit Co-Operatives

SASRA : Sacco Society Regulation Authority

WOCCU : World Council of Credit Union

ABSTRACT

The research on risk management systems in savings and credit cooperatives in Nairobi County, Kenya, was informed by the fact that many SACCO societies are not active due to closer of business operations. This inactivity of SACCO societies led to the question whether it could be as result of inadequate risk management systems. This research had two objectives, namely; to determine the efficiency of risk managements systems within savings and credit Co-operatives and to enhance effective operations within savings and credit Co-operatives in Nairobi County, Kenya. The researcher collected primary data from a purposefully selected sample of target population and analysed the data with the help of statistical tools such as mean, frequency, mode, percentages and micro-softy excel computer package for presentation of the findings. The researcher found out that there was a gap in risk management systems in savings and credit cooperatives which had immensely contributed to the closer of SACCO business operations within Nairobi County, Kenya.

CHAPTER ONE: INTRODUCTION

1.1 Background of the study

Risk management is the process of measuring or assessing risk and then developing strategies to manage it (Friends Consult). In the context of Credit Union (SACCO) risk management is a conscious attempt by the management to identify, measure and control all exposures to loss which are created by the activities within the credit union. Risk management fundamentally starts by asking a basic question; to what risks is this organization exposed? The familiar categories of risks SACCOs are exposed to include; credit risk, liquidity risk, market risk and operational risk. Traditionally, managing these risks has been associated with insurance, but with the emerging risks, organizations have found out that the traditional approach to risk management cannot keep pace; the risk of fraud is on the rise as well as regulatory and information technology risks. These challenges however come with opportunities as well. Risk management can help credit unions mitigate the downside of risk while tapping the benefits of its upside.

Savings and Credit Co-operatives (SACCOs) also known as Credit Unions are Co-operative financial institutions which are owned and controlled by its members and operate for the purposes of promoting thrift, providing credit and other financial services to members at low interest rates (Makori et al, 2013). SACCO societies have a departure from other financial service providers such as banks in that, SACCO members are owners and customers at the same time. They conduct their voting mandate on one member one vote basis irrespective of the number of the members' shareholding (Makori et al, 2013). According to the International Co-operative Alliance (ICA), a Co-operative is an autonomous association of persons united

voluntarily to meet their common economic, social and cultural needs and aspirations through jointly owned and democratically controlled enterprise. The definition recognizes voluntary as one of the most essential elements in Co-operation. There should not be coercion, one should join freely and leave at will.

Vision 2030 recognizes SACCO societies as playing a very important role in widening financial access, mobilizing savings for investment in enterprises and personal development. It is projected that by 2020 Co-operatives will be a leader in economic, social and environmental sustainability; a preferred business model and a fastest growing form of enterprise. The innovation of Front Office Savings Activity (FOSA), quasi banking services brought hope to the rural unbanked, low income earners who were excluded from banking system especially during the 1990 economic crisis which led to closure of bank branches in the rural areas (Mohammed, 2013).

Co-operative development in Kenya can be traced back into the pre-independence period with accelerated growth in the subsequent period. The movement has played an important role in wealth creation, food security and employment generation. It is estimated that 63% of Kenya's population at 40 million participate directly or indirectly in Co-operative- based enterprises. Among the issues affecting the Co-operative sector is the challenge of risk management. Co-operatives experience unique risks that cannot be adequately addressed by commercial insurers. This is because the business models of Co-operatives are different from that of other business concerns.

1.1.1 Concept of Co-operatives

The United States Department of Agriculture (USDA 1987) defines a Co-operative as a user-owned, user- controlled business that distributes benefits on the basis of use.

The three primary principles of a Co-operative are captured in this definition. The first one is user-owned. This implies that members use or patronize the Co-operative products and services at the same time finance the Co-operative. Secondly, user-controlled; this implies that members govern the Co-operative directly by either voting on important matters and decisions or indirectly through delegate system. The bylaws of the Co-operative society normally dictate that only active members of the Co-operation can vote and the voting system is one-member, one-vote. Thirdly, distribution of benefits according to use; this principle of proportionality implies that members should share benefits, costs and risks of doing business in equal proportions of their patronage.

The importance of Co-operatives positively affects members' economic, social and political aspects. Through Co-operatives, members are able to obtain better prices for their goods and services, improved service delivery, dependable source of inputs and market for their outputs, Kimberly and Cropp, (2004). Co-operatives also make annual profits. A part of this profit is ploughed back to the members as dividends in proportions of their patronage.

Historically, Co-operatives then and now were created in times and places of economic stress and social upheavals, Brett (2004). As earlier as 1530, People in Europe without public support had established various types of self help organizations and mutual fire insurance companies in London and Paris. By the year 1696, the people of England had created mutual aid societies called Friendly Societies which offered financial assistance to members in times of unemployment, sickness or death (Association of Friendly Societies- AFS). The precursor for mutuals and unions are guilds, the association of merchants, artisans, and craftsmen that date back to medieval times. In the 19th century the founders of Rochdale society in England were

celebrated for launching the modern Co-operative movement, and setting principles that guide the development of Co-operatives across the world, Kimberly and Cropp, (2004). Rochdale's Co-operative principles include the following: voting is by members on democratic basis (one-member, one-vote), membership is open, Equity is provided by members, equity ownership share of individual members is limited, net income is distributed to members as patronage refunds on a cost basis, dividends on equity capital are limited, exchange of goods and services at the market prices, duty to educate, cash trading only, no unusual risk assumption, political and religious neutrality, Equality in membership (no discrimination by gender) David Barton (1989).

1.1.2 Risk Management

Risk is a potential for loss that can be caused by adverse events (Bateman, 2009). In this definition unmitigated risk can lead to asset deterioration and or shrinking member value. In the context of savings mobilization, risk is the danger caused by an event or a loss that could impair the value of savings deposit or substantially affect the net worth of the institution (Bless, 2010). Risk taking is at the heart of financial service providers. In SACCOs, risks take the form of Liquidity risk, Credit risk, Institutional risk and Operational risk. SACCOs, quickly convert the available saving deposits into long term loans, charge fixed interest rates throughout the period, and individual savings are usually small to the extent that one would require multiple deposits to serve one loan. These are risky transactions (Bald, 2007)

Risk management is the process of measuring, or assessing risk and then developing strategies to manage it. The benefits of Risk management include the following: early warning systems for potential problems, more efficient resource (both capital and cash) allocation, more successful new product development and roll-out as well as

better information on potential consequences both positive and negative (Friends Consult-RCA). In managing emerging risks, organizations are now building risk intelligent units within. These organizations not only consider the potential loss a risk poses but also realizes business growth activities like introducing new products which though carries risks but can also result into profitable opportunities.

1.1.3 Co-operative Structure in Kenya

Lumbwa Farmers Co-operative society was the first one to be established in Kenya by the white settlers in 1908. The Co-operative society ordinances became law in 1931 and since then Co-operatives were formerly registered. The Kenya Farmers Association (KFA) became the first Co-operative to be registered under the new Act. The commissioner for Co-operatives was appointed a year after the new ordinance for Co-operatives was passed in 1945. By the year 1963 there were over 600 primary Co-operatives and Kenya National Federation of Co-operatives formed in 1964 to oversee and advocate for Co-operatives in Kenya. This development led to the passing of new Act in 1966 under Cap 490 of the laws of Kenya (Maina and Kibanga, 2004)

In 2007, the International Co-operative Association (ICA) ranked Kenya Co-operatives number seven (7) in the world and number one (1) in Africa in terms of number of enterprise, membership, capital and contribution to the national economy. The apex body for all Co-operative societies in Kenya is the Co-operative Alliance of Kenya (CAK). By Aug 2013, Kenya had 15,000 registered Co-operatives which can be categorized into financial and non financial Co-operatives. The financial Co-operatives include SACCOs and SACCO Unions, Housing and investment Co-operatives. Non financial Co-operatives include trading, produce and marketing Co-operatives (Mohammed, 2013).

The Kenya Union of Savings and Credit Co-operatives (KUSCCO) is the umbrella body for SACCO societies in Kenya. According to Procasur (2012) there were 6,007 registered SACCOs in Kenya as at December 2010 of which 2959 were active (SACCOs whose annual accounts have been audited and the audit registered with commissioner for Co-operatives as well as newly registered SACCOs during the year under review). Of the active SACCOs 218 were Deposit Taking (DT) and 2741 Non-Deposit Taking (NDT). DT SACCOs are licensed, regulated and supervised by SASRA, while NDT SACCOs are supervised by the commissioner of co-operatives. The total SACCO sub-sector assets stood at Kshs 293 billion, the total deposit stood at Kshs 213 billion and the total loans for the same period was kshs 221billion (SASRA 2012). The supervisory and regulatory requirements that SASRA seeks to enhance include corporate governance, transparency, accountability liquidity, loan classifications and provisioning, capital adequacy requirements investments, risk management frameworks and financial reporting. The Act of parliament also provides for establishment of Deposit Guarantee Fund (DGF). This fund shall protect each member up to Kshs 100,000.00 (Kenya Financial Sector Stability report 2010)

1.2 Research Problem

The introduction of “bank like” services and the expansion of membership definition have led to additional risks hitherto conservative and closed bond SACCO societies (Mohammed, 2013). SACCOs are member owned whose core business is to encourage thrift and then extend small credit to members from their mobilized savings (Were, 2009).

While analyzing the deposit growth and share capital among the two categories of SACCOs in Kenya, Procasur Africa (2012) found out as follows; deposits from

SACCO members grew by 25% among the Deposit Taking (DT) in five consecutive years between 2006 and 2010, but the Non Deposit Taking (NDT) grew by 5.6% within the same period. Between 2009 and 2010 there was a significant drop of deposits from Kshs 38 million to Kshs 21 million among NDT SACCOs and although there was an increment of deposit from Kshs 105 million to Kshs 123 million among DT SACCOs, this represented a decline of growth rate from 49% to 16%. This scenario leads to uncertainty and anxieties among the stakeholders about liquidity of SACCOs which to a large extent depend on deposits from members. On the other hand, DT SACCOs grew their Share Capital by an average of 28% while NDT SACCOs realized an average of 256% growth. This raises questions as to whether SACCO management has the necessary skills in financial management or is overpaying dividends at the expense of building reserves.

Studies have been done on various risk management factors affecting Savings and Credit Co-operatives in Kenya but there has not been one with holistic approach to risk factors and risk management systems affecting Savings and Credit Co-operative societies in Kenya. For example Owino (2012), researched on the Impact of regulation on financial performance of Savings and Credit Co-operatives societies in Kenya. He found out that through regulation, there was generally a positive impact in that SACCO savings and profits had increased. According to Mugwe, (2012) assets of deposit taking SACCOs grew by 15% from the time regulations were operational in 2008. This study was partial as it focused only on deposit taking SACCOs; it had a narrow scope as the study only covered three SACCOs within Nairobi County and hence could not be relied upon in assessment and generalized conclusion for the entire industry. Clement, Ambrose, and Martin, (2013) researched on the contribution of SACCO financial stewardship to growth of SACCOs in Kenya. They found out that

the use of institutional capital as a mode of financing SACCO activities would ensure their sustainability in the competitive Co-operative sector. The study also shows that growth of SACCO wealth depends on loan management, institutional strength and innovativeness of SACCO products. This study cannot be relied upon to arrive at above findings in that there are other factors that contribute to financial sustainability of SACCOs, as well as risks and risk management factors that contribute to growth of SACCO wealth.

This study therefore sought to answer the following question: Could lack or inadequate risk management system be the root cause of the collapse of some SACCO societies?

1.3 Research Objectives

The objectives of this research were;

- i. To determine the efficiency of risk managements systems within savings and credit Co-operatives in Nairobi County, Kenya
- ii. To enhance effective operations within savings and credit Co-operatives in Nairobi County , Kenya

1.4 Value of the Study

Through this study, Stakeholders of SACCO societies including members, ministry of industrialization and enterprise development, banks and the general public would benefit from this study by making informed decisions pertaining to risk management activities, investment opportunities and instill confidence on the safety of member savings in the industry.

Scholars would find this study appropriate for reference and a source of knowledge in the Co-operative movement in Kenya and the world. It will also be a basis for conducting a further and more in-depth research on the subject for the benefit of the stakeholders.

Through this research, policy makers will be guided appropriately in making relevant and effective policies that are intended to mitigate or avoid the various risks associated with the operations and management of SACCO societies. This will lead to investor confidence and hence enhance economic, social and political development in line with vision 2030.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

In this chapter, the researcher presented an overview of literature in respect to risk management systems within savings and credit Co-operatives in Nairobi County, Kenya.

2.2 Theoretical Foundations of the Study

Risk management is a systematic approach or process of identifying; prioritizing risks and implementing strategies to mitigate risks. Risk management policies are inevitable in SACCO societies in providing guidelines to mitigate risks facing the nature of business. The killer risk to businesses including SACCO societies is the inability to know what their risks are and to what extent these risks can damage their businesses (Zihiga, 2011). SACCO societies are characterized by large number of small loans, decentralized operations, large number of illiterate clientele, and managers with social instead of business background and pressure to keep costs at minimal. These characteristics on the other hand are causative risk factors. Large number of small payments that is difficult to track, difficulties in communication, limited use of information systems and poor control mechanisms (Zihiga, 2011).

Risk management practices and processes should be in place in order to effectively develop and sustain SACCO societies. The independent risk variables for effective risk management systems include, risk identification, risk analysis, risk monitoring, risk evaluation and risk mitigation. The moderating variables are, risk management policies and risk management attitudes and the dependent variable is the performance.

The study of Risk management began after the World War II. The origin of modern risk management dates back to 1955-1964 (Crockford 1982; Harrington and Niehaus

2003; Williams and Heins, 1995). During that time Snider (1956) observed that there were no books on risk management and no university offered courses on the subject. The first two academic books, whose content covered pure risk management but excluded corporate financial risk, were published by Mehr and Hedges (1963) and Williams and Hems (1964). Engineers also developed parallel technological risk management models covering technological losses and operational risk of projects (Dionne G.2013).

For long Risk management has been associated with the use of market insurance for protection from individual and corporate loss (Harrington and Niehaus 2003). In mid 1950s, new forms of pure risk management emerged as alternative to market insurance owing to the fact that insurance coverage became very expensive and incomplete. Contingent planning activities, risk planning activities, self-protection and self insurance instruments were developed during 1960s. Derivatives began to be used as instruments to manage insurable and uninsurable risk in 1970s. The international regulation of risk began in 1980s as well as intensifying financial risk management covering market risk and credit risk especially in banking institutions to become complimentary to pure risk management for most corporations. In 1990s, Operational risk and Liquidity risk emerged (Georges Dionne, 2013).

2.2.1 Sarbanes-Oxley Regulations

In 2002, Sarbanes-Oxley regulations was introduced in United States due to increased scandals and bankruptcies arising from poor risk management. These rules, regulations and risk management methods could not prevent the financial crisis of 2007. It was found out that the reasons for failure could not be attributed to governance rules and risk regulations, but rather their applications and enforcement.

2.2.2 Modern Financial Theory

In his seminal work, Louis Bachelier used Brownian motion for the first time in 1900 to analyze fluctuations in financial assets, effectively becoming the reference point for modern financial theory. In 1930s active research on prices of financial assets began with focus on price setting, financial market efficiency and detection of profitable strategies. During the period between 1950s and 1960s, researchers such as Markowitz, Lintner, Treynor, Sharpe, and Mossin; studied on financial decisions which resulted in the modern theory of Portfolio choice based on Capital Asset Pricing Model (CAPM).

2.2.3 Black and Scholes' Model

The main financial risk management products which were published in the 1970s were mainly as a result of the work of Black and Scholes' model. They were the first to propose the formula for pricing of a derivative called an option. Risk coverage derivative afterwards expanded to including currency and interest rates swaps as well as over the counter options (OTC). Consequently, banks developed and put in place new statistical tools to identify the credit worthiness of their clients in managing credit risk.

2.2.4 Risk and Credit Metrics

The best two known internal risk management models developed by JP Morgan are Risk Metrics for market risk developed in 1994 and Credit Metrics for credit risk in 1997. The models focused on the idea of measuring risks in portfolio form by taking into account of their dependencies and using Value at Risk (VaR) to quantify aggregate portfolio risk. VaR refers to the maximum value that a portfolio or a company can lose during a given period of time at a specified level of confidence. VaR also makes possible the measurement of optimal capital requirement for the

protection of a company or a portfolio from the anticipated or unanticipated losses (Scaillet, 2003).

2.2.5 Basel Accord

Basel evolved in 1988 when a group of ten (10) most industrialized countries (G10) signed an accord to regulate banks. Regulation of financial institutions as a measure of risk management was as a result of risk of default and bankruptcy. Since 1967 more than 43 banks have gone bankrupt in Canada and during 2007 to 2012 period more than 65 U.S.A banks became insolvent. This shows that default risk is real. Bank deposits and insurance policies which are traditionally considered risk-free securities are at risk in event of bankruptcy and default. In response to this several countries have, introduced deposit insurance or insurance guarantee fund (Crouhy et al, 2000). The four main risks for banks for which financial hedging products were developed include Credit risk (80%), Operational risk (15%), Market risk (5%) and Liquidity risk. Market risk has been associated with volatile prices or asset returns. Credit risk on the other hand has been associated with default of exposures. These risks have been addressed by Basel accord of 2004 (Elton et al. 2001)

Basel I, which was limited to credit risk, required each bank to set aside a capital reserve of 8% (Cooke ratio) of the value of securities representing a credit risk in its portfolio. The Cooke ratio serves as a solvency reserve for the bank. Other Basel I regulations include no holding shall exceed 25% of the company's capital and the highest risks shall not exceed eight times the required capital. In 1996 amendment to Basel I was made to introduce Market risk which came into force in 1998 in many countries. Basel II Accord took place in 2004 with more reforms on credit risk management and the start of Operational risk management which took effect in 2006, Bis (2005). In 2010 Basel III Accord took place and its implementation takes place

between 2013 and 2019. Basel III required more risk management measures, increased bank supervision, and Liquidity coverage ratio was introduced.

2.3 Risk Management in Corporate World

Corporate risk management is a set of financial or operational activities that maximize the value of a company or a portfolio by reducing the costs associated with cash flow volatility (Stulz, 1996, 2003). Risk identification, assessment, and management process is part of companies' strategic development. It is planned at the highest level especially by the board of directors. It aims at creating a reference framework that will enable companies to handle risk and uncertainty. The main risk management activities are diversification and hedging using various tools like derivatives and structured products, market insurance, self-insurance, and self- protection. The target costs for reduction through corporate risk management activities are costs of financial distress, risk premiums, income taxes, investment financing and manager's behavior to towards risk.

2.4 Legislation and Statutory Regulations

The formation and management of Co-operatives in Kenya are guided by Co-operative societies (Amendment) Act of 2004. It originates from the Co-operatives Act, Cap 490 of 1966 and was revised in 1977 into Co-operative societies Act Number 12 of 1997. The revisions contained in the Act seek to reduce strict Co-operative supervision by the state in order to promote liberalization and empowered members to be responsible for the management of the Co-operatives they are party to by electing the management committees. This freedom and liberalization did not however meet the expectations of the stakeholders. The leaders of Co-operatives abused this freedom by mismanaging, stealing Co-operative property, split of viable

Co-operatives into small ineffective units, failure of employers to remit deductions from payroll and many corruption cases reported (Thomson, 1991).

Due to these ills, the 1997 Act was amended in 2004. This amendment reinforced the state regulation of Co-operative movement through the office of commissioner of Co-operatives. According to the Co-operative Societies (Amendment) Act 2004, the roles to be undertaken by the state include, creating the policy and legal framework for development of Co-operatives, improving growth and development of Co-operatives through registration, operation, advancement and dissolution, and development of partnerships through consultative forums based on policy, legislation, and regulation.

The SACCO societies Act of 2008 also provides for the licensing, regulation, supervision, inspection and promotion of deposit taking SACCOs by the SACCO Societies Regulatory Authority (SASRA). For a SACCO to be licensed by SASRA, it should have been registered by the commissioner of Co-operative development, meet the minimum capital requirement, meet the three capital adequacy ratios, fit and proper test for the board of directors and Business plan among others. The SACCO societies Act 2008 also provides for the establishment of deposit guarantee fund to secure each SACCO member's deposit up to KES 100,000.00. The boards of directors are required to establish audit and credit committees as well as put in place policy documents governing credit, investment, human resource, savings, liquidity, information preservation, and dividend and risk management (Makori, Munene and Muturi, 2013)

Historically, microfinance institutions have waited for external reviews by regulators to point out problems and risks and then act on those recommendations. In today's fast world and changing financial environment, regulators are often left analyzing

wreckage. To foster stronger microfinance institutions, regulators are now emphasizing the quality of internal control systems to address potential problems quickly.

2.5 Risk Based Supervision Approach

According to the association of Asians Confederation of Credit Union (ACCU), Risk Based Supervision (RBS) approach is to be preferred more than the Traditional Supervision approach. This is because RBS identifies key risks to which the industry and individual credit union are involved, it assess the risk mitigation techniques that are used to manage risks as well as treating risk mitigation and offsetting as valid techniques for risk management, it also assesses the net risk exposure in terms of its level and volatility and hence focuses its supervisory effort in the most significant net risk exposure. This is as opposed to intuitive assessment by the traditional approach which is biased in favor of risk- avoidance and hence against innovative products and services.

ACCU also holds that integrating effective management, operational supervision, and market discipline is a factor towards successful risk management strategies. The success of credit unions depends on the security, privacy and reliable services alongside robust operational practices. The in-system risk management measures of credit unions are introduced to the national federation of credit unions. The national federation of credit unions reviews the status of risk management architecture and initiates measures to bridge the gaps. These may include supervision based on systems and not transaction based, set up compliant units, clearly defined standards of governance, and institute risk based internal audit.

2.6 Credit Risk Management

Anamet. Al (2012) investigated on liquidity risk management of Islamic banks in Brunei Darussalam on two perspectives. The early part covered issues related to understanding risk and risk management, risk assessment and analysis, risk identification, risk monitoring, credit risk and risk management practices. The later part covered methods of risk identifications and risks Islamic banks face. The study revealed that Islamic banks face three risks namely, foreign exchange risk, credit risk and operation risk. It was also revealed that, inspection by Sharia's supervisors, executive and supervisory staff, audit and physical inspection, financial statement analysis and risk survey are the most important risk identification methods.

Olomola (2002) on risk management techniques by examining the perception of senior Islamic banker towards risk found out that repayment performance is significantly affected by borrower's characteristics, lender's characteristics, and loan characteristics. The borrower alone cannot be held responsible for the mess, it is proper to examine the extent to which the borrower and the lender as well as the nature of the facility comply. Basel committee (1999) on management of credit risk, observed that many credit problems reveal basic weaknesses in credit granting and monitoring processes; lack of testing and validation of new lending techniques and senior managers making subjective decisions by extending credits to companies associated with them. These could be avoided or mitigated through a strong internal credit control process.

Hunte (1996) examined the credit rationing technology of lenders and the repayment behavior of borrowers at a rural financial institution based on 504 sample observations. Loan rationing equation and loan repayment equations estimated

employing Tobit model using survey data at Guyana Co-operative Agricultural and Industrial Development Bank revealed that only 33% of the criteria utilized identified credit worthy borrowers implying that the screening technology was not efficient and needed to be repaired. The result also indicated that tightening the loan contract terms by reducing the grace period on loans and rejecting applications which had long processing times enhanced the pool of credit worthy borrowers.

In its published report 'Regulator should Crack the whip on Errant SACCOs' on 13th September 2012, SASRA and the media, reports that despite the large amounts of cash held in by SACCO societies, unscrupulous officials filtering money to 'ghost' accounts or mismanagement of funds are rife as there are many loopholes for shoddy transactions. It was found out that this was mainly due to poor management structures, lack of proper information management systems, poor corporate governance, poor regulations and laws to prosecute wayward officials and employees.

Waweru (2011) investigated into the cash balance management approaches in savings and credit Co-operative societies in Nakuru County, Kenya. He found out that though majority of SACCOs were conscious about the need to manage their cash balances, very few had policies on cash balance management and very few had set optimum cash balance levels. Among the few SACCOs that had set optimum cash balance levels, used a combination of various models (Bumol, Miller-Orr, Beranek, Lockyer, Archers and Gibbs). No one model was found to be used entirely. Hence this led to haphazard management of cash balances.

Procasur Africa (2012) conducted an overview of SACCOs in Kenya in pursuit of ideas to develop SACCOs found out that the major shortcomings in the Co-operatives societies Act included failure to; establish rules that specify qualifications of board

members, bringing out rules that limit risk exposure and specify disclosure norms, specify liquidity reserves, state the audit report standards, and failure to establish the provision for writing off non-performing loans leading to financial statements being overstated in both revenues and assets accounts. Roselyne (2007) conducted a study which found out that factors that influenced repayment of loans in SACCOs were salary; nature of loans and control recovery measures that the SACCO society has in place to check defaulters.

In another study by Kimani (2007) it was found out that the main causes of inefficiency and ineffectiveness in credit administration were unqualified staff in SACCOs; inadequate funds to lend; inadequate training; lack of effective technology; weak internal control system; and credit management is very powerful and able to manipulate the lending.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter describes the methods and procedures the researcher employed to conclusively answer the research question. The chapter covered the following areas; research design, study population, sampling procedure, data collection and data analysis.

3.2 Research Design

The researcher adopted a descriptive survey design in conducting this research. Descriptive research is a process of collecting data in order to test hypothesis or to answer questions concerning the current status of the subject in the study (Gay, 1981). According to Orodho (2002), a descriptive survey is a method of collecting information by interviewing or administering a questionnaire to a sample of individuals.

Descriptive survey design is appropriate for conducting this research due to its economical value of sampling the population to generalize results rather than researching on the whole population. According to Kerlinger, (1993), it guarantees breadth of information and accurate descriptive analyses which are characteristic of a sample that can enable the researcher make inferences about the population.

3.3 Study Population

The population for this research covered SACCO societies in Kenya within the county of Nairobi. Nairobi County has the highest number of SACCO society's distribution in Kenya compared to other Counties. According to the SACCO Supervision report (2012) the County had 45 Deposit Taking SACCOs which was more than twice

higher than the closest county with 16 Deposit Taking SACCOs. It is also estimated from unpublished report that the County has about 1000 SACCOs but only 600 of them are Active. These SACCOs enjoy diversity of common bond covering various sectors of the national economy and easy access to information affecting the industry.

3.4 Sampling Procedure

Sampling is the process of selecting a sub set of cases in order to draw conclusions about the entire set Orodho (2004). Due to various limitations a researcher selects a sample that would facilitate in making necessary findings instead of researching on the whole population (Gay, 1976). The sampling procedure employed in this study was purposeful sampling. The researcher sampled a total of 130 SACCOs comprising of 10 deposits taking and 120 non-deposit taking SACCOs from various common bonds and of at least five years in existence. Purposeful sampling is ideal as it would enable inclusion of all SACCO societies from various common bonds and ensure reliable data collection that would be generalized within a margin of error as would be statistically determined (Borg, 1987; Mugenda and Mugenda, 1999)

3.5 Data Collection

For the purpose of carrying out this research and achieving the objectives of this study, data collection was primary. According to Donald & Schilder (2006), primary data collection involves administration of questionnaires and interviews by approaching relevant persons who answers such questions appropriately. According to Mugenda, (1999), research tools are means by which primary data is collected. In this study the researcher mainly used questionnaires. These Questionnaires contained closed and open ended questions in which the researcher required the respondent to choose from the available options and to respond according to knowledge. The

respondents in this case were senior management team from sampled societies and or board members. According to Selltiz (1977), questionnaires that have a chance of coming back are those of attractive presentation, short, clear, and easy to fill. The questionnaires sought to obtain data on risk management systems in place in order to enable the researcher make correct inferences.

3.6 Data Analysis

The data collected was statistically analyzed through the use of statistical tools such as mean, mode, frequencies and standard deviation. Quantitative data were presented by the use of graphs, tables, and charts with the help of Microsoft Excel software. Qualitative data was descriptively analyzed to determine the effect and level of risk management systems within SACCOs in Nairobi County, Kenya.

CHAPTER FOUR: DATA ANALYSIS, FINDINGS AND DISCUSSION

4.1 Introduction

This chapter is about data analysis, presentation and interpretation of research findings. The procedures, processes and techniques applied in data analysis, presentation and interpretation are explained in this chapter.

4.2 Response Rate

This section focuses on the response rate and the SACCO demographics. One Questionnaire each was sent to 130 SACCOs. The target respondent was either a board member or senior staff of the target SACCO. Out of 130 targeted SACCOs, 90 responded while 5 failed to respond. The response rate therefore was 96% which was reasonable for the researcher to draw necessary conclusions.

Among the respondents 20% were female while 80% were male. It was also found out that the age bracket of the respondents was 16% between 18 - 30years; 40% between 31-45years; 24% between 46-55years and 20% between 56-70years

4.3 The Period the Respondents Worked in the Industry

The questions were framed to the end that the researcher could determine the extent to which the respondent is skilled, knowledgeable and understands the industry. The longer the experience, the more reliable is the information. It was found out that all the respondents have had a previous leadership or management experience in a SACCO sector for a period of over 5 years. The response to this question was analyzed as shown in Table 4.1

Table 4.1 Period respondents have worked in the SACCO

| Years worked | Frequency | % |
|---------------------|------------------|----------|
| Less than a year | Nil | - |
| 1-5years | Nil | - |
| Over 5years | 125 | 100% |
| Total | 125 | 100% |

Source: Author

4.4 Views of Risk Management

This question was intended to determine the attitude of SACCOs towards risk. 76% of the SACCOs said, risk management is critical and 24% said it is strategic. None said not important or, not rated. This implies that risk management is valued in SACCO societies as shown in Table 4.2

Table 4.2 Views of risk management

| Views | Frequency | % |
|---------------|------------------|----------|
| Critical | 95 | 76 |
| Strategic | 30 | 24 |
| Not important | - | - |
| Not rated | - | - |

Source: Author

4.5 Views of the SACCOs Future

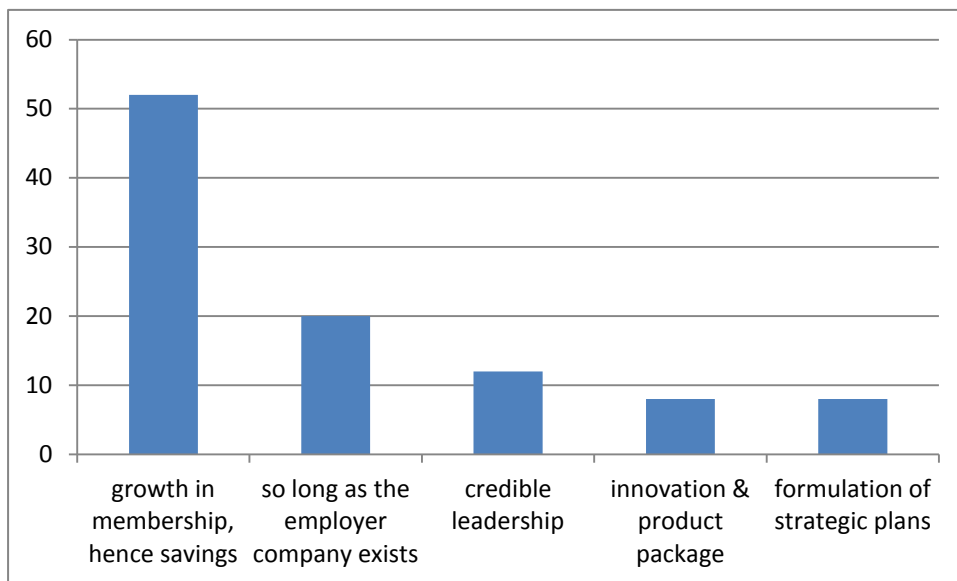
Respondents gave various views in support of their believe that their SACCO future is bright; 52% said because they are experiencing an increase in membership, 20% said as long as their employer company exist the SACCO will as well. 12% said because of credibility of leadership, 8% said because of innovation and right packaging of the product and 8% said because leaders are formulating a strategic plan. This implies that majority of SACCO officials lack knowledge of what it takes to sustain their organization. The findings are shown in Table 4.3 and illustrated in figure 4.1

Table 4.3 Views for promising SACCO future

| Reasons for promising future of the SACCO | Frequency | % |
|---|-----------|----|
| Growth in membership and hence savings | 65 | 52 |
| So long as employer company exists | 25 | 20 |
| Credible leadership | 15 | 12 |
| Innovation and product packaging | 10 | 8 |
| Formulation of strategic plans | 10 | 8 |

Source: Author

Figure 4.1 Views on SACCO future expressed in %



Source: Author

4.6 Sources of Income

SACCOs were asked to show their sources of income. This was a pointer to diversity levels of income generating activities. Multiple sources of income is an indicator that liquidity needs can be sustained by other sources even when there is a failure of some. It was found out that all SACCOs interviewed, traditionally depend on member savings and interest income on loans issued. Only 8 SACCOs had ventured into business related investments such as Mpesa, sale of items at a profit and owning supermarkets. The findings are shown in Table 4.4

Table 4.4 Sources of SACCO income

| Sources of income | Frequency | % |
|-------------------|-----------|-----|
| Member savings | 125 | 100 |
| Interest income | 125 | 100 |
| Business | 8 | 6.4 |
| Other | - | - |

Source: Author

4.7 Products Offered

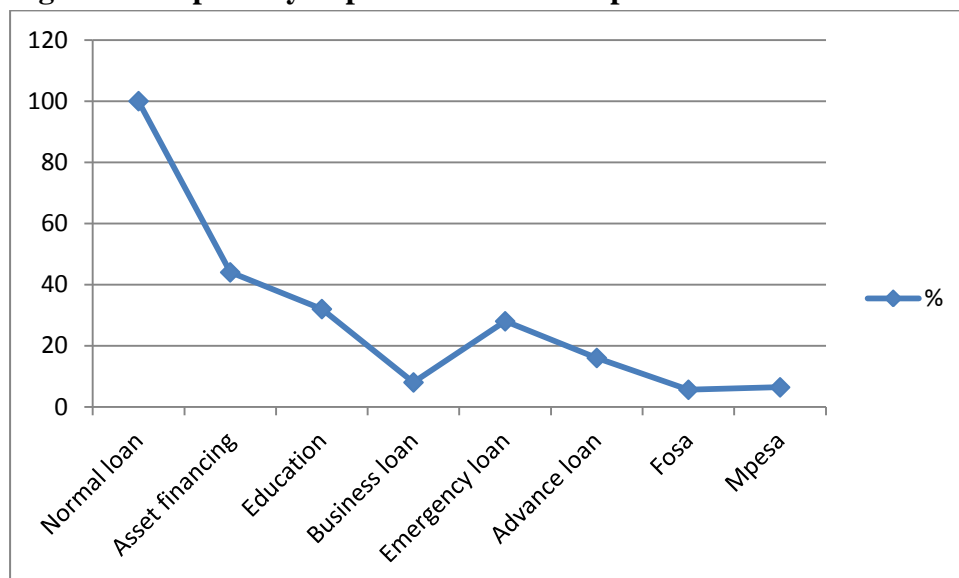
The researcher sought to know the type of products offered by the respondents. This was intended to determine the level of product innovations that creates a competitive edge in the market as well as meeting the demands of the clients. It was found out that SACCOs are still patronizing same traditional products. The most common one is Normal loan product patronized by all respondent SACCOs i.e. 100%, Education 32%, Emergency 28%, Advance loan 16%, Asset financing 44%, Fosa 5.6% and Mpesa 6.4%. This implies that if other financial players in the market provide similar or improved products, SACCOs will be faced out. Secondly, most SACCOs offer long term products such as normal loan and asset financing which tie resources in the hands of few members with little income interest, hence escalating liquidity problem. The findings are shown in Table 4.5 and illustrated in figure 4.2

Table 4.5 products offered

| Products | Frequency | % |
|-----------------|-----------|-----|
| Normal loan | 125 | 100 |
| Asset financing | 55 | 44 |
| Education | 40 | 32 |
| Business loan | 10 | 8 |
| Emergency loan | 35 | 28 |
| Advance loan | 20 | 16 |
| Fosa | 7 | 5.6 |
| Mpesa | 8 | 6.4 |

Source: Author

Figure 4.2 Popularity of products offered expressed in %



Source: author

4.8 Period Taken to Issue Loans

This question was intended to show the time period a SACCO takes to issue loans that have already been approved. Longer time taken to issue loans implies poor service delivery and or lack of liquidity. Hence the SACCO is at risk of losing member due to dissatisfaction. It was found out that 20% of the SACCOs issue loans in less than 4weeks, 48% take 2-3months, 16% take 4-6months and 16% take 7-12months. This finding is shown in Table 4.6 and illustrated in figure 4.3

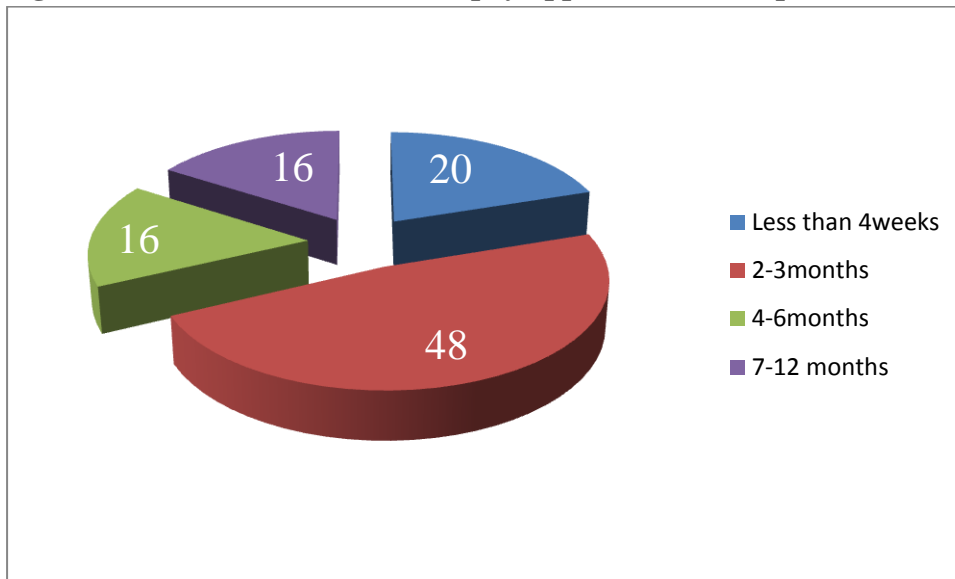
Table 4.6 Period taken to issue loans

| Period | Frequency | % |
|------------------|-----------|----|
| Less than 4weeks | 25 | 20 |
| 2-3months | 60 | 48 |
| 4-6months | 20 | 16 |
| 7-12 months | 20 | 16 |

Source: Author

Some SACCOs gave reasons for delays in loan disbursement while others said there were no delays. Those that accepted that there were delays in issuing loans cited the following as the main causes; firstly, lack of funds and secondly, delay by the employer to remit funds deducted through check-off system.

Figure 4.3 Period of time taken to pay approved loans expressed in %



Source: Author

4.9 Loan Default Amount

Respondents were asked to show loan defaulted amount for the last three years. In determining this portfolio, the researcher cumulated individual respondent's amount in respect to the relevant year. This portfolio shows Kes 9,500,360.00 as defaulted amount in 2011; Kes 9,326,500.00 in 2012 and Kes 8,230,200.00 in 2013. The findings show that there is a reducing trend of total defaulted amount albeit by a small margin. This implies that more risk management measures need to be put in place to bring risk exposure to manageable levels. Table 4.7 show the findings of the amount in default.

Table 4.7 Cumulative loan default for the last 3 years

| Period | Cumulative Amount | % |
|-----------|-------------------|------|
| Year 2013 | 8,230,200.00 | 30.4 |
| Year 2012 | 9,326,500.00 | 34.5 |
| Year 2011 | 9,500,360.00 | 35.1 |
| Total | 27,057,060.00 | 100 |

Source: Author

On the other hand, when asked why there were defaults as shown in table 4.7 above; 60% said it was due to job termination, and 20% tied up in their view by suggesting that it was due to change of jobs and financial constraints experienced by the loaned. From the findings, majority of SACCO members depend on their employer to repay loans. Any slight change affecting their working terms and conditions will affect their loan repayment as well. This implies that employees with no alternative financial sources are risky creditors as presented in Table 4.8

Table 4.8 Causes of default

| Causes of default | Frequency | % |
|--|-----------|-----|
| Termination of employee work contract | 75 | 60 |
| Change of jobs | 25 | 20 |
| Financial constraint experienced by the loaned | 25 | 20 |
| Totals | 80 | 100 |

Source: author

4.10 Structures Put in Place to Mitigate Risk

This question was intended to find out measures put in place to manage or mitigate risk. A society with strategic organizational structures can cope with environmental changes which affect its operations and hence achieve its desirable objectives. It was found out that 100% of the respondents said they have both Credit and Supervisory committees in place, 4.8 % have Internal audit, 4% have loan repayment monitoring & follow-up committee, risk management committee and relevant policies reviews committee. Those with 100% are considered to be traditional structures among

SACCO societies, while those with 4% and 4.8% are more contemporary structures to effectively mitigate risk. Table 4.9 illustrates the findings.

Table 4.9 Risk mitigation organizational structures

| Measure | frequency | % |
|---|-----------|-----|
| Credit committee | 125 | 100 |
| Risk management committee | 5 | 4 |
| Internal audit | 6 | 4.8 |
| Loan repayment monitoring & follow-up committee | 5 | 4 |
| Supervisory committee | 125 | 100 |
| Relevant policies & reviews committee | 5 | 4 |

Source: Author

When asked to show the level of trust and efficiency of organizational structures meant to mitigate risk, 95 out of 125 respondents and 80 out 125 respondents said, the credit committee and supervisory committee respectively, which are common organizational structures among the respondents were moderate performers. That means they cannot be relied upon to instill investor confidence. The findings are shown in Table 4.10

Table 4.10 Organizational structure efficiency appraisal

| Measure | Very efficient | Efficient | moderate | weak | Very weak | Total respondents |
|---|----------------|-----------|----------|------|-----------|-------------------|
| Credit committee | - | 10 | 95 | 15 | 5 | 125 |
| Risk management committee | 1 | 3 | 2 | - | - | 5 |
| Internal audit | 2 | 1 | 3 | - | - | 6 |
| Loan repayment monitoring & follow-up committee | - | 3 | 2 | - | - | 5 |
| Supervisory committee | 2 | 25 | 80 | 15 | 3 | 125 |
| Relevant policies & reviews committee | 1 | 2 | 2 | - | - | 5 |

Source: Author

4.11 Analysis of the Level of Education

The researcher sought to know the academic qualifications of the respondent. This sampling is a pointer to the academic qualifications of the board and the senior management as well as the level of knowledge and understanding of SACCO matters. It was found out that 24% had High School qualifications, 32% had diploma, 32% were undergraduates and 12% were post graduate degree holders. It therefore implies that a total of 58.75% of leaders in management are without university level of education. Table 4.11 indicates the response on the academic qualifications of the board members as well as the senior staff.

Table 4.11 Academic qualification

| Education | Frequency | % |
|---------------|-----------|-----|
| Post graduate | 15 | 12 |
| Undergraduate | 40 | 32 |
| Diploma | 40 | 32 |
| High School | 30 | 24 |
| Totals | 125 | 100 |

Source: Author

4.12 Periodical Visits by SASRA and Cooperative Officials

External visits by cooperative and SASRA officials are critical in supervision in order to ensure that prudent management policies and ethical values are adhered to. Through frequent inspection fraud and other risks are detected early and managed while scant inspections implies damages can be done unnoticed. It was found out that 9.6% of the SACCOs were frequently visited in a span of 3 months; 44% were visited twice a year; and 46.4% once a year. The findings are shown in Table 4.12

Table 4.12 Number of inspection visits

| Inspection visit intervals | frequency | % |
|----------------------------|-----------|------|
| 1-3 Months | 12 | 9.6 |
| 4-6 months | 55 | 44 |
| 7-12 Months | 58 | 46.4 |
| Total | 125 | 100 |

Source: Author

CHAPTER 5: SUMMARY, CONCLUSIONS, AND RECOMMENDATIONS

5.1 Introduction

This chapter deals with summary of findings, conclusions and recommendations for further research.

5.2 Summary

This research was intended to determine the level of risk management systems in Savings and Credit Cooperatives within Nairobi County, Kenya. Strategic Risk management systems ensures investor confidence, mitigates risk exposure, checks mismanagement of resources, wits out fraud and inspires growth in the Savings and Credit Cooperative subsector.

From the findings, it is clear that there are gaps in risk management systems in Savings and Credit Cooperatives that work against efficient services delivery to the stakeholders. The risk factors leading to inefficiency include the following; lack of innovative products which are attractive in the target market; limited sources of funds hence leading to liquidity crunch; long period taken to issue already approved loans; constant loan defaults due to inappropriate loaning policies and reviews; inadequate risk management organizational structures to counter any risk operations and low educational qualifications.

The research findings also reveal that operations of Savings and credit cooperatives are not effective. Lack of standardization of services, management ethics, checks and balances, research and innovation; leaves a lot of room for risk transaction which are unhealthy to the target society.

5.3 Conclusions

The study on risk management systems in Savings and Credit Cooperatives in Nairobi County Kenya shows inadequacies that need urgent attention. The SACCO subsector is a thriving sector, commanding a large portion (40%) of Kenya's economy in terms of savings. Strategic risk management systems should be put in place to counter major risks which includes credit exposure, liquidity risk, operational risk and market risk. From the findings it is clear that lack of efficient risk management systems have led to ineffective SACCO operations. Consequently, some have either become dormant or closed shop.

5.4 Recommendations

From the above findings; there is need for constant improvement and reviews of both organizational structures and policies of saving are credit cooperatives to enhance operations as well as counter risky operations. This should be done in the spirit of ensuring safety of member savings, inspire confidence among stakeholders and ultimate long time survival of the organization.

5.5 Suggestions for Further Research

The study on risk management systems in savings and credit cooperatives had two objectives; to determine the efficiency of risk management systems and to enhance effective operations among Savings and credit cooperatives. This study targeted SACCOs in Nairobi County, Kenya. Further studies should therefore be conducted in respect to the following;

- i). Case studies on savings and credit cooperatives which are dormant or have closed down their business operations should be conducted in order to establish on how faulty risk management systems contributed to their downfall.

ii). A study on prevalent contextual risk factors in savings and credit cooperatives in Kenya for the purposes of risk prioritization.

5.6 Limitations of the Study

In conducting this study, the researcher was faced with various challenges which include the following: Confidentiality, the respondents were reserved in answering to the questionnaire due to fear of divulging some confidential information that may end up working against them; Lack of cooperation. A number of respondents were reluctant in answering to the questionnaire claiming to be busy and lacking time for the exercise, in the process there were time loss and delays.

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APPENDICES

Appendix I: Questionnaire

Risk Management Systems in Savings and Credit Co-operatives within Nairobi County, Kenya

This questionnaire has been designed to enable the student to carry out research on the topic above. The study is purely academic work in partial fulfillment of Master of Business Administration (MBA) in the University of Nairobi (UoN). Your assistance will be highly appreciated and your comments will be treated with utmost confidence.

SECTION A: GENERAL INFORMATION

1(i). SACCO Name.....(ii). SACCO common bond.....

2(i) Your Occupation(ii) Gender: Male Female

3. Age bracket; i) 18-30 ii) 31-45 iii) 46-55 iv) 56-70

4. What is your position in the SACCO? i). Board member ii). CEO/Mngr

5. How long have you worked in this SACCO?

i). Less than a year ii). 1-5 years iii). Over 5 years

6. What is your view of Risk Management according to your SACCO?

i). Critical ii). Strategic (iii). Not Rated iv). Does not exist

7. In your opinion does your SACCO have a future? Why?.....

.....

SECTION B: RISKS

8. Please indicate sources of SACCO funds

i). Members' savings ii).Interest Income iii). Business

iv). Other investment/specify.....

9. Please Tick against products /services offered by your SACCO.

| SNo | Product/service | ✓ | SNo | Product/service | ✓ |
|-----|----------------------|---|-----|-----------------|---|
| 1 | Development loan | | 5 | Emergency loan | |
| 2 | Asset financing Loan | | 6 | Advance | |
| 3 | Education loan | | 7 | Fosa | |
| 4 | Business loan | | 8 | Mpesa | |

10(a).How long does it take your SACCO to process and pay loans / advances applied for?

i). Less than 4 weeks ii).2-3months iii). 4-6months

iv). 7-12months v). More than 1yr vi). Indefinitely

10(b) Please state the reasons for delays if any.....

.....

11 (a). In the boxes provided below Please fill the total SACCO defaulted loan amounts in the past 3years.

i). Year 2013 ii).Year 2012 iii).Year 2011

11 (b). In your own words what are the causes of these default?

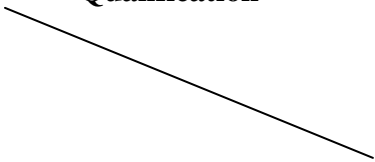
.....

12. In a scale of 1 to 5 where 1=very efficient, 2=efficient, 3=moderate, 4=weak and 5=very weak; appraise the functional efficiency of the following organizational structures if they are in place in your SACCO society?

| | Are the structures in place? | Appraise |
|--|-------------------------------------|-----------------|
| Credit Committee | | |
| Supervisory Committee | | |
| Risk management committee | | |
| Internal Audit unit | | |
| Loan repayment monitoring & follow-up unit | | |
| Relevant policies and reviews | | |

SECTION C. REGULATIONS AND MANAGEMENT QUALITY.

13. What are the qualifications of the following management team?

| Qualification  Management position | High school | diploma | undergraduate | postgraduate |
|---|-------------|---------|---------------|--------------|
| Chairman | | | | |
| Treasurer | | | | |
| Hon. Secretary | | | | |
| C.E.O/Manager | | | | |
| Chair Credit committee | | | | |
| Chair supervisory committee | | | | |

14. How often is your SACCO inspected by either SASRA or ministry officials

- i). 1-3 months ii).4-6 months iii).7-12 months

Thank you for your Co-operation. The information shared here will be treated with utmost confidence.

*******THE END*******

Appendix II: Time Schedule for the Research

| Details | Dec | Jan | Feb | Mar | Apr | May | Jun | Jul |
|----------------------|-----|-----|-----|-----|-----|-----|-----|-----|
| Problem Formulation | X | X | | | | | | |
| Writing a proposal | | | X | X | X | | | |
| Data Collection | | | | | | X | | |
| Data Analysis | | | | | | | X | |
| Defense presentation | | | | | | | | X |

Appendix III: Proposed Budget for the Research

| Details | Quantity | Unit Cost | Total Kes. |
|---------------------------|-----------------|------------------|-------------------|
| Stationery | - | - | 1,500.00 |
| Transportation | - | - | 6,000.00 |
| Questionnaire development | | | 2,000.00 |
| Printing | 500 | 10 | 5,000.00 |
| Photocopying | 100 | 3 | 300.00 |
| Binding | 3 | 75 | 215.00 |
| Total | | | 15,015.00 |