

**CORPORATE GOVERNANCE BEST PRACTICES AND  
PERFORMANCE BY DEPOSIT TAKING SAVINGS AND CREDIT  
CO-OPERATIVE SOCIETIES IN NAIROBI CITY COUNTY**

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## **DECLARATION**

I, John O. Omolo, declare that this project paper is my original work and has not been submitted to any other University for examination.

Sign \_\_\_\_\_ Date \_\_\_\_\_

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**D61/65121/2013**

This research project has been submitted for examination with our approval as the University supervisor.

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## **DEDICATION**

This research project is dedicated to my wife Florence and lovely children Annette, Freddy and Ronny; the world is yours for the taking. I also want to dedicate to my mother Lucia Omolo for the unending love of education she has instilled in me.

## **ABSTRACT**

Proponents of corporate governance say there is a direct correlation between good corporate governance practices and long-term shareholder value. This study examined the relationship between corporate governance best practices and the financial performance of deposit taking SACCOs in Nairobi County. It investigated the composition of boards of directors within these organizations and analyzed whether corporate governance best practices have an impact on financial performance, as measured by return on assets (ROA). The study used primary data from a developed questionnaire and secondary source data collected from the SACCOs financial reports filed with SASRA. It specifically looked at four board characteristics (board independence, board size, gender of the board of directors and number of board committees) which were set as the independent variables. The Ordinary Least Squares (OLS) regression was used to estimate the relationship between corporate performance measures and the independent variables. Findings from the study show that there is strong positive association between board size and corporate financial performance. Evidence also exists that there is a positive association between board independence and financial performance. Good positive association was also observed between number of the board committee and gender of the board members, and firm financial performance. In conclusion therefore The study suggests that large board size should be encouraged and the composition of outside directors as members of the board should be sustained and improved upon to enhance corporate financial performance.

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## **LIST OF ACRONYMES AND ABBREVIATIONS**

ICA	-	International Co-operative Alliance
GDP	-	Gross Domestic Product
KUSCCO	-	Kenya Union of Savings and Credit Co-operatives
NP	-	Net Profit
ROA	-	Return on Asset
ROE	-	Return on Equity
SACCOs	-	Savings and Credit Co-operatives
SASRA	-	SACCO Societies Regulatory Authority

# **CHAPTER ONE: INTRODUCTION**

## **1.1 Background of the study**

Savings and Credit Co-operatives (SACCOs) have been noted to contribute a considerable portion to Kenya's Gross Domestic Product (GDP). They have become important vehicles for poverty eradication in the country, International Monetary Fund (IMF) (2004). IMF estimated that the proportion of the population living in poverty has risen from about 48.8 percent in 1990 to 55.4 percent in 2001. The proportion is estimated to have risen to more than 56 percent in 2003.

These statistics have made the Government of Kenya to put more emphasis in the co-operative movement as an important tool to poverty alleviation. This led to the creation of an independent Co-operative Ministry in the year 2003, which has seen the sector grow tremendously from strength to strength over the past period. Good corporate governance shields a firm from vulnerability to future financial distress (Bhagat and Black, 2002). The argument has been advanced repeatedly that the governance structure of any corporate entity affects the firm's ability to respond to external factors that have some bearing on its financial performance (Donaldson, 2003 Claessens, et.al. (2002) also suggested that better corporate framework benefits firms through greater access to financing, lower cost of capital, better financial performance and more favorable treatment of all stakeholders.

### **1.1.1 Corporate Governance**

Corporate governance is a set of rules that define the relationship between stakeholders, management, and board of directors of a company and influence how that company is operating (Jensen and Meckling, 1976). At its most basic level, corporate governance deals with issues that result from the separation of ownership and control. But corporate governance goes beyond simply establishing a clear relationship between shareholders and managers. Corporate governance involves a set of relationships between a company's

management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.

According to Maati, (1999) corporate governance describes how companies ought to be run, directed and controlled. It is about supervising and holding to account those who direct and control the management. He notes that for a Small and Medium Enterprise, it concerns the respective roles of the shareholders as owners and the managers (the directors and other officers). He emphasizes further that it is about setting rules and procedures as to how the company is run. It is also about putting checks and balances in place to prevent abuses of authority and ensure the integrity of financial results. As a result, the role and independence of the auditor has been under the microscope. He further emphasizes that Company law, along with other forms of regulation (including stock exchange listing rules and accounting standards), both shape and is shaped by prevailing systems of corporate governance. Agumba (2008) also asserted that the meaning of governance is exercising direction and control of human resources. He emphasizes that corporate governance as the processes and structures by which the business and affairs of an institution are directed and managed and stresses that good corporate governance fosters accountability for interest of all stakeholders.

### **1.1.2 Corporate Governance Practices**

Proponents of corporate governance say there is a direct correlation between good corporate governance practices and long-term shareholder value. There is no uniform set of governance practices, (Keyes, 2014)). These governance best practices will positively impact every company's performance and long-term viability. According to him some of the best governance practices are: building a strong qualified board of directors and evaluating performance, defining roles and responsibilities, emphasizing integrity and ethical dealing and valuating performance and making principled compensation decisions, as well as engaging in effective risk management.

Cornforth (2004) conducted a study and found out that governance is a complex, inherently difficult and problematic activity. He noted that new ways of thinking about governance that move beyond narrow theoretical frameworks have to be found. Davis (2007) observed that in the UK, co-operatives generally are lagging behind the private sector in their application of corporate governance practices. Mostly smaller co-operatives lack effective basic personnel systems and management structures and few of the larger co-operatives have not fully embraced these practices. He concluded that this failure to develop clear programs for the incorporation of corporate governance principles is a missed opportunity.

Agumba (2008) asserted that in SACCOS the governance is concerned with allocation of power and authority between the clients, the board, committee and management. The governance in SACCOS focuses on four areas which are leadership, stewardship, monitoring and reporting where the six governance models which are democratic or association perspective, agency theory (a compliance model), stewardship theory (a partnership model), resource dependency theory (a co-optation model), stakeholder theory (a stakeholder model) and managerial hegemony theory (a rubber stamp) models are applied. He emphasized that application of these theories and models in SACCOS are related with good credits risks management practices and fosters the SACCOS' performance.

### **1.1.3 Organization Performance**

According to Moseng and Bredup (1993), organizational performance is the integration of three broad dimensions: effectiveness, efficiency and adaptability. The various measures of performance are either quantitative or qualitative. Quantitative measures include return on equity (ROE), return on assets (ROA), net profit and dividend yield (DY). Qualitative measures on the other hand, include market share, employee and customer satisfaction and corporate image.

Barney (2011), argued that financial performance for much of the business and economics literature is focused on providing financial returns, variously referred to as

profits, return on investment (ROI), economic rents or shareholders return. Financial performance relates to the way and manner in which financial resources available to the organization are judiciously used to achieve the overall corporate objective of an organization.

#### **1.1.4 Corporate Governance Best Practices and SACCOs**

Good governance is essential to the safe and sound operations of Credit Unions. Transparency, accountability, oversight, diversity and training are recognized as the cornerstones of good governance in these institutions, World Council of Credit Unions, (WOCCU) (2002). According to WOCCU, good governance stems from clearly defined roles and responsibilities of the board of directors, committees and senior managers. It also stems from codes of conduct which directors and staff at every level of the institute sign on to and respect in the completion of their tasks. Sound bylaws and policies seek to avoid conflicts of interest and provide mechanisms for dispute resolution where they do arise. WOCCU further observes that while many factors contribute to the governance of an institution, good governance begins and ends with the board. It's governance that sets the tone of the credit union.

Traditionally, corporate governance has been associated with larger companies and the existence of the agency problem. Agency problem arises as a result of the relationships between shareholders and managers. It comes about when members of an organization have conflicts of interest within the firm. This is mainly due to the separation between ownership and control of the firm. It is tempting to believe that corporate governance would not apply to SACCOs since the agency problems are less likely to exist. In many instances, SACCOs are made up of managers who also happen to be shareholders (members) of the same (Mudibo 2005). Basically, SACCOs tend to have a less pronounced separation of ownership and management than larger firms. Some argue that the question of accountability by SACCOs to the public is non-existent since they do not depend on public funds. As a result, provision of loan facilities to the members, increasing dividend payment and minimizing cost are the common aims of the members. In spite of these arguments, there is a global concern for the application of corporate

governance to SACCOSs. It is often argued that similar guidelines that apply to listed companies should also be applicable to SACCOs.

WOCCU (2002) issued guidelines on the code of conduct in Credit Unions. These guidelines emphasize on the obligations of SACCO officials and employees that extend beyond ensuring that their actions do not violate any statute or regulation. They are fiduciaries who owe it to the SACCOs to act in good faith in the performance of their duties. Gupta (2004) observed that transparency (openness and disclosure of information), integrity (straight forward dealing), and accountability are the three pillars of effective corporate governance. He further notes all the three are equally applicable to co-operatives.

### **1.1.5 SACCOs in Kenya**

The Sacco sub-sector in Kenya has had an important role to play in spurring economic growth given that they represent a vast portion of the firm tissue in the economy. Kenya has the highest number of registered Co-operatives in Africa with one out of five Kenyans being members of a Co-operative, Kenya Union of Savings and Co-operatives, (Mudibo 2005). The fact that they tend to provide relatively less expensive forms of credit compared with bank loans to individuals on low incomes suggests that there is potential for the Co-operative sector to grow to even higher levels. KUSCCO (2005) reported that there are over 4500 registered Co-operative Societies in Kenya with a total membership of 2.5 million. Their asset base stands at over Kenya Shillings 150 Billion, an indication that the sector controls a substantial portion of Kenya's economy. They further noted that although the Co-operative movement will not necessarily develop along similar lines to the banking sector, it is already playing a pivotal role in providing banking facilities to the relatively poor and disenfranchised sectors of society.

Wasike (2012) argues that despite these gains, studies have shown that lack of sufficient growth of SACCOs' wealth has made it difficult for them to absorb their operational losses, which has threatened their sustainability. This has led to the losses being absorbed by members' savings and share capital, hence loss of members' savings. While the

purpose of SACCOs is to mobilize members' funds and grant credit for the members' development, this has made it difficult for the SACCOs to grow their wealth, achieve this objective and contribute favorably to National Domestic Savings.

#### **1.1.6 Deposit Taking SACCOs in Nairobi County**

The SACCO sub-sector comprises of Deposit Taking and non-Deposit Taking SACCOs. Deposit Taking SACCOs are defined by law as those that accept withdrawable deposits and are licensed and regulated by SASRA while non-Deposit Taking SACCOs are supervised by the Commissioner of Co-operatives. SASRA licenses SACCOs that have been duly registered under the Co-operative Societies Act CAP 490. According to SASSRA, there were 135 Deposit Taking SACCOs in Kenya as at the end of December 2014, of which 35 were operating in within Nairobi County. The SSA and the Regulations requires SACCOs already operating Front Office Services Activity (FOSA) as at the date of publication of the regulations which was June 2010 to apply for license with SASRA. These deposit taking SACCOs are actually observed to be controlling more than 78% of the total deposits and assets of the SACCO industry, IMF (2011). The need for closer oversight is that accepting withdrawable deposits is particularly considered a high-risk activity as depositors risk losing their money.

#### **1.2 Research Problem**

The failure of some of the big Saccos in Kenya, has thrown up a myriad of questions about the effectiveness of contemporary accounting, auditing and corporate governance practices within these institutions. The recent scandals of corruption in some of the largest SACCOs are just the latest in a long line of failings and bankruptcies due to bad practices. The lack of proper governance mechanisms have been attributed for the failure of some of these institutions. Not much research has been made on the corporate governance of Deposit Taking SACCOs, except general guidelines associated with FOSAs and as in Ademba (2006). This phenomenon may well cripple the effective development and growth of SACCOs in Kenya and eventually the overall economic recovery process. It is important then for proper management of this sector to ensure

enhanced performance. Wasike (2012) noted that corporate governance helped Elimu SACCO in defining the relation between the SACCO and its general environment, the social and political systems in which it operated and also linked the way management and control were organized thus affecting the performance of the SACCO and its long run competitiveness.

Corporate governance mechanisms may result in greater performance for SACCOs as well, if appropriate measures are mandated by the regulators. It has been observed by the Credit Union Directors Newsletter, (2004), that in most countries, Credit Unions do not strictly comply with the codes of corporate governance, but it has often been argued that such codes should also apply to these institutions. Governance problems specific to the SACCOs pose challenges not faced by many other forms of organizations as Mwango (2010) found out. Mudibo (2005) noted that despite the enormous potential of co-operative societies to significantly contribute to Kenya's development, the performance of the sector has been constrained by a number of factors namely poor governance and limited transparency in their management, market intelligence and market research, weak capital leading to low capital volume, low resource base and narrow borrowing base, and infrastructural weakness occasioned by operational and structural flaws.

A study of corporate governance issues in the sub-sector is therefore a relevant research area. Research in this area, however, has largely focused on corporate governance issues in the large corporations. In contrast this study was concerned with SACCOs, more specifically, the Deposit Taking category within Nairobi. With the enactment of the SACCO Act, 2008 (SSA) and the subsequent establishment of the SACCO Societies Regulatory Authority (SASRA), SACCOs have been brought under regulation and supervision. This research therefore sought to explore the corporate governance practices in Deposit Taking SACCOs in Nairobi County and try to answer the question; does corporate governance practices influence performance of the SACCOs?

### **1.3 Research Objectives**

The objectives of this study were:-

- i) To determine corporate governance practices in Deposit Taking SACCOs in Nairobi County.
- ii) To determine how such practices enhance the performance of the SACCOs.

#### **1.4 Value of the study**

This study was intended to come up with information on the best practices on corporate governance applied by SACCOs in enhancing their performance. The findings of this study will provide the necessary information to the SACCO movement and its various stakeholders for purposes of meeting their current and long-term shareholder value. It will also enhance on the existing information and enable further researchers in their various studies. The cooperative sector in Kenya plays a significant role in the Kenyan economy currently contributing to over 31% of the national savings and over 40% of the Gross Domestic product supporting over 60% of the nation's population either directly or indirectly(DOCD&M 2011). However, this sector has been faced with various governance challenges.

The study will also help the stakeholders of the sector in formalizing governance policies (codes and guidelines), improve functioning of the board of directors and relations with executive management, strengthening of shareholder rights, improving the control environment, improve the process of transparency and disclosure of information and ensuring the sustainability of the SACCOs. Proper management of these institutions will also ensure their profitability and growth.

## **CHAPTER TWO: LITERATURE REVIEW**

### **2.1. Introduction.**

Corporate governance has dominated policy agenda in developed market economies for more than a decade and it is gradually warming its way to the top of the policy agenda on the African continent (Berglof and von Thadden, 1999). This chapter therefore reviews broadly the theoretical, conceptual and empirical aspects of corporate governance and delves into the various theories upon which this study is based.

### **2.2 Theoretical Foundation**

A theoretical framework is a collection of interrelated concepts. Various theories have been reviewed with regard to corporate governance. These theories are agency theory, stakeholders and resource dependency theory, stewardship theory, social contract theory, legitimacy theory and political theory.

#### **2.2.1 Agency Theory**

Corporate governance has traditionally been associated with the principal-agent or agency problem. Berle and Means (1932) explains that principal-agent relationship arises when the person who owns a firm is not the same as the person who manages or controls it. For example, investors or financiers (principals) hire managers (agents) to run the firm on their behalf. Investors need managers' specialized human capital to generate returns on their investments, and managers may need the investors' funds since they may not have enough capital of their own to invest. In this case there is a separation between the financing and the management of the firm, i.e. there is a separation between ownership and control.

Agency theory suggests that employees or managers in organizations can be self-interested. The agency theory shareholders expect the agents to act and make decisions in the principal's interest. Jensen and Meckling (1976), further argues that agency theory revolves around an individual referred to as the principal who hires another individual

(the agent) and delegates decision making authority to the agent. A Sacco, being an artificial person, interacts and enters into contracts with other entities. The entities could be: suppliers; creditors; employees and the government among others. This brings about an agency relationship between the Sacco and the entities.

### **2.2.2 Stakeholder Theory**

This theory centers on the issues concerning the stakeholders in an institution. It stipulates that a corporate entity invariably seeks to provide a balance between the interests of its diverse stakeholders in order to ensure that each interest constituency receives some degree of satisfaction (Abrams, 1951). Stakeholder theory has become more prominent because many researchers have recognized that the activities of a corporate entity impact on the external environment requiring accountability of the organization to a wider audience than simply its shareholders. For instance, Donaldson & Davis (1991) proposed that companies are no longer the instrument of shareholders alone but exist within society and, therefore, has responsibilities to that society. One must however point out that large recognition of this fact has rather been a recent phenomenon.

### **2.2.3 Stewardship Theory**

In contrast to agency theory, stewardship theory presents a different model of management, where managers are considered good stewards who will act in the best interest of the owners (Donaldson & Davis 1991). According to Smallman (2004) where shareholder wealth is maximized, the steward's utilities are maximized too, because organizational success will serve most requirements and the stewards will have a clear mission. He also states that, stewards balance tensions between different beneficiaries and other interest groups. Therefore stewardship theory is an argument put forward in firm performance that satisfies the requirements of the interested parties resulting in dynamic performance equilibrium for balanced governance.

Clarke (2004) however takes a more relaxed view of the separation of the role of chairman and CEO, and supports appointment of a single person for the position of

chairman and CEO and a majority of specialist executive directors rather than non-executive directors.

### **2.3 Corporate Governance**

The concept of corporate governance is poorly defined because it potentially covers a large number of distinct economic phenomenon. As a result different people have come up with different definitions that basically reflect their special interest in the field. Therefore, the best way to define the concept is perhaps to list a few of the different definitions rather than just mentioning one definition.

Deakin and Slinger, (1997) defines it as a concept concerned with the relationship between the internal governance mechanisms of corporations and society's conception of the scope of corporate accountability. They note that it should be viewed to include “the structures, processes, cultures and systems that engender the successful operation of the organizations”. Corporate governance is also seen as the whole set of measures taken within the social entity that is an enterprise to favour the economic agents to take part in the productive process, in order to generate some organizational surplus, and to set up a fair distribution between the partners, taking into consideration what they have brought to the organization (Maati, 1999). The Cadbury Committee (Cadbury, 1992, p. 15) defines corporate governance as “the system by which companies are directed and controlled”.

According to Claessens (2002), corporate governance is seen as the process and structure used to direct and manage the business affairs of the company towards enhancing business prosperity and corporate accountability with the ultimate objective of realizing long-term shareholder value, whilst taking into account the interest of other stakeholders. His argument replicated by Monks and Minnow (2003) who describe corporate governance as the structure that is intended to make sure that the right questions get asked and that checks and balances are in place to make sure that the answers reflect what is best for the creation of long term, sustainable value.

Though the CG codes, regulations and practices may vary from country to country, according to the Millstein Report (1998), there are four core principles of corporate governance: fairness, transparency, accountability and responsibility.

Fairness is by ensuring the protection of shareholder rights and the equitable treatment of all shareholders while transparency is by the timely and quality disclosure of adequate, clear and comparable information concerning corporate performance, governance and ownership (OECD, 2004).

In Kenya, some related research has been carried out with some findings of interest. Agumba (2008) asserted that in SACCOS the governance is concerned with allocation of power and authority between the clients, the board, committee and management. He noted that the governance in SACCOS focuses on four areas which are leadership, stewardship, monitoring and reporting where the six governance models which are democratic or association perspective, agency theory (a compliance model), stewardship theory (a partnership model), resource dependency theory (a co-optation model), stakeholder theory (a stakeholder model) and managerial hegemony theory (a rubber stamp) models are applied. He summarized that application of these theories and models in SACCOS are related with good credits risks management practices and fosters the SACCOS' performance. For examples if SACCOS' management acts as leaders and stewards, they will make sure loans are issued according to regulations and are collected and repaid according to contracts and by doing so they promote the effective credit risks management in the SACCOS.

From the above definitions, it may be stated more generally that different systems of corporate governance will embody what are considered to be legitimate lines of accountability by defining the nature of the relationship between the company and key corporate constituencies. Additionally, proponents of corporate governance say there's a direct correlation between good corporate governance practices and long-term shareholder value. There's no uniform set of governance practices. The right-sized ones (those that comply with legal requirements and meet the company's particular needs) depend on such factors as the company's business, size, and stage of development, resources, shareholder expectations, and legal and regulatory requirements.

## **2.4 Savings and Credit Co-operatives (SACCOs)**

Savings and Credit Co-operatives (SACCOs) are mutual institutions providing saving and loan services to their members, (Mudibo 2005). They comprise legal entities owned and democratically controlled by their members. KUSCCO has defined a co-operative as an autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs based on the values of self help, self responsibility, democracy, equality, and solidarity. The Co-operative Societies (Amendment) Act (2004) explicitly states that co-operative members must have a "common bond" in order for their registration to be accepted. The common bond refers to being in a particular occupation from which one's contributions can be channeled to the SACCO through a payroll system. SACCOs membership is open to all and the management board is elected after every three years in an Annual General Meeting to form the Central Management Committee charged with the overall governance of the SACCO affairs.

According to the World Council of Credit Unions, (WOCCU) (2002), the first credit society was started in 1850 in what is now Germany. By 1888 there were 425 credit unions in Germany, and by 1909 there were 735 in Italy. Credit unions are now prospering in all five continents. There are more than 200,000 credit unions operating in 89 countries. International Co-operative Alliance (ICA 2006) statistical analysis indicate that the co-operative movement brings together over 800 million people around the world.

Co-operatives are also significant economic actors in national economies: In Brazil, co-operatives are responsible for 72% of the wheat production, 44% of barely and 43% of soya among others and Agricultural co-operatives exported over USD 1.3 billion. Canadian maple sugar co-operatives produce 35% of the world's maple sugar production. In Côte d'Ivoire co-operatives invested USD 26 million for setting up schools, building rural roads and establishing maternal clinics. In Australia, Credit Unions encourage members to save money together and pooled resources are then used to provide low-cost loans to members (Turner, 2006). They operate within a clearly defined area of location

and a mutual link must exist between all members. This link is known as the common bond of the credit union. The common bond may be based on all members living in the same locality or all members working for the same employer. The credit union members elect a voluntary board of directors to manage the credit union on their behalf. The aims of a credit union are multiple. There is a mixture of financial and social aims. The financial aims can be broadly summarized as to; promote thrift by encouraging members to save regularly, provide loans to members at a reasonable rate of interest and to assist members to make more effective use of their financial resources.

A SACCO does not seek to make profits as its main objective. Equally, it is not a charity, which means members have to demonstrate their ability to save regularly before being considered for a loan, (Mudibo 2005). Credit unions aim to provide a service to their members. Thus, although a SACCO is very different from a bank, the two types of organizations are potentially in competition in the areas of savings and loans. The World Council of Credit Unions (WOCCU) estimates that the Kenyan SACCO sector is the largest in Africa; in 2005, SACCOs had an estimated membership of more than 2.5 million, share capital and deposits of US\$1.66 billion, and a loan portfolio of US \$1.24 billion (WOCCU 2005)

## **2.5 Empirical studies on corporate governance practices and firm performance**

There has been an exponential increase in the number of publications dealing with corporate governance and firm performance. Proponents of corporate governance say there is a direct correlation between good corporate governance practices and long-term shareholder value. In its 'Global Investor Opinion Survey' of over 200 institutional investors first undertaken in 2000 and updated in 2002, IMF found that 80% of the respondents would pay a premium for well-governed companies. They defined a well-governed company as one that had mostly out-side directors, who had no management ties, undertook formal evaluation of its directors, and was responsive to investors' requests for information on governance issues

Studies have shown that there are various benefits associated with good corporate governance practices. Good corporate governance shields a firm from vulnerability to future financial distress (Bhagat and Black, 2002). The argument has been advanced repeatedly that the governance structure of any corporate entity affects the firm's ability to respond to external factors that have some bearing on its financial performance (Donaldson, 2003). Again, poorly governed firms are expected to be less profitable. Claessens, et.al. (2002) also posit that better corporate framework benefits firms through greater access to financing, lower cost of capital, better financial performance and more favorable treatment of all stakeholders. External investors consider corporate governance as a significant factor which affects their investment decisions, because appropriate governance structures reduce risks and promote performance . The governance structures that are considered in this study are board size, board composition and board committees.

### **2.5.1 Board Size and firm performance**

Previous studies conducted have found out that board size play a role in performance of businesses. It is argued that although larger board size initially facilitates key board functions, there comes a point when larger boards suffer from coordination and communication problems and hence board effectiveness and firm performance declines (Lipton and Lorsch, 1992; and Jensen, 1993). Lipton and Lorrch (1992) argue that a board size of eight to nine directors is optimal, while Jensen (1993) argues that the optimum board size should be around seven or eight.

Locally some studies have been carried out. Wambua (2011) conducted a study on the effects of corporate governance on the financial performance of Sacco's in Kenya. The study found that 59% of the respondents indicated that the board size and composition affected the financial performance in the Sacco to a little extent. Wasike (2012) also conducted a study corporate governance practices and performance at Elimu Sacco in Kenya. The study concluded that the corporate governance helped in defining the relation between the SACCO and its general environment, the social and political systems in which it operates and also linked the way management and control were organized thus affecting the performance of the SACCO and its long run competitiveness.

### **2.5.2 Board composition and firm performance**

The composition of the board in this research refers to the proportion of inside or executive and outside directors or non-executive directors serving on the board. The distinction between the roles of inside and external directors is important, because the latter bring in specific advantages and disadvantages. Access to inside information by the inside directors is as important as the expertise and objectivity of the outside directors in evaluating managers decisions. Best practice recommendations on corporate governance require boards to be composed of a majority of non-executive directors (Cadbury 1992; Hampel 1998; OECD 1999). These recommendations were also incorporated in the code of best practice on corporate governance in Sri Lanka, because investors consider boards composed of non-executive directors as an important determinant of firm performance.

A number of studies in the past, which aimed at establishing the effect of non-executive directors on the success or failure of firms, have examined the board composition and its impact on firm. Empirical evidence on independent non-executive directors and firm performance have found a majority of non-executive directors improved performance (Donaldson 2003). Wambua (2011) in his study found out that the number of non-executive directors affected the performance of the Sacco a great extent as was shown by a mean of 4.20.

### **2.5.3 Board Sub-Committees and firm performance**

Board committees are an important component of the board structure in affecting firm performance. The areas considered important are the quality of financial reporting, director remuneration and appointment of directors (Spira & Bender 2004). Therefore, the Cadbury Committee (1992) recommended establishing oversight committees for remuneration of executive directors, the auditing of financial statements and appointment of directors, initiatives supported by agency theory, because independent monitoring alleviates agency problems. They considered board committees were an additional control mechanism that increased accountability and ensured the interests of the shareholders were safeguarded.

The establishment of board committees is expected to have a positive influence on the motivation of the directors and provide confidence in the financial reports of the firm. (Spira & Bender 2004) reported that the companies, which introduced board committees to the board structure, performed better than those without them, and showed a significant improvement in firm performance by firms which have introduced audit and remuneration committees. Given the recommendation in the codes of practice, monitoring by board sub committees is expected to have a positive influence on firm performance. In Kenya a study conducted by Ademba (2006) reported that the FOSAs, which experienced frauds, were the same that neither had a signed code of ethics nor had established board audit committee.

## **CHAPTER THREE: RESEARCH METHODOLOGY**

### **3.1 Introduction**

This chapter discusses the research methodology that was used to carry out the study. It covers the research design, data collection and data analysis methods that will be used in the study.

### **3.2 Research Design**

This research employed descriptive research approach, which is a correlation study that will examine the relationship between Corporate Governance Variables i.e., Board size, (BS), Board Composition (BC), Board Sub-Committees (BSC) and performance i.e., Return on Assets (ROA) of SACCOs within Nairobi County. Descriptive research portrays an accurate profile of persons, events or situation (Robson, 2002). Surveys allow the collection of large amount of data from sizable population in highly economical way.

It allows one to collect quantitative data, which will be analyzed quantitatively using descriptive and inferential statistics (Sanders et al 2007). Therefore the descriptive survey was deemed the best strategy to fulfill the objectives of this study. Descriptive Research is the investigation in which quantity data is collected and analyzed in order to describe the specific phenomenon in its current trends, events and linkages between different factors at the current time. Descriptive research design was chosen because it enables the researcher to generalize the findings to a larger population.

### **3.3 Population**

According to population to Cooper and Schindler (2000), a population is a total collection of elements about which to make inferences. The population under this study was of similar characteristics which totalled to 127 of these SACCOs.

### **3.4 Sampling**

There were a total of 127 of Deposit Taking SACCOs in the whole of Kenya according to SASRA. Of this number, the study focused only on those within Nairobi County which number 35 (Thirty five) in all. This was therefore a census study of all the Deposit Taking SACCOs in Nairobi County.

### **3.4 Data Collection Methods**

Data was collected both from primary and secondary sources. Primary data was collected using a structured questionnaire administered to the Chief Executive Officers of the SACCOs which enabled the researcher to collect quantitative data. Secondary data was obtained from annual reports of the respective SAACOs filed with SASRA since its inception including publications from the department of Co-operative Development and Marketing, WOCCU, ICA and KUSCCO, and other publications from the Internet.

### **3.5 Data Analysis**

The data analysis method was by both descriptive statistics and inferential statistics. The result was computed using SPSS version 17 for windows. Multiple regression analysis was used in order to establish whether the set of independent variables (Corporate Governance variables, on one hand) explain a proportion of the variance in the dependent variable ( financial performance variables, on the other hand) and also establish the relative descriptive importance of the independent variables (by comparing beta weights) . The multi-variate regression will be computed using SPSS version 17.

## CHAPTER FOUR

### DATA ANALYSIS, PRESENTATION AND INTERPRETATION

#### 4.1 Introduction

This chapter presents the outcome of data analysis and findings in line with the objectives of the Study. The data was analyzed using the Statistical Program for Social Sciences (SPSS) version 17, by use of both descriptive and inferential statistics. Descriptive statistics such as mean, median, maximum, minimum, standard deviation, Skewness and Kurtosis were used. The regression model was preceded by diagnostic tests.

#### 4.2 Descriptive Statistics

Table 4.1 gives the summary statistics of the main variables that have been included in the model including: minimum, maximum, mean, standard deviation, skewness, kurtosis and Jarque-Bera test for normality.

**Table 4.1: Descriptive Statistics Results**

	ROA	Tobin's Q	Board Size	Board independence	Gender	Board committee	Size	Age
Mean	0.11	1.53	8.00	0.4994	2.043	3.319	391.64	13.44
Median	0.12	1.22	9.00	0.913	0.646	1.213	36.97	12.00
Maximum	0.38	7.35	12.00	0.312	4.831	4.183	8,881.52	37.00
Minimum	-0.47	0.43	7.00	0.191	0.000	1.224	0.91	0.00
Std. Dev.	0.12	1.07	2.62	0.331	0.078	0.238	6.71	9.44
Skewness	0.453	0.651	0.045	0.829	0.9979	0.698	0.787	0.877
Kurtosis	2.045	3.004	2.034	3.223	3.567	2.314	3.312	3.456
Jarque-	6.754	5.523	4.582	13.311	20.416	11.488	10.474	12.41

Bera								3
Observations	315	315	315	315	315	315	315	315

Table 4.1 above reports summary statistics for the sample, ROA is the ratio of operating profit before depreciation and provisions divided by total assets. Tobin's Q is book value of total assets plus market value of equity minus book value of equity divided by book value of total assets. The results showed that board size had a mean of 8.00 with a minimum of 7.00, a maximum of 12.00, skewness 0.045 and kurtosis of +2.034. Comparatively, Board independence had a mean of .4994, minimum of .312, maximum of .191, skewness of 0.829 and kurtosis of +3.223. Gender had a mean of 2.043, minimum of 0.000, maximum of 4.831, skewness of 0.698 and kurtosis of +3.567. Board committee had a mean of 3.319, minimum of 1.224, maximum of 4.183, skewness of 0.698 and kurtosis of +2.314.

Analysis of skewness shows that all the variables are asymmetrical to the right around its mean. Additionally, 'gender and board independence' are highly peaked compared to other regressors. Jarque-Bera is a test statistic for testing whether the series is normally distributed. It measures the difference of the skewness and kurtosis of the series with those from the normal distribution using the null hypothesis of a normal distribution. A small probability value leads to the rejection of the null hypothesis of a normal distribution. Jarque-Bera test for normality shows that all variables are normally distributed.

#### 4.2.1: Corporate governance practices

The respondents were asked to indicate the extent to which they agreed or disagreed with statements on corporate governance practices in Deposit Taking SACCOs in Nairobi County. The results from the analysis of the findings are indicated in the table

**Table 4.2: Corporate governance practices**

Corporate governance practices		
	Mean	Std. Dev.
Corporate governance goes beyond simply establishing a clear relationship between shareholders and managers	4.32	0.845
Stock exchange listing rules are shaped by prevailing systems of corporate governance	3.98	0.716
Accounting standards shapes the prevailing systems of corporate governance.	4.52	0.458
Corporate governance describes how companies ought to be run, directed and controlled	4.15	0.325
Corporate governance facilitates companies' access to capital for long-term investment	4.65	0.984
Corporate governance ensures that shareholders and other stakeholders who contribute to the success of the corporation are treated fairly.	4.49	0.421

From the findings in the SPSS analysis, the statement, corporate governance facilitates companies' access to capital for long-term investment had the highest level of mean (4.65) meaning that majority of the respondents concurred that corporate governance facilitates companies' access to capital for long-term investment. The standard deviation calculated from the analysis of 0.984 indicated uniformity in the responses from the respondents. Also noted was that a great number of the respondents agreed that accounting standards shapes the prevailing systems of corporate governance. This was

supported by the mean value calculated of 4.52. A significant number of the respondents agreed to the statement; corporate governance ensures that shareholders and other stakeholders who contribute to the success of the corporation are treated fairly; this was inferred from the mean value calculated in the analysis of 4.49. The standard deviation of 0.421 calculated in the SPSS indicated that majority of the respondents were of a similar opinion. Generally it was clear that corporate governance best practices are essential for the performance of deposit taking savings and credit co-operative societies in Nairobi City County.

#### **4.2.2: Governance practices on performance of SACCOs**

The study sought to establish the effect of governance practices on performance of Deposit Taking SACCOs. The results from the analysis of the findings are illustrated in the table 4.3 as shown.

<b>Governance practices</b>		
	Mean	Std. Dev.
Good governance practices are essential to the safe and sound operations of Credit Unions	4.26	0.21
good governance ensures that there are clearly defined roles and responsibilities to the board of directors	4.33	0.48
Transparency, Integrity and accountability are the three pillars of effective corporate governance practices.	3.98	0.79
Similar guidelines that apply to listed companies are also be applicable to SACCOs	4.79	1.09
There is a direct correlation between good corporate governance practices and long-term shareholder value	4.04	0.5489

Based on the responses from the respondents, it was clear that most respondents saw that governance practices influence performance of deposit taking savings and credit corporative societies. This inference was realised by responses of statements relating to governance practices in the respondents. It was established from the analysis that most respondents strongly agreed on the statement; similar guidelines that apply to listed companies are also be applicable to SACCOs. This was established by the high mean value calculated of 4.79. The standard deviation calculated of 1.09 indicates uniformity in the responses from the respondents. It was also established that good governance ensures that there are clearly defined roles and responsibilities to the board of directors. This was seen true by the high mean value calculated in the spss analysis of 4.33. The standard deviation calculated in the analysis of 0.48 indicated little variance from the mean mark in the responses. It was also established that good governance practices are essential to the safe and sound operations of Credit Unions. This was seen true by the high mean value calculated in the spss analysis of 4.26. The standard deviation calculated in the analysis of 0.21 indicated uniformity in the responses from the respondents. Generally it was noted from the analysis of the findings that governance practices influence the performance of Deposit Taking savings and credit co-operatives societies in Nairobi.

### **4.3 Diagnostic Tests for Regression Assumptions**

The preferred regression model was subjected to a number of diagnostic tests to evaluate the validity of the model. The diagnostic tests included: Breusch-Pagan test for heteroskedasticity and White Heteroskedasticity Test (LM) for constant variance of residual over time, the ARCH (Autoregressive conditional heteroscedasticity) test which detects the problem of heteroscedasticity and Ramsey RESET test for the specification of the regression. Further regression and correlation analysis were used to establish the relationship between the independent and the dependent variables. Control variables i.e. age and size of the firm were incorporated to determine the changes in coefficient of determination ( $R^2$  change). The results were presented in Table 4.2 below.

**Table 4.3: Diagnostic Tests**

Test	F-statistics	Probability
Ramsey RESET Test:	1.760507	0.163014
White Heteroskedasticity Test:	2.125333	0.079932
ARCH Test:	1.185552	0.324352
Breusch-Pagan Test for Heteroskedasticity LM Test:	1.12472	0.573265

Table 4.2 shows that the parameters of the regression analysis were stable and the model can be used for estimation at 5 percent confidence level. The Ramsey RESET Test for model specification, ARCH Test and White Heteroskedasticity Test for constant variance of residuals and Breusch-Godfrey Serial Correlation LM Test for serially correlated residuals used the null hypothesis of good fit (specification, heteroskedasticity, and non-auto correlated against the alternative hypothesis of model mis-specification, heteroskedasticity, and auto correlated respectively. All the probability values were less than F-statistics coefficients at 5 percent level of significance and therefore the null hypothesis was not rejected. The diagnostic test outcomes were therefore satisfactory.

#### **4.4 Pearson's Correlation Coefficient**

Correlation analysis was used to measure the degree of association between different variables under consideration. In this section, the study measured the degree of association between the corporate board structure variables and firms financial performance i.e. if the board structure proxies (board size, board independence, and gender and board committee) and firm's financial performance. From the a priori stated

in the previous chapter, a positive relationship is expected between the measures of corporate board structure and firms financial performance. Table 4.3 and 4.4 presents the correlation coefficients for all the variables considered in this study.

**Table 4.4: Correlation Analysis Results**

		<b>Board independence</b>	<b>Board size</b>	<b>Gender</b>	<b>Board committee</b>	<b>ROA</b>
<b>Board independence</b>	<b>Pearson Correlation</b>	<b>1</b>				
	<b>Sig. (2-tailed)</b>					
	<b>N</b>	<b>315</b>				
<b>Board size</b>	<b>Pearson Correlation</b>	<b>.624(**)</b>	<b>1</b>			
	<b>Sig. (2-tailed)</b>	<b>.000</b>				
	<b>N</b>	<b>315</b>	<b>315</b>			
<b>Gender</b>	<b>Pearson Correlation</b>	<b>-.447(**)</b>	<b>.409(**)</b>	<b>1</b>		
	<b>Sig. (2-tailed)</b>	<b>.000</b>	<b>.001</b>			
	<b>N</b>	<b>315</b>	<b>315</b>	<b>315</b>		
<b>Board committee</b>	<b>Pearson Correlation</b>	<b>.528(**)</b>	<b>-.496(**)</b>	<b>-.225</b>	<b>1</b>	
	<b>Sig. (2-tailed)</b>	<b>.000</b>	<b>.000</b>	<b>.076</b>		

	<b>N</b>	<b>315</b>	<b>315</b>	<b>315</b>	<b>315</b>	
<b>ROA</b>	<b>Pearson Correlation</b>	<b>.669(**)</b>	<b>.657(**)</b>	<b>.132(**)</b>	<b>.453(**)</b>	<b>1</b>
	<b>Sig. (2-tailed)</b>	<b>.000</b>	<b>.000</b>	<b>.032</b>	<b>.005</b>	
	<b>N</b>	<b>315</b>	<b>315</b>	<b>315</b>	<b>315</b>	<b>315</b>

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

Source: computed by researcher using data extracted from annual reports of Licensed SACCCOs at SASSRA.

From the correlation result for the study model in table 4.3, board independence has a strong positive correlation with ROA (.669, p=.000), the study further indicated that board size has also a strong and positive relationship with ROA (.654, p=0.000). The study also indicated that gender has a weak insignificant relationship with ROA (.132, p=0.32). Further the results indicates that board committee has a moderate and significant relationship with ROA (.453, p=0.21). This implies that board independence and board size influences performance of firms strongly, board committee influences firm performance to a moderate extent whereas gender has insignificant influence on firm's financial performance.

#### 4.5 Regression Analysis

Regression analysis was used to determine the impact of the corporate board structure variables on firms' financial performance.

**Table 4.5: Regression Coefficients of the Corporate Board Structure Variables and Firm's Financial Performance Indicators**

	<b>Unstandardized Coefficients</b>		<b>Standardized Coefficients</b>		
	B	Std.	Beta	T	Sig.

		Error			
<b>(Constant)</b>	7.13	0.443		4.335	.000
Board size	0.444	0.254	0.021	3.993	.000
Board independence	0.738	0.262	0.022	3.446	.002
Gender	0.612	0.372	0.038	4.937	.000
Board committees	0.223	0.242	0.032	1.931	.003

*Source: Research Findings*

The regression model

$$ROA = \alpha + \beta_1 (BS) + \beta_2 (BI) + \beta_3 (G) + \beta_4 (BC) + \varepsilon_i$$

$$\text{Becomes } ROA = 7.13 + 0.444BS + 0.738 BI + 0.612 G + 0.223 BC$$

According to the regression equation established, taking all factors into account (board size, board independence, gender and board committee financial performance measured by ROA is 7.13. The Standardized Beta Coefficients give a measure of the contribution of each variable to the model. A large value indicates that a unit change in this predictor variable has a large effect on the criterion variable. The t and Sig (p) values give a rough indication of the impact of each predictor variable – a big absolute t value and small p value suggests that a predictor variable is having a large impact on the criterion variable. At 5% level of significance and 95% level of confidence, board size had a 0.000 level of significance, board independence had a 0.002 level of significance, gender had a 0.000 level of significance and board committees had a 0.003 level of significance.

#### **4.5.1 Regression Model Summary**

From the results shown in Table 4.5, the model shows a goodness of fit as indicated by the coefficient of determination ( $R^2$ ) with a value of 0.7338. This implies that the independent variables gender of the board of directors; Board independence, board size and board committee explain 73.38 percent of the variations of financial performance of deposit taking savings and credit companies in Kenya.

The study therefore identifies gender of the board of directors; Board independence, gender distribution and board committee as critical factors for enhancing financial performance deposit taking savings and credit companies in Kenya

Table 4.6: Regression Model Summary of Corporate Board Structure Variables and Financial Performance Indicators

<b>Model Summary</b>				
<b>Model</b>	<b>R</b>	<b>R Square</b>	<b>Adjusted R Square</b>	<b>Std. Error of the Estimate</b>
<b>1</b>	0.8566	0.7338	0.7011	0.7638

*Source: Research Findings*

Predictors: (Constant), gender of the board of directors; Board independence, board size and board committee.

The study then incorporated in the effect of control variables i.e. age of the firm and size of the firm. The results are summarized in Table 4.6.

**a) The Goodness-of-fit**

**Table 4.7: Regression Results**

**a) The Goodness-of-fit**

		<b>R</b>	<b>R Square</b>	<b>Std. Error of the Estimate</b>	<b>Change Statistics</b>				
					<b>R<sup>2</sup> Change</b>	<b>F Change</b>	<b>Df 1</b>	<b>Df 2</b>	<b>Sig. F Change</b>
1	.653(a)	0.85	0.7338	.0358	.730	19.241	3	2	.000
		6							
2	.873(b)	.901	.811	.0234	.081	31.554	1	2	.000

Predictors

- a. Gender of the board of directors; Board independence, board size and board committee.

The results in Table 4.6 show that corporate board structure explain 73% of the variation in firms financial performance ( $R^2 = .7330$ ). At step 2, age and size of the firm adds

significantly to the corporate board structure towards firms financial performance as the variation increased from .730 to .811 ( $R^2$  change=.081 p-value=.000). The results reveal that the variance explained by age and size of the firm as control variables is significant ( $F=12.313$ , p-value=.001). The results revealed that the regression coefficients for corporate board structure increased from .653 to .873 when age and size of the firm were added to the regression suggesting that age and size of the firm are exerting a strong control effect.

**Table 4.8: Analysis of Variance (ANOVA)**

	Sum of Squares	df	Mean Square	F	F-statistics	Significance
Regression	52.55	4	14.93	18.33	88.33	0.00
Residual	3.34	19	4.22			
Total	55.89	23				

**NB:** F-critical Value 88.33 (statistically significant if the F-value is less than 88.33: from table of F-values).

- a. **Predictors: (Constant)**, board size, board independence, gender and board committee.

The value of the F statistic, 18.33 indicates that the overall regression model is significant hence it has some explanatory value i.e. there is a significant relationship between the predictor board size, board independence, gender and board committee (taken together) and financial performance of deposit taking savings and credit co-operative societies.

#### **4.5.2: Five year analysis on performance**

The study gave a five analysis of the financial performance of the Deposit taking savings and credit co-operative societies. The results from the analysis are illustrated in the table 4.9 as shown

**Table 4.9: Financial performance**

<b>Year</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>
<b>EBIT (000)</b>	3,212	3,561	3,672	3,995	4,071
<b>Total Assets (000)</b>	70,837	82,739	77,379	89,748	92,849

From the analysis of the findings it was noted that averagely there was progressive increase in the earnings before interest rates (EBIT) from 3.212 million in 2011 to 4.071 million in 2014. The total assets were noted to progressively increase from 70.837 million in 2010 to 92.849 million in 2014.

#### **4.6 Chapter Summary**

This chapter presented data analysis and interpretation, Descriptive statistics such as mean, median, maximum, minimum, standard deviation, Skewness and Kurtosis were used. The regression model was preceded by diagnostic tests of regression assumption which included the Ramsey RESET Test for model specification, ARCH Test and White Heteroskedasticity Test for constant variance of residuals and Breusch-Godfrey Serial Correlation LM Test for serially correlated residuals used the null hypothesis of good fit (specification, heteroskedasticity, and non-autocorrelated against the alternative hypothesis of model mis-specification, heteroskendasticity, and autocorrelated respectively. Further correction and regression analysis were performed to determine if the variables were significant in explaining the dependent variable financial performance. ANOVA was also used to determine if the model has explanatory value i.e. the influence of the independent variables on the dependent variable.

## **CHAPTER FIVE**

### **SUMMARY, CONCLUSION AND RECOMMENDATIONS**

#### **5.1 Introduction**

This chapter summarizes the study and makes conclusion based on the results. The implications from the findings and areas for further research are also presented. This section presents the findings from the study in comparison to what other scholars have said as noted under literature review.

#### **5.2 Summary**

The main objective of the study was to establish the effect of corporate governance best practices on financial performance of deposit taking SACCOs in Nairobi County. Therefore a descriptive research design was used to study whether there is an effect of corporate board structure on financial performance of deposit taking SACCOs. The population of interest in this study constituted deposit taking savings and credit co-operative societies within Nairobi County for the period of five years from 2010 to 2014. Secondary financial data sources was used for the study, where annual financial reports of individual SACCOs was used over the five year period where profitability was extracted and used as a measure of financial performance.

The findings showed that corporate governance best practices variables considered in the model are significantly associated with financial performance as indicated by the positive mean values and their respective standard deviations. From skewness, the study observed that all the variables are positively skewed which clarified that the variables are asymmetrical. Skewness value of all the variables is very near to zero so it is relatively symmetrical. Kurtosis values indicated that all variables have platy-kurtic distribution and it is concluded that variables are normally distributed.

The descriptive statistics of the variables used in the analysis of the sample was very crucial for the study. The study presents the descriptive statistics of the variables used in the analysis: gender of the board of directors; Board independence, board size, board committee and return on asset ratio (ROA). The findings show that corporate board structure is significantly associated with SACCOs' financial performance as indicated by the positive mean values and their respective standard deviations. From skewness, the study revealed that all the variables are positively skewed which clarified that the variables are asymmetrical. Skewness value of all the variables is very near to zero so it is relatively symmetrical. Kurtosis values indicated that all variables have platy-kurtic distribution and it is concluded that variables are normally distributed.

The study further determined the correlation between the independent variables used in the study i.e. corporate governance best practices variables and firms financial performance indicators. For this analysis Pearson correlation was used to determine the degree of association within the independent variables and also between independent variables and the dependent variable. The analysis of these correlations seems to support the hypothesis that each independent variable in corporate board structure has its own particular informative value in the ability to explain firm's financial performance. The significance of the coefficients was calculated at the level of 95%. The study findings indicate that corporate governance best practices i.e. board independence, board size and board committee are statistically significance to firms' financial performance indicators as indicated by the positive and strong Pearson correlation coefficients whereas gender is statistically insignificant with financial performance indicators as indicated by their weak Pearson correlation coefficients. This implies that gender distribution may not influence financial performance of deposit taking SACCOs in Nairobi County.

According to the regression equation established, taking all factors into account (gender of the board of directors; Board independence, board size and board committee financial performance measured by ROA will be 7.13. The Standardized Beta Coefficients gave a measure of the contribution of each variable to the model. A large value indicated that a unit change in this predictor variable has a large effect on the criterion variable. The t and

Sig (p) values gave a rough indication of the impact of each predictor variable – a big absolute t value and small p value suggests that a predictor variable is having a large impact on the criterion variable.

From the results, the model showed a goodness of fit as indicated by the coefficient of determination  $R^2$  (0.7338). This implies that the independent variables gender of the board of directors; Board independence, board size and board committee explain 73.38 percent of the variations of financial performance of deposit taking SACCOs in Nairobi County.

Further the study carried out the hypothesis testing between corporate governance best practices variables and financial performance. A Pearson coefficient measure showed a strong, significant, positive relationship between corporate board structure and financial performance of deposit taking SACCOs in Nairobi County. Therefore basing on these findings the study rejected the null hypothesis that there is no relationship between corporate governance best practices and financial performance of companies deposit taking SACCOs in Nairobi County and accepted the alternative hypothesis that there exists a relationship between corporate board structure and financial performance of deposit taking SACCOs in Nairobi County.

### **5.3 Conclusion**

The analysis of the correlations results seemed to support the hypothesis that each independent variable in corporate governance best practices has its own particular informative value in the ability to explain financial performance. The significance of the coefficients was calculated at the level of 95%. The study findings indicate that corporate governance best practices variables i.e. gender, board independence and board committee are statistically significant to firms' financial performance indicators as indicated by the positive and strong Pearson correlation coefficients whereas gender is statistically insignificant with financial performance indicators as indicated by their weak Pearson correlation coefficients.

According to the regression equation established, taking all factors into account (gender of the board of directors; Board independence, board size and board committee, financial performance measured by ROA will be 7.13. A Pearson coefficient measure showed a strong, significant, positive relationship between corporate governance best practices and financial performance of deposit taking SACCOs in Nairobi County. Therefore basing on these findings the study rejected the null hypothesis that there is no relationship between corporate governance best practices and financial performance of deposit taking savings and credit co-operatives and accepted the alternative hypothesis that there exists a relationship between corporate governance best practices and financial performance of deposit taking SACCOs in Nairobi County.

The findings showed that corporate governance best practices variables considered in the model are significantly associated with financial performance as indicated by the positive mean values and their respective standard deviations. From skewness, the study observed that all the variables are positively skewed which clarified that the variables are asymmetrical. Skewness value of all the variables is very near to zero so it is relatively symmetrical. Kurtosis values indicated that all variables have platy-kurtic distribution and it is concluded that variables are normally distributed.

#### **5.4 Policy Recommendations**

The study recommends that stakeholders in listed companies should take in to account the corporate governance best practices variables i.e. gender, board size, board independence and board committee when electing board of directors. That is the body should have equal distribution in terms of gender, board size, board committee and board independence to minimize stakeholders conflicts and improve on overall firm performance.

The variables considered in the study explained 73% of the variation in firm financial performance implying that there are other important factors not included in the model and therefore the study recommends that the management should put in to consideration such factors in order to enhance the effectiveness of corporate governance index.

The study also recommends that policy makers should set an index on corporate governance to act as a base to all deposit taking savings and credit co-operative societies so that the efficiency of governance committees can be enhanced. This will create a management momentum among the committees mandated for corporate governance issues.

There should be continuous revision of policies governing the committees on the corporate governance boards so that the ineffective clauses can be improved since the governance index keep on changing as a result of prevailing economic conditions. This will enable policy makers in the sector to decide on the possible best guidelines that will enhance the overall management issues as far as corporate governance is concerned.

### **5.5 Limitations of the Study**

Although this study helped to shed light on the dynamics of corporate governance best practices on financial performance of deposit taking savings and credit co-operative societies, it was subject to a number of limitations. These mainly related to the setup of the study relative to the resources available within the research period. As such the constraints influenced the scale of the study but did not affect the conduct of the research once the design was arrived at.

The data used in the study covered three year period of 2011-2014. The practices of corporate governance are long term and may affect the financial performance of an organization in later years. Thus the result may be different if the covered more than 4 years. Additionally, since the main purpose of this study is to identify the relationship between corporate governance best practices and financial performance of deposit taking savings and credit co-operative societies in Nairobi County, the respondents considered some information sensitive and confidential and thus the researcher had to convince them that the purpose of information is for academic research only and may not be used for any other intentions.

The study focused on a limited number of variables and constructs but firm's financial performance is influenced by many more factors. Other variables can provide additional insights and explanations concerning the performance indicators in the sector.

### **5.6 Suggestions for Further Research**

The study suggests that more studies to be carried out covering a longer sample period and taking in to account the prevailing macroeconomic variables as the control variables since they play major roles in decision making among the board of directors. More studies should also be carried out taking in to account other performance variables such as leverage and Return on equity as opposed to the current study which only considered Return on Assets as a measure of financial performance.

A similar study should also be carried out on relationship between SACCOs financial performance and corporate board structure in Kenya incorporating more corporate governance variables as opposed to the current study which took into consideration only four of these variables.

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## APPENDIX I: QUESTIONNAIRE

### SACCO INFORMATION

Name of the SACCO.....

Sector.....

Position in the SACCO.....

1. Does your SACCO have a governance charter?

i) Yes

ii) No

iii) Not Applicable

2. What is the Size of the board?

i) Less than 5

ii) 5 - 10

iii) 11 – 15

iv) More than 15

3. How many Sub-Committees are there in the board?

i) Less than 3

ii) 3 - 5

iii) More than 5

4. Does the Board and Sub-Committees have clearly defined roles or terms of reference?

i.) Yes

ii.) No

iii.)Not Sure

5. Does the Board as a whole undertake a formal and rigorous annual evaluation of its own performance and that of its Committees?

i.) Yes

ii.) No

iii.)Not Sure

6. Does the SACCO have any kind of mechanism for rotating board members?

i.) Yes

ii.) No

iii.)Not Sure

7. How often are the board members rotated?

i.) Once very year

ii.) Once every two years

iii.)Once every year

iv.)Others

8. Is there a formal process for appointing and removal of directors?

i.) Yes

ii.) No

9. Who makes the recommendations for appointment of the directors?

- i.) Chief Executive Officer
- ii.) Current Board members
- iii.) Shareholders
- iv.) Others (Specify).....

10. Please indicate the minimum academic and professional qualification if any, for appointment of a board member?

- i.) Primary level (KCPE)
- ii.) High School (KCSE)
- iii.) Bachelors degree
- iv.) Others (Specify).....

11. Out of the total number of directors, how many are from outside?

- i) Less than 3
- ii) 3 - 5
- iii) More than 5

12. Is there an independent internal Audit Function?

- i.) Yes
- ii.) No

13. Is the Board Chairman a member of the Board Audit Committee?

- i.) Yes
- ii.) No

14. To whom does the Internal Audit Function report to?

- i.) CEO
- ii.) Audit Committee
- iii.) Both CEO and Audit Committee
- iv.) Head of Finance
- v.) Others (Specify).....

15. Does your CEO also double up as the Chairman of the Board?

- i.) Yes
- ii.) No

16. Please give the following financial information on the performance of your SACCO for the last five (5) years.

<b>Year</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>
Earnings before Interest and Taxes (EBIT)					
Total Assets					

17. Indicate the extent to which you agree or disagree with the following statements on corporate governance practices in your SACCO.

**1= Strongly Disagree 2= Disagree 3= Neutral 4= Agree 5=Strongly Agree**

	1	2	3	4	5
Corporate governance goes beyond simply establishing a clear relationship between shareholders and managers					
Stock exchange listing rules are shaped by prevailing systems of corporate governance					
Accounting standards shapes the prevailing systems of corporate governance.					
Corporate governance describes how companies ought to be run, directed and controlled.					
Corporate governance provides a means to support economic efficiency, sustainable growth and financial stability.					
Corporate governance facilitates companies' access to capital for long-term investment					
Corporate governance ensures that shareholders and other stakeholders who contribute to the success of the corporation are treated fairly.					

18. Indicate the extent you agree or disagree with the following statements on governance practices in relation to the performance of the SACCOs

**1= Strongly Disagree 2= Disagree 3= Neutral 4= Agree 5=Strongly Agree**

	1	2	3	4	5
Good governance practices are essential to the safe and sound operations of Credit Unions					
good governance ensures that there are clearly defined roles and responsibilities to the board of directors					
Transparency, Integrity and accountability are the three pillars of effective corporate governance practices.					
Similar guidelines that apply to listed companies are also be applicable to SACCOs					
There is a direct correlation between good corporate governance practices and long-term shareholder value					

## APPENDIX II

### LIST OF DEPOSIT TAKING SACCOS IN NAIROBI COUNTY

NO.	NAME OF SOCIETY	POSTAL ADDRESS
1.	AFYA SACCO SOCIETY LTD	P.O.BOX 11607 – 00400, NAIROBI.
2.	AIRPORTS SACCO SOCIETY LTD	P.O.BOX 19001 – 00501, NAIROBI.
3.	ASILI SACCO SOCIETY LTD	P.O.BOX 49064 – 00100, NAIROBI.
4.	CHAI SACCO SOCIETY LTD	P.O.BOX 278 – 00200, NAIROBI.
5.	CHUNA SACCO SOCIETY LTD	P.O.BOX 30197 – 00100, NAIROBI.
6.	COMOCO SACCO SOCIETY LTD	P.O.BOX 30135 – 00100, NAIROBI.
7.	FUNDILIMA SACCO SOCIETY LTD	P.O.BOX 62000 – 00200, NAIROBI.
8.	HARAMBEE SACCO SOCIETY LTD	P.O.BOX 47815 – 00100, NAIROBI.
9.	HAZINA SACCO SOCIETY LTD	P.O.BOX 59877 – 00200, NAIROBI.
10.	JAMII SACCO SOCIETY LTD	P.O.BOX 57929 – 00200, NAIROBI.
11.	KENPIPE SACCO SOCIETY LTD	P.O.BOX 314 – 00507, NAIROBI.

12.	KENVERSITY SACCO SOCIETY LTD	P.O.BOX 10263 – 00100, NAIROBI.
13.	KENYA BANKERS SACCO SOCIETY LTD	P.O.BOX 73236 – 00200, NAIROBI.
14.	KENYA POLICE STAFF SACCO SOCIETY LTD	P.O.BOX 51042 – 00200, NAIROBI.
15.	KINGDOM SACCO SOCIETY LTD	P.O.BOX 8017 – 00300, NAIROBI.
16.	MAGEREZA SACCO SOCIETY LTD	P.O.BOX 53131 – 00200, NAIROBI.
17.	MAISHA BORA SACCO SOCIETY LTD	P.O.BOX 30062 – 00100, NAIROBI.
18.	MILIKI SACCO SOCIETY LTD	P.O.BOX 43582-00100, NAIROBI
19.	MWALIMU NATIONAL SACCO SOCIETY LTD	P.O.BOX 62641 – 00200, NAIROBI.
20.	MWITO SACCO SOCIETY LTD	P.O.BOX 56763 – 00200, NAIROBI.
21.	NACICO SACCO SOCIETY LTD	P.O.BOX 34525 – 00100, NAIROBI.
22.	NAFAKA SACCO SOCIETY LTD	P.O.BOX 30586 – 00100, NAIROBI.
23.	NAKU SACCO SOCIETY LTD	P.O.BOX 78355 – 00507, NAIROBI.
24.	NASSEFU SACCO SOCIETY LTD	P.O.BOX 43338 – 00100, NAIROBI.
25.	NATION SACCO SOCIETY LTD	P.O.BOX 22022 – 00400, NAIROBI.
26.	SAFARICOM SACCO SOCIETY	P.O.BOX 66827 – 00800, NAIROBI.

	LTD	
27.	SHERIA SACCO SOCIETY LTD	P.O.BOX 34390 – 00100, NAIROBI.
28.	STIMA SACCO SOCIETY LTD	P.O.BOX 75629 – 00100, NAIROBI.
29.	UFANISI SACCO SOCIETY LTD	P.O BOX 2973-00200, NAIROBI.
30.	UKRISTO NA UFANISI SACCO SOCIETY LTD	P.O BOX 872-00605, NAIROBI.
31.	UKULIMA SACCO SOCIETY LTD	P.O.BOX 44071 – 00100, NAIROBI.
32.	UNITED NATIONS SACCO SOCIETY LTD	P.O.BOX 30552 – 00100, NAIROBI.
33.	WANAANGA SACCO SOCIETY LTD	P.O.BOX 34680 – 00501, NAIROBI.
34.	WANANDEGE SACCO SOCIETY LTD	P.O.BOX 19074 -00501, NAIROBI.
35.	WAUMINI SACCO SOCIETY LTD	P.O.BOX 66121 – 00800, NAIROBI.

Source: SASRA website