

**THE RELATIONSHIP BETWEEN AGENCY COSTS AND
FINANCIAL PERFORMANCE OF SACCOS WITH FOSA IN
GITHUNGURI DISTRICT**

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DECLARATION

I declare that this project is my original work and has not been published or submitted as part of any other course at this or any other institution.

Signature_____ Date_____

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D61/70928/2008

This project has been presented for examination with my approval as the University Supervisor.

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Most of all to the almighty God who has brought me this far.

DEDICATION

To my mum-you always told me that I would make it.

ABSTRACT

The “Management Board System” used in the governance of SACCOs makes them have a peculiar kind of leadership in which both the Boards of Directors and the hired management participate in the operational day to day activities of the SACCOs. The directors closely monitor the hired professionals to ensure that their actions are in line with the welfare of the members. The end result is high agency costs in terms of directors’ allowances and other payments. This study aimed at finding out the impact of this close supervision of the agents (managers) by the principals (directors) on the financial performance of SACCOs.

A descriptive research methodology was used. Four SACCOs with FOSA in Githunguri district were targeted and three of the four were included in the study. Data was obtained from the audited financial statements of the SACCOs for the years 2007 to 2011. All expenses relating to the directors were used as proxy for agency costs and return on assets (ROA) used to measure financial performance. The data was analyzed for both correlation and regression and the results tested at 5% level of significance.

The study results did not show any significant relationship between the financial performance of the SACCOs and agency costs when only agency costs were used as the independent variable. After both size and expenditure on marketing were added into the model however, a significant relationship was observed. From the findings of this study, it can be concluded that agency costs alone do not have a significant impact on the financial performance of SACCOs but that interplay between a combination of factors within the SACCOs determine their ultimate financial performance.

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ABBREVIATIONS

AGM	-	Annual General Meeting
ANOVA	-	Analysis of Variance
BOD	-	Board of Directors
BOSA	-	Back Office Service Activities
CEO	-	Chief Executive Officer
CMA	-	Capital Markets Authority
FFCF	-	Founding Family Controlled Firms
FOSA	-	Front Office Service Activities
HID	-	Human Integrated Development
ICA	-	International Co-operative Alliance
MBV	-	Market to Book Value
MOCDM	-	Ministry of Co-operative Development and Marketing
NSE	-	Nairobi Stock Exchange
ROA	-	Return on Assets
SACCO	-	Saving and Credit Co-operative Society
SASRA	-	SACCO Societies Regulatory Authority
SPSS	-	Statistical Package for Social Sciences
UCA	-	Uganda Cooperative Alliance
WOCCU	-	World Council of Credit Unions

CHAPTER ONE

INTRODUCTION

1.1 Background

1.1.1 Saving and Credit Co-operative Societies

The recent past has seen great growth and development in the financial sector. This growth has resulted in an increase in the number players in the sector including commercial banks, non-bank financial institutions, hire-purchase companies, merchant banks, insurance companies, investment advisory firms, security and equity brokerage firms, pension plans, building societies, mortgage finance companies, development finance institutions, and Savings and Credit Co-operative Societies (SACCOs). Of these financial institutions, SACCOs are unique because they are member based micro-finance institutions whose owners are also the users of the services that they offer (Ahimbisibwe, 2007). They are member owned, member used, member controlled and exist for the benefit of members (UCA-Uganda Cooperative Alliance, 2002).

SACCOs are co-operative societies whose objectives are to encourage members to save thereby creating capital which can then be lent to the members at reasonable rates of interest and better lending conditions than other financial institutions. They are associations of people who have come together with a common goal of improving their livelihood economically by mobilizing savings and on-lending the same to the members. Their main objective is to promote thrift amongst the financially weaker sections of the community, and thus enable them put their financial resources to prudent economic use. They convert the weaknesses of members into strengths by adopting the principle of “self-help through mutual co-operation”. By working jointly on the principle of “each for all and all for each”, the members are able accumulate their own funds and use the same to lend amongst themselves without any dependence on outside funding. The funds are lent to members at lower interest rates and better lending conditions than can be found in other financial institutions (Ahimbisibwe, 2007).

Kenya has the largest and the most vibrant SACCO sector in Africa commanding 67% and 62 % of the total assets and deposits/savings respectively in the African continent.

The Kenyan SACCO sub-sector comprises both deposit taking and non deposit taking SACCOs. As at 31st December 2010, there were 5,544 registered SACCOs in Kenya. The total SACCO sub-sector was worth Kshs 210 billion of which deposit taking SACCOs had about Kshs 171 billion. Out of the 3,983 active SACCOs, 218 or 6% have FOSAs (front office service activity) (they are deposit taking) while the rest or 84% do not have FOSAs. The movement controls 43% of Kenya's gross domestic product and contributes about Kshs.210 billion towards the national savings (SASRA, 2011).

1.1.2 Agency Costs in SACCOs

To ensure that the SACCOs manage their finances well and serve their members effectively and efficiently, they hire professionals who are charged with running their day to day activities. The rise of hired professionals (agents) to run businesses on behalf of owners (principals) led to the rise of the problem of agency conflict. Agency conflict is best explained by Smith (1776) when he states that professionals employed to manage the businesses of other people would not put as much effort in the management of such companies as the actual owners would, but would instead be less keen, negligent and profuse.

Agency costs result when the principals use a combination of incentives, punishment, bonding and managerial processes in order to monitor the actions of their agents; so as to minimize the chances that the agents will pursue their interests rather than those of the principals (Chrisman, Chua & Lits, 2004). They include the costs of structuring, monitoring, metering and bonding a set of contracts among agents with conflicting interests, plus the residual loss incurred because the cost of full enforcement of contracts exceeds the benefits (Fama & Jensen, 1983).

According to the International Co-operative Alliance (ICA) (1997), management of the co-operative is a team effort that combines three elements - the members, the elected directors and the hired management. The directors represent members within the framework of an official Board of Directors (BOD). Their three main responsibilities include setting policies, employing the Chief Executive Officer (CEO) and evaluating the CEOs performance. The BOD in turn delegates much of its overall management

responsibility to a full-time manager - the CEO who is empowered to employ and discharge other employees who together with the manager comprise the hired management team.

Unlike the boards of other firms, SACCO boards are very much involved in the day-to-day management of the institutions on behalf of the members. Scholl (1995) states that many boards are so busy watching over, approving and inspecting a myriad of organizational activities that they never have time to lead the co-operative into the future. They do not relinquish operational roles but continue to very closely supervise the hired professionals and indeed carry out operational functions. The end result is very high agency costs in terms of directors' allowances and other payments since every other activity of a director on behalf of the SACCO is paid for.

1.1.3 Financial performance in SACCOs

SACCOs are co-operative in nature, and therefore not very much profit oriented. "Not for profit" however, does not mean operating at a loss (Kidanu, 2008). In addition to being co-operatives, they are also businesses and in fact, an alternative way of doing profitable business. They therefore need to succeed both as co-operatives and as businesses by pursuing prudent commercial business practices in addition to the co-operative principles. They should seek to generate income that exceeds expenses and at the end of the year, distribute any surplus back to the members (Smith, Cargill and Meyer, 1981). Prudence in governance is therefore important to ensure that they make reasonable surpluses for development and long term survival.

According to the ICA (1997), a successful SACCO is one that is viable both as a co-operative (maintains its co-operative nature) and as an economic business venture (maintains a healthy financial performance). In order to thrive as a viable business, a SACCO needs to prudently manage its assets such as cash, loans to members, inventory, fixed assets, investments, and liabilities such as members' deposits and accounts payable. This would result in good financial performance in the areas of liquidity, solvency, profitability, financial efficiency and repayment which are important to ensure that the

SACCO survives in the long run. One of the most popular measures of financial performance in SACCOs and which was used for this study is the return on assets (ROA).

1.1.4 Determinants of Firm Financial Performance

The environment in which a firm operates is a very important determinant of its financial performance. Environmental factors include the sociological, political, economic and technological surroundings of the firm (Hansen & Wernerfelt, 1989). The market influences the conduct of firms within it and their conduct, in turn, affects performance (Mason, 1939; Caves, 1977). Market factors that influence performance include the market share, product (service) quality, marketing expenditures, research and development expenditure, and breadth of product line (Schoeffler et al., 1974; Boston Consulting Group, 1968; Chevalier, 1972).

A firm's organizational factors-including structure, systems, size, history and strategy also have a great impact on its financial performance (Hansen & Wernerfelt, 1989; Khandwalla, 1973; Rumelt, 1972). The success of a firm depends on its ability to adopt an organizational structure sufficient to deal with changing competitive circumstances (Burns & Stalker, 1961). A firm's optimal structure depends on the firm's size, environment, and diversity of operations (Steer & Cable, 1978). Stopford and Wells (1972) suggest that increases in size (i.e. volume of operations) and attendant increases in task specialization are primarily responsible for firms moving from undifferentiated structures (stage I) to functionally differentiated structures (stage II). Firm size however is also often seen as a source of organizational costs or inefficiencies which affect performance negatively (Shepherd, 1972; Rumelt, 1982; Porter, 1977).

Performance is also greatly determined by people factors including skills, personalities and age which affect the quality of management hence performance (Hansen & Wernerfelt, 1989). The level of motivation and skill of staff impacts on the achievement of operating efficiency (Liebenstein, 1966) and reaching a workable combination of strategy, structure, and technology (Child, 1977; Stopford & Wells; 1972; Selznick, 1957).

Organizational climate including decision making practices, communication flow, goal emphasis, human resource management, leadership, group processes and job conditions influence individual behaviour thus firm performance (Hansen & Wernerfelt, 1989). Closely related to decision making practices and leadership is governance and with it agency costs. These are costs incurred by organizations in order to ensure that the hired professionals exercise power for the benefit of the owners and not for their own (Chrisman et al., 2004).

1.1.5 Agency Costs and Financial Performance

In modern organizations, the employment of professional managers and staff who have more training, proficiency, skills and expertise to run the complex day to day operations is inevitable. As noted by Mills and Moberg (1982), during the provision of knowledge intensive professional services, the costs of both metering and monitoring are high. Agency costs arise as a consequence of processes, systems, structures and resources expended by the principals in order to monitor and align their interests with those of the agents (Chrisman et al., 2004). According to agency theory, without the incurrence of agency costs, agents who are not owners and therefore neither bear the full costs nor reap the full benefits of their actions would not act in the best interest of the principals. They would be less committed, repetitively shirk and engage in the consumption of perks (Ross, 1973, Jensen & Meckling, 1976). The result would be poor long term financial performance.

Some scholars however believe that firms with lower agency costs, (e.g. owner managed firms) are more efficient than agent managed firms (Schleifer and Vishny, 1997). The processes, systems, structures and resources expended by principals in order to monitor and align their interests with those of the agents result in expenses which lower the net income. Agency costs also lead to residual loss when the agents cannot make decisions which would maximize the welfare of the principals as a result of restrictions imposed on them by the principals (Jensen & Meckling, 1976).

Several studies carried out have shown that firms managed by outside professionals rather than owners perform better than those managed by their owners (Wall, 1998;

Lauterbach & Vaninsky, 1999; Perez-Gonzalez, 2001; Morck et al., 1998). In order for these firms to perform well, their owners must have incurred agency costs as they monitored the hired professionals.

It is also argued that often times, boards may not act in the interest of the owners but in their own interests, fixing numerous meetings not for the welfare of the firm but for the allowances. The end result is that an increase in directors' costs (as they monitor management) may not necessarily lead to an improvement in performance.

Holding everything constant, the incurrence of agency costs should improve performance if the benefits from controlling agency problems are higher than the costs (Chrisman et al., 2004). The benefit can however be negated if the costs are higher than the benefits.

1.1.6 Githunguri District SACCOs

Githunguri district is located Kiambu County in the central region of Kenya. The district was carved out of the former Kiambu district and its headquarters are in Githunguri town that is situated some forty kilometers north of Nairobi. The area is a rich agricultural land well endowed with rainfall and rich in cash crops; mainly coffee and tea. The area is also one of the leading areas in Kenya in the production of milk and is home to the third largest milk processor in Kenya-Githunguri Dairy Farmers Co-operative Society Limited; the makers of the Fresha brand of dairy products. Most of the residents are small scale farmers who do small scale dairy, coffee and tea farming.

The district being more in a rural than an urban setting, most banks avoided opening up branches there until recently. It therefore occurred that in order to save their income from farming and access credit, most of the farmers joined together and formed SACCOs. The area is therefore home to several SACCOs some which offer only BOSA services and others which offer both BOSA and FOSA services. In this study, the researcher chose SACCOs offering FOSA because of their professional management skill requirements. These are also the only SACCOs requiring regulation and licensing by the SACCO Societies Regulatory Authority (SASRA).

1.2 Statement of the Problem

Managing a co-operative is challenging and difficult because it involves not only managing resources and business operations, as in other businesses, but also dealing with problems stemming from the co-operative's distinctive characteristics. Because the co-operatives' members are both owners and patrons, special relationships and problems arise concerning member and BOD's roles and responsibilities. Often, questions arise about the division of responsibilities between the BOD and the hired management. Sometimes they overlap and an exact division cannot be made (ICA, 1997).

In most SACCOs though the BODs have appointed professional managers, they are unwilling to delegate to the managers severely hampering the manager's ability to function and by extension ability of the SACCOs to compete successfully in the competitive market (Gamba & Komo, 2005). As Carver (1990) observes, many boards are so busy watching over, approving and inspecting a myriad of organizational activities that they never have time to lead the SACCO to the future. Dimsdale (1994) also observes that many organizations have large boards with directors who have little interest in the organization except for the influence, allowances and other perks that they draw on the board.

The "Management Board system" in Kenyan SACCOs results in absence of a clear division between the role of the board and that of the hired management. The system results in the BOD very closely monitoring management and often times carrying out managerial activities. The end result is that the benefits of separation of ownership and control in SACCOs and the presence of professional management are negated by excessive monitoring costs. As noted by Lauterbach and Vanisky (1999), the costs of monitoring and bonding the manager may be too excessive and the advantages of professional management very minor and in-sufficient to outweigh the expected agency costs.

In majority of the SACCOs, the directors are paid allowances for any time spent doing SACCO business, be it attending to board meetings or other duties. This makes agency costs in terms of director's allowances relatively high. It would normally be expected that

because of this close supervision and monitoring, the hired professionals would devote all their effort and skills for the welfare of the SACCO and thus the high agency costs would be neutralized by exceptional financial performance.

The purpose of this study was to examine the relationship between agency costs (as represented by directors' allowances and other costs) and the financial performance of SACCOs operating FOSA in Githunguri district.

Although several studies on the relationship between agency costs and firm performance have been carried out in the developed world, the researcher has not come across any such study in the Kenyan context. Majority of the studies carried out in Kenya have concentrated more in corporate governance as a whole and its relationship with firm performance with none looking at agency costs in particular and their relationship with firm performance. Most of the local studies have also been carried out in more "formal urban" organizations (e.g. quoted companies, parastatals, insurance companies and banks) with none being carried out in less "formal institutions" like SACCOs in a rural setting.

The researcher notes that past studies on agency costs and firm performance have yielded mixed results. Whereas some reported evidence of a negative relationship (Boardman et al, 1997; Vafeas, 1999; Xiao & Zhao, 2008; Moustafa, 2005; McConoughy et al, 1998; Murage, 2010), others reported evidence of a positive relationship (Lauterbach & Vanisky, 1999; Langat, 2006; Mutisya, 2006). The results are thus inconclusive and further study into this area would add more knowledge into the existing theories.

The peculiar governance structure in SACCOs – "The Management Board System" makes a study into the agency costs of monitoring and metering managers' performance by the SACCOs' boards very timely. Save for a study by Mwanza in 2009, the researcher has not come across any other study on the performance of SACCOs in relationship to governance. There is thus need for an empirical study in this area.

1.3 Objectives of the Study

- i. To determine the trend in the financial performance of SACCOs with FOSA in Githunguri district over the period 2007 to 2011
- ii. To determine the trend in agency costs expenses of the SACCOs over the same period
- iii. To investigate the relationship between agency costs and the financial performance of the SACCOs.

1.4 Importance of the Study

The findings of this research will be of benefit to the following groups:

a) SACCO directors and managers

SACCO directors and managers will be in a better position to know which governance model best suits their organizations. Is it close monitoring or performance based supervision that emphasizes on results?

b) The government

The research findings will help the government to better understand the performance of SACCOs and develop policies that will ensure better and more effective governance in the co-operative movement.

c) Scholars and future researchers

The findings of this study will provide additional literature in the field of SACCOs that will assist future scholars in understanding the dynamics of the co-operative movement.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter presents a review of the related literature on the subject under study as presented by various researchers, scholars, analysts and authors. The review draws its materials from several sources related to the theme and objective of the study.

2.2 Governance, Related Costs and Financial Performance

The Centre for Corporate Governance in Kenya (2005) defines corporate governance as the process by which corporate entities are directed, controlled and held accountable. It is concerned with the processes, systems, practices and procedures, the formal and informal rules that govern institutions, the manner in which these rules and regulations are applied and followed, the relationships that these rules and regulations determine or create, and the nature of those relationships. According to the Private Sector Corporate Governance Trust (1999), corporate governance is the manner in which the power of a corporate entity is exercised in the stewardship of the entity's total portfolio of assets and resources with the objective of maintaining and increasing shareholder value and satisfying other stakeholders.

Governance is concentrated around five pillars including: - accountability, responsibility, transparency, efficiency & effectiveness and integrity & fairness (Private Sector Corporate Governance Trust, 1999). It can be discussed under six main models including; agency, stewardship, stakeholder, political, resource dependency and transaction cost models.

2.2.1 Agency Theory

Agency theory is concerned with the conflict of interest between an agent-acting as a representative of a principal (Ross, 1973; Eisenhardt, 1989). Jensen & Meckling (1976), say that where the principal and the agent are both utility maximizers, the most probable occurrence is that the agent will not always act in the best interests of the principal. If

both parties had the same interests, there would be no conflict of interests and no agency problem (Jensen and Meckling, 1976).

Agency conflict is best explained by Adam Smith (1776) when he says that professionals employed to manage the businesses of other people would not put as much effort in the management of such companies as the actual owners would; but they instead, would be less keen, negligent and profuse. Sharma (1997) adds to say that the principals do not possess the technical knowledge to evaluate the effort invested or the outcome accomplished by professional agents.

Agency problems could arise from either adverse selection or moral hazard. Adverse selection occurs when the principal inadvertently contracts with an agent who is less committed or industrious, or whose interests are less compatible than the principal expected. Moral hazard on the other hand, involves commission or omission of actions after contracting that work in the interest of the agent but are detrimental to those of the principal (Chrisman et al., 2004).

Two broad ways in which agency conflicts can be managed include; the principal monitoring agent's behaviour to ensure that the agent actually behaves as stipulated in the contract and comparing actual performance of the agent as measured by the outcome relative to expectations (metering). The principal cannot monitor the agent's behaviour or meter his performance without the incurrance of costs which gives rise to agency costs (Sharma, 1997).

2.2.2 Stewardship Theory

Stewardship theory depicts managers as collectivists, pro-organizational, trustworthy and whose behavior is aligned with the interest of principals (Donaldson & Davis, 1991). The theory postulates that managers will act in the organization's best interest even in the absence of controls (Tosi et al, 2003). Managers are viewed as good stewards of the corporations who diligently work to attain high levels of corporate profit and shareholders returns (Donaldson and Davis 1991). They are principally motivated by achievement and responsibility needs, are responsible and self-directed and therefore

organizations may be better served to free managers from monitoring and control by boards (Klein et al, 2005).

According to this theory, managers seek other ends besides financial ones. These include a sense of worth, altruism, a good reputation, a job well done, a feeling of satisfaction and a sense of purpose. They inherently seek to do a good job, maximize company profits and bring good returns to stockholders, not necessarily for their own financial interest, but because they feel a strong duty to the firm. They merge their ego and sense of worth with the reputation of the firm (Abdullah and Valentine, 2009).

2.2.3 The Stakeholder Theory

The stakeholder theory incorporates corporate accountability to a broader range of groups or individuals who affect and are affected by the achievement of the organization's objectives (Freeman, 1984). A firm is therefore seen as a system of stake holders operating within the larger system of the host society that provides the necessary legal and market infrastructure for the firm's activities (Clarkson, 1995). The theory recognizes the interdependence created between a firm and its strategic stakeholders such as employee, customers, suppliers, and members of the communities in which the corporation operates. According to Donaldson and Preston (1995), all groups participate in a business to obtain benefits and the interests of all stakeholders have intrinsic value with no sets of interests dominating others.

The purpose of the firm is to create wealth or value for its stake holders by converting their stakes into goods and services. A firm can maximize total wealth creation by enhancing the voice of and providing ownership-like incentives to those participants in the firm who contribute or control critical, specialized inputs (firm specific human capital) and aligning the interests of these critical stakeholders with the interests of outside, passive shareholders. Control of the firm should be shared between investors and stakeholders through multiple boards to remove conflicts of interest and so agency costs. Corporations should seek long-term owners, give them a direct voice in governance, and nominate significant owners, customers, suppliers, employees, and community representatives to the BODs.

2.2.4 The Political Theory

The political theory recognizes that the allocation of corporate power, privileges and profits between owners, managers and other stakeholders is determined by how governments favour their various constituencies (Shann, 2000). In this theory, public interest is much reserved as the government participates in corporate decision making, taking into consideration cultural challenges (Pound, 1993). Hawley & Williams (1996) observe that the political theory places severe limits on the traditional economic analysis of the corporate governance problem, and locates the performance-governance issue squarely in a broader political context. Political however does not necessarily imply a government role but merely that it is non-market (Shann, 2000).

Pound (1993) defined the 'political model of governance' as an approach in which active investors seek to change corporate policy by developing voting support from dispersed shareholders rather than by simply purchasing voting power or control. The theory is concerned with the issue of institutional agents monitoring corporate agents, i.e. watching the watchers (Monks & Minow, 1996). These issues are influenced by government laws and regulations and are subject of public policy debate for changes and reform.

2.2.5 Resource Dependency Theory

The resource dependency theory concentrates on the role of the board directors in providing access to resources needed by the firm through their linkages to the external environment. The directors bring resources to the firm, such as information, skills, access to key constituents such as suppliers, buyers, public policy makers, social groups as well as legitimacy (Hillman, Canella and Paetzold, 2000). According to Johnson et al (1996), the focus is on the appointment of representatives of independent organizations as a means for gaining access to resources critical to firm success. For example, outside directors who are partners to a law firm provide legal advice, either in board meetings or in private communication with the firm executives that may otherwise be more costly for the firm to secure.

Directors can be classified into four categories of insiders, business experts, support specialists and community influentials. The insiders are current and former executives of

the firm, business experts are current and former senior executives and directors of other large for-profit firms and support specialists are the lawyers, bankers, insurance company representatives and public relations experts all who provide support in their individual specialized field. Community influentials on the other hand are the political leaders, university faculty, members of clergy, leaders of social or community organizations.

2.2.6 Transaction Cost Theory

Transaction cost theory is an interdisciplinary alliance of law, economics and organizations. In this theory, the firm is viewed as an organization comprising of people with different views and objectives. The underlying assumption of the theory is that firms have become so large that they in effect substitute for the market in determining the allocation of resources. According to the theory, managers are seen as opportunists who arrange firms' transactions in their own interests (Williamson, 1996).

2.2.7 Governance in SACCOs

The co-operatives governance structure comprises of the Annual General Meeting (AGM), the BOD and the management. The principal-agent nature of the relationship requires separation of ownership and decision making between the BOD and management (Mudibo, 2005). The three main responsibilities of the BOD include setting policies, employing the Chief Executive Officer (CEO) and evaluating his/her performance. The BOD in turn delegates much of its overall management responsibility to a full-time manager the CEO who together with other employees comprise the hired management team (ICA, 1997).

There are two main types of governance models practiced by the SACCOs in the world according to Agumba (2008). These are the guideline-based models and the principle based models or the conference board's models. In the guideline-based model, boards develop and approve policies and then hold management accountable for their effective implementation. In the principle based model on the other hand, the boards focus on strategic planning, oversight, risk management and succession.

In the early years, the boards through the various committees directly carried out the operations of their co-operatives and maintained the accounting records. Co-operatives have however become larger, more diversified and integrated to match similar advances in the corporate world. They are no longer viewed as independent entities but as part of a larger system. This has necessitated the employment of professional managers and staff who have more training, proficiency, skills and expertise to run the complex day to day operations of the SACCOs (ICA, 1997).

The employment of professionals to run the co-operatives has brought with it the “agency problem”- the chance that the professional managers may take actions that are against the best interests of the members. There is therefore need for a monitoring and metering system that will align the managers’ interests and actions with the interests of the members.

In the name of monitoring the hired professionals, many boards become very much involved in the day-to-day management of the SACCOs. Scholl, (1995) states that many boards are so busy watching over, approving and inspecting a myriad of organizational activities that they never have time to lead the co-operative into the future. They do not relinquish operational roles but continue to very closely supervise the hired professionals and indeed carry out operational functions. It therefore occurs that though SACCOs hire professionals, they give them only limited decision making authority. Gisemba (2010) observes that the management board system results in the absence of a clear division between the role of the BOD and that of management. He further notes that the unwillingness of many boards to delegate to the managers severely hurts their (managers’) ability to function.

Often times, the board may not act in the interest of the members but in their own interests, fixing numerous meetings not for the welfare of the SACCO but for the allowances. It would have been expected that with the appointment of professionals in the running of SACCOs, the role of the boards would have been reduced to that of oversight only and not operations. In many rural SACCOs however, this has not been so. Most of the boards do not “trust” the hired professionals but spend most of their time supervising

the daily operations. The end result is that an increase in directors' costs (as they monitor management) may not necessarily lead to an improvement in performance.

2.2.8 Measurement of Financial Performance in SACCOs

Financial performance is a measure of the results of a firm's policies and operations in monetary terms as reflected in its return in investment, return on assets and value added (Business directory, 2012). It is a subjective measure of how well a firm uses its assets to generate revenues. One of the most popular methods of measuring financial performance is the use of financial ratios. These are transformations of financial statement data by statement users to aid in decision making (Rick, 2001).

The World Council of Credit Unions (WOCCU) has developed a set of financial ratios known as PEARLS to help measure key areas of credit unions financial performance. P-stands for Protection of assets hence adequate provision for loan losses, E-stands for effective financial structure comprising of assets, liabilities and capital, A-stands for asset quality thus a prudent balance between productive and non-productive assets, R-stands for rates of return and costs considering investment yields and operating expenses, L stands for liquidity which is very critical especially when the SACCOs take deposits from members and S- stands for and signs of growth which is the only successful way to maintain asset values.

The use of PEARLS helps monitor the performance of SACCOs, provide standardized evaluation ratios and formulae, a way to provide objective comparative rankings and facilitate supervisory control (WOCCU, 2002). According to Macharia (2003), financial ratios obtained from the financial statements of co-operative societies, can be relied upon to separate performing co-operative societies from non-performing ones.

This study uses the performance ratios under R-the rate of return and costs per WOCCU PEARLS. Return on Assets (ROA) was used to measure the rate of return and agency costs (directors' costs) used to measure cost.

2.3 Empirical Evidence

Boardman, Shapiro and Vining (1997) examined the role of agency costs in the superior profitability of foreign multi-national enterprises over the domestic corporations in Canada. The study involved Canadian companies for the years 1986 and 1991. They found out that lower agency costs due to more concentrated ownership contributed to foreign subsidiaries performing better than Canadian companies.

Vafeas (1999) studied the relationship between board meetings and firm performance using 307 firms between the years 1990 – 1994. The annual number of board meetings was found to be inversely related to firm value. He further found out that operating performance improves following years of abnormal board activity. These improvements are most pronounced for firms with poor prior performance and firms not engaged in corporate control transactions. Overall the results suggested that board activity measured by board meeting frequency is an important dimension of board operations.

Xiao and Zhao (2008) examined the effects of the agency costs on firm performance in 156 Chinese publicly listed companies with private ultimate owners between 2002 and 2007. They examined the relationship between agency costs and Tobin's Q using regression analysis. Agency costs were found to be negatively and significantly affect firm performance as measured by Tobin's Q.

Moustafa (2005) examined the effect of separation between ownership and control on firm performance. The objective of the study was to examine whether there was a significant difference between the performances of owner controlled firms and manager controlled firms in the United Arab Emirates. His sample comprised of 24 owner controlled and 25 manager controlled firms. The return on equity (net profit), asset utilization (sales /total assets) and operating expense ratios (operating expenses/sales) between 1998 and 2002 were used for the research. The first variable measured the managerial efforts to realize profits for owners while the last two were used to measure agency costs. The empirical results revealed that owner controlled firms outperformed the manager controlled ones when performance was measured by the return on equity and asset utilization.

Lauterbach and Vaninsky (1999) examined the extent to which performance in Israeli firms was influenced by how the management function was organized. They distinguished between firms managed by a representative of the owners and those managed by a professional top manager. Their sample included 280 public companies traded in the Tel Aviv Stock Exchange and data on the 1992-1994 net income was used with relative performance measured using Data Envelopment Analysis. Their analysis demonstrated that firms managed by a representative of their owners performed worse than those managed by professional managers. This is in contrast to the prepositions of early theorists such as Williamson (1964) who proposed that non-owner managed firms are less efficient than owner-managed firms.

McConoughy, Mathews and Fiako (1998) studied the effects of founding family control (owner control) on firm efficiency, capital structure and value on 219 Founding Family Controlled Firms (FFCFs) and management controlled firms for the years 1986 through 1988. Accounting ratios and sales growth were used to asses operating efficiency, productivity through sales growth, sales per employee and cash flow per employee. Profitability was measured through gross margins and net margins.

They found out that FFCFs provided higher stock market returns, were better run, and generated higher sales growth, higher gross and net margins on sales and cash flow per employee. The results demonstrated that FFCFs were generally more efficiently run than other firms and had greater value as measured by the market equity/ book equity ratio than other firms. The arguments for these results can be explained from agency theory arguments that reduced costs of monitoring as a result of having owners involved in management increases the firms' efficiency.

Langat (2006) studied the corporate governance structures and performance in firms quoted in the Nairobi Stock Exchange (NSE). The study followed a cross sectional survey design that sought to identify differences in governing structures between companies facing a decline in value, those with appreciating values and those with stable values between years 2000- 2005. The study used four governance structures that are favored by companies in sustained financial crisis that include the CEO compensation, board composition, CEO and insider equity holdings and the frequency of board meetings

with reference to financial performance of firms. The study targeted all the 47 companies listed on the NSE for the period of five years from the beginning of the year 2000 through 2005. The Tobin's Qs (or book to market ratio) for all listed companies were computed at the end of the calendar years 2000, 2001, 2002, 2003, 2004 and 2005.

The data collected was analyzed using two approaches; first descriptive statistics were computed for all the governance variables. Regression analysis was then applied to cross check the conclusion reached in the first approach. A regression model was specified relating each of the four corporate governance structures to the value of the firm as proxied by the Tobin's Q or the book to market ratios.

The findings established that there is a positive relationship between the listed firms performance and frequency of board meetings, the ratio of outside directors to total directors, percentage of insider ownership and the executive compensation.

Mutisya (2006), studied 39 companies listed on the NSE for the period 2000 to 2005 to determine if the components of corporate governance affect profitability and is if so how. The study covered three years before the introduction of the Capital Markets Authority (CMA) corporate governance guidelines and three years after to ascertain if there was an improvement in performance that could be attributed to CMA guidelines introduction. The study used secondary data from NSE. Analysis of the data collected was done using multiple regressions to examine the effects of the various aspects of corporate governance on financial performance of companies. The independent variables were board size, proportion of executive and non-executive directors, number of meetings per year, proportions of shares held by directors, proportion of shares held by top 10 shareholders and number of women on the board. The dependant variables was corporate performance measured by return on assets (ROA) and market to book value (MBV).

The study revealed that board size, and number of board meetings per year significantly contributed to performance of the company.

Murage, (2010) studied the relationship between corporate governance and financial performance in parastatals in Kenya. Using regression analysis, he studied the relationship between various corporate governance indicators and financial performance

in seventy nine state corporations. The corporate governance indicators used in the study included independence of the board, the board size, external auditors, institutional ownership, managerial ownership and the competence of the audit committee. To measure financial performance he used, liquidity, solvency, revenue growth, profitability and financial position as reflected by surplus funds and increase in interests and dividend income.

One of the findings of the research was that increase in committee meetings led to a decrease in financial performance indicating that board activity intensity affects profitability negatively. His conclusions were in line with Jensen (1993) that while regular board meetings are essential for good performance they do not necessarily enhance firm performance. Too many of the meetings have a tendency to shift the focus of the board from strategic policy issues to operational day to day matters thus paving way for internal conflicts.

2.4 Conclusion

Whereas agency theory proposes that close supervision, monitoring and metering of agents by the principals improves performance, empirical research shows mixed results. Some studies have found that close monitoring of agents by principals improves performance due to the alignment of the divergent interests of owners and their managers, others have found an inverse relationship between close monitoring and performance especially when the costs of monitoring are higher than the benefits and yet others have found no relationship between the two. The researcher believes that the results of this research will shed more light and add valuable information to the existing literature on governance.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter covers matters related to the design of the study, data and data source, data analysis techniques and procedures. It describes in depth all steps involved in conducting the study to arrive at a conclusion regarding the importance of agency costs and performance.

3.2 Research Design

Descriptive research methodology was adopted for this study. This design involves either identifying the characteristics of an observed phenomenon or exploring possible correlations between two or more phenomena. It involves examining a situation as it is without changing or modifying it. For this study, the motive was to provide a systematic description that is factual, and as accurate as possible, hence use of descriptive research methodology was justified.

3.3 Population and Sample for the Study

3.3.1 Population

The target population for this study was all SACCOs offering FOSA in Githunguri district. The total number of SACCOs offering FOSA in Githunguri and which have been licensed by SASRA is four, that is: Githunguri Dairy & Community SACCO, Tai SACCO, Fariji SACCO, and K-Unity SACCO.

3.3.2 Sample

Of the four SACCOs making the study population, K-Unity SACCO was left out for this study. This is because it just recently transformed into a SACCO having operated as a co-operative union (Unity Finance-formerly Kiambu Dairy and Pyrethrum Farmers Co-operative union) until 2010. The researcher was of the opinion that its operations over the years that it operated as a co-operative union could be different from those of the other

SACCOs which could affect the results of the study. In addition, unlike the other three SACCOs whose headquarters are in Githunguri district, its head quarters are located in Kiambu East district and not Githunguri district though it has a branch in Githunguri town. Including it in the sample could in the opinion of the researcher have a contextual implication in the results of the study.

By sampling the three SACCOs the study sought to ensure that the data collected was as representative as possible and suitable for generalization about the operation of SACCOs within the district. The data tested was for the years 2007-2011.

3.4 Data and Data Source

For the purpose of this study, secondary data on financial performance and agency costs from the SACCOs' audited financial statements for the periods 2007-2011 was used. To measure financial performance, the researcher used net income as a percentage of average total assets (ROA) ratio as recommended by WOCCU's PEARLS performance monitoring system. This performance ratio appears under the sub-heading of rates of return and cost. The ratio measures the adequacy of earnings and the capacity to build institutional capital.

For its computation, the following information was considered: -

a) Net income after dividends, b) total assets as of current year end, c) total assets as of previous year end.

Formula:
$$\frac{a}{(b + c)/2}$$

The above performance ratios were computed for the years 2007-2011.

Agency costs, on the other hand considered total directors' (committee) expenses as a percentage of total expenses. These include all allowances, honoraria and other ex-gratia payments.

Formula: Total directors' expenses/total expenses

3.5 Data Analysis

Since data used was quantitative in nature, descriptive statistics was used to analyze the data using correlation and regression analysis. The method involves either identifying the characteristics of an observed phenomenon or exploring possible correlations between two or more phenomena. It involves examining a situation as it is without changing or modifying it. This method was justified for the study since the objective was to provide a systematic description that was factual and as accurate as possible.

The data was first cleaned, sorted and collated before it was entered into the computer after which analysis was done with the help of Statistical Package for Social Sciences (SPSS). To test the research hypothesis, the Pearson Product Moment Correlation Coefficient and Regression Analysis were used. The results were presented in the form of tables.

3.6 Model Specification

To measure the strength of the relationship between the dependent and the independent variables, the Pearson Product Moment Correlation Coefficient (r) was calculated. This is a measure of the strength of a linear association between two variables and is always between -1 for a strongly negative relationship and +1 for a strongly positive relationship. To decide whether agency costs and financial performance are actually related, the calculated value for r was tested at 5% level of significance to determine whether the value was sufficiently different from zero.

To determine the effects of agency costs on performance, regression analysis was used.

The regression model used in the study was $y = \alpha + \beta X$

Where y is the dependent variable (financial performance), α is a constant, β is the coefficient of the explanatory variable (Agency costs score) and X is the explanatory independent variable (agency costs score).

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

4.1. Introduction

This chapter focuses on the analysis of data, presentation and discussion of findings. Correlation and regression analysis was carried out on the data collected using SPSS and the results further tested at 5% level of significance to establish whether they were sufficiently different from zero. After the initial analysis, where agency costs were only independent variable, the model was expanded to control for SACCO size and expenditure on marketing. The results of the data analysis were presented using tables.

4.2 Data Analysis and Results

4.2.1 Summary Statistics for Agency Costs and ROA Measures

Table 1 presents the summary statistics of the performance measures of ROA and agency costs as a percentage of total expenses ratio for the period of the study i.e. from 2007 to 2011. The ROA for the SACCOs ranged from a minimum of -0.02% to a maximum of 6.5% with a mean of 1.69 % (std deviation of 1.629). Agency costs as a percentage of total expenses on the other hand ranged from a minimum of 3.49% to a maximum of 14.75% with a mean of 7.91% (std deviation of 3.115).

Table1: Summary statistics for agency costs and ROA

	N	Minimum (%)	Maximum (%)	Mean (%)	Std. Deviation
ROA	15	-0.02	6.51	1.6912	1.62876
AGENCY	15	3.49	14.75	7.91	3.11467
Valid N (list wise)	15				

4.2.2 Correlation and Regression Analysis

The results of a correlation analysis between the two variables: agency costs and ROA are as presented in table 2. The results indicate a weak positive correlation coefficient (r) of 0.331 and high a t value of 0.229 when tested at the 5% level of significance.

Table 2: Correlation coefficients - Model 1

		ROA	AGENCY
ROA	Pearson Correlation	1	.331
	Sig. (2-tailed)		.229
	N	15	15
AGENCY	Pearson Correlation	.331	1
	Sig. (2-tailed)	.229	
	N	15	15

Table 3 indicates the results of a simple regression analysis between the two variables: agency costs and the ROA of the SACCOs. In this model, only agency costs were considered as the independent variable ignoring the effect of other relevant variables. The results indicate a weak positive regression co-efficient for agency costs at 0.173. The resulting regression model as obtained from table 3 is: $ROA = 0.003 + 0.173 (\text{agency costs})$.

Table 3: Regression coefficients - Model 1

Model		Un-standardized Coefficients		Standardized Coefficients	t	Sig.	95% Confidence Interval for B	
		B	Std. Error	Beta			Lower Bound	Upper Bound
1	(Constant	.003	.012		.280	.784	-.022	.028
	Agency	.173	.137	.331	1.26	.229	-.123	.469

The results of an analysis of variance (ANOVA) test performed at the 5% level of significance are presented in table 4. The test was based on a null hypothesis (H_0) that there exists no linear relationship between the SACCOs' ROA and agency costs over the study period. The decision rule was to reject H_0 if the P-Value was less than 0.05. The results indicate a small value for the F statistics and a relatively large value of 0.229 for the P value.

Table 4: Analysis of variance (ANOVA) - Model 1

Model	Sum of Squares	df	Mean Square	F	P.
Regression	.000	1	.000	1.595	.229
Residual	.003	13	.000		
Total	.004	14			

4.2.3 Controlling for Size and Expenditure on Marketing.

In order to refine the results of the study, it was considered important to control for other factors deemed to have an effect in the performance of the SACCOs. For this research, SACCO size and expenditure on marketing were picked.

The measure for size was split in to two i.e. size according to the average outstanding loan portfolio (obtained from the average of the opening and closing outstanding loan portfolio per year) and size according to the average members' funds per year (obtained from the average of the opening and closing total members funds per year). Marketing expenditure included all sales promotion and advertising costs as a percentage of the total expenditure per year. The resulting model was $Y = \alpha + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \epsilon$ Where $Y = \text{ROA}$, $\alpha = \text{Constant}$, $\beta_{1-4} = \text{Beta coefficients}$, $X_1 = \text{Agency costs}$, $X_2 = \text{Average outstanding loan portfolio}$, $X_3 = \text{Average members' funds}$, $X_4 = \text{Marketing expenditure}$ and $\epsilon = \text{Error term}$.

The summary statistics of the average outstanding loan portfolio, average members' funds and marketing expenditure as a percentage of total expenses ratio are presented in table 5. The average outstanding loan portfolio for the SACCOs ranged from a minimum of Kshs 37,886,677 to a maximum of Kshs 330,897,644.50 with a mean of Kshs 152,275,404.27 (std deviation of Kshs 91,457,359.08). Average members' funds ranged from a minimum of Kshs 48,255,495 to a maximum of Kshs 273,318,955 with a mean of Kshs 145,806,853.43 (std deviation of Kshs 61,521,786.73). Marketing expenditure as a percentage of total expenses on the other hand ranged from a minimum of 0.35% to a maximum of 9% with a mean of 2.7% (std deviation of 2%).

Table 5: Summary statistics for size and marketing expenditure

	N	Minimum (Kshs)	Maximum (Kshs)	Mean (Kshs)	Std. Deviation (Kshs)
Ave Portfolio	15	37,886,677.00	330,897,644.50	152,275,404.27	91,457,359.08
M/Funds	15	48,255,495.00	273,318,955.00	145,806,853.43	61,521,786.73
Mar/Exp	15	.0035	.09	.027	.02
Valid N (list wise)	15				

The results of a correlation analysis after controlling for size and expenditure on marketing are presented in table 6. The correlation coefficients between ROA and the independent variables: average loan portfolio and average members' funds were negative and very weak at -0.177 and -0.098 respectively. The correlation between ROA and marketing expenditure on the other hand, was positive and strong at a correlation coefficient (r) of .849. At 5% level of significance the correlation coefficients between ROA and the independent variables average loan portfolio and average members' funds were insignificant but significant for the independent variable marketing expenditure.

Table 6: Correlation coefficients - Model 2

	ROA	Agency	Ave Portfolio	M/Funds	Mrkt /Exp
ROA Pearson Correlation	1	.331	-.117	-.098	.849(**)
Sig. (2-tailed)		.229	.678	.728	.000
N	15	15	15	15	15

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

Table 7 indicates the results of a multiple regression analysis. The coefficients for average portfolio and expenditure on marketing are positive at 0.000 and 0.599 respectively while that for members' funds was negative at - 0.000. In this model, the coefficient for agency costs dropped to 0.074 as compared to 0.173 in the previous model.

At 5% level of significance, the independent variables, average loan portfolio and members' funds had small t values of 0.519 and -0.611 respectively but expenditure on marketing had a high t value of 4.994. The probabilities (p) of the t statistics for the β

coefficients for average loan portfolio and members' funds were 0.615 and 0.555 respectively while that for expenditure on marketing was <0.001.

The resulting regression model as obtained from table 7 is: ROA= 0.000 + 0.074 (agency costs) + 0.000 (average loan portfolio) - 0.000 (average members' funds) + 0.599 (expenditure on marketing).

Table 7: Regression analysis - Model 2

Model		Un-standardized Coefficients		Standardized Coefficients	t	Sig.
		β	Std. Error	Beta		
1	(Constant)	.003	.012		.280	.784
	Agency	.173	.137	.331	1.263	.229
2	(Constant)	0.000	.022		.004	.997
	Agency	.074	.155	.141	.474	.646
	Portfolio	0.000	.000	.232	.519	.615
	M/Funds	-0.000	.000	-.302	-.611	.555
	Mark Exp	0.599	.120	.851	4.994	.001

a) Dependent Variable: ROA

The results of an ANOVA test on the second model are as presented in table 8. The F statistic for the overall regression relationship was 8.445 with a probability of 0.003 and the coefficient of determination (r^2) was 0.772.

Table 8: ANOVA - Model 2

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.000	1	.000	1.595	.229(a)
	Residual	.003	13	.000		
	Total	.004	14			
2	Regression	.003	4	.001	8.445	.003(b)
	Residual	.001	10	.000		
	Total	.004	14			

a) Predictors: (Constant), Agency

b) Predictors: (Constant), Agency, Market expenditure, Ave Portfolio, M/Funds

c) Dependent Variable: ROA

Table 9: Summary - Model 2

Model	R	R Square	Std. Error of the Estimate	Change Statistics				
				R Square Change	F Change	df1	df2	Sig. F Change
1	.331(a)	.109	.0159523	.109	1.595	1	13	.229
2	.878(b)	.772	.0092106	.662	9.665	3	10	.003

a) Predictors: (Constant), Agency

b) Predictors: (Constant), Agency, Marketing Exp, Ave Portfolio, M/Funds

4.3 Discussion of Results

The positive correlation coefficients (r) of 0.331 and .849 respectively between ROA and both agency costs and expenditure on marketing indicate that an increase in either of the two variables resulted in an increase in ROA and vice versa. The correlation coefficient for agency costs was however quite weak but that for expenditure on marketing quite strong. At a 5% level of significance, the t value of 0.229 for agency costs indicates that there is a 23% probability that the calculated value of r was not significantly different from zero. The t value of .000 for expenditure on marketing on the other hand indicates that there is only a negligible chance that the calculated value of r was zero.

From the study results therefore, it can be concluded that the study did not reveal a sufficiently significant correlation between agency costs and the financial performance of the SACCOs. A strong positive relationship between ROA and marketing expenditure was however found. This is in line with the findings of Lenz, (1981) and Porter and Spence, (1979) who found expenditure on marketing as one of the important determinants of firm performance.

In relation to both average loan portfolio and average members' funds, the negative correlations of -0.177 and -0.098 respectively indicate an inverse albeit weak relationship between the two variables and the ROA of the SACCOs. A negative relationship between size and financial performance was also noted by Rumelt, 1982 and Porter, 1977. The results however disagree with Lenz, (1981) and Steer & Cable, (1978) who found size to have a positive impact on the performance of an organization. The negative correlation between size and financial performance could be an indication of an increase in inefficiency as the SACCOs grew in size where costs rose at higher rate than revenue. At

the 5% level of significance however, the t values of 0.678 and 0.728 respectively for average loan portfolio and average members' funds are quite high indicating that there is a 68% and 73% chance that the values of r indicated in the studies could have arisen due to chance.

A regression co-efficient of 0.173 for agency costs (before controlling for size and expenditure on marketing) indicates that for any unit increase in agency costs, the ROA of the SACCOs increased by 0.173 units. This however reduced to 0.074 after controlling for both size and marketing expenditure. This means that in addition to agency costs, the other factors played an important role in the performance of the SACCOs. At the 5% level of significance however, the probabilities of the t statistics of .229 and .646 respectively in the two models are too high meaning that the calculated coefficients for agency costs are not significantly different from zero.

The positive regression coefficients of 0.000 and 0.599 for average loan portfolio and expenditure on marketing respectively show that higher values of average loan portfolio and expenditure on marketing were associated with better financial performance. This is as opposed to for members' funds which had a negative coefficient of -0.000 indicating an inverse relationship with financial performance.

The independent variables average loan portfolio and members' funds had small t values of 0.519 and -0.611 respectively and their corresponding p values for the β coefficients were 0.615 and 0.555 respectively; which are far much greater than 0.05. This indicates that the slopes of the two variables were not significantly different zero (β_2 and $\beta_3 = 0$). Expenditure on marketing on the other hand had a high t value of 4.994 and a low p value for the β coefficient of <0.001 which is less than the level of significance of 0.05. This means that the slope of the variable was statistically different from zero ($\beta_4 \neq 0$). The results therefore indicate a statistically significant relationship between expenditure on marketing and financial performance but no statistically significant relationship between size and financial performance of the SACCOs over the study period

The resultant F value of 1.595 from the ANOVA test when only agency costs are considered is quite low. The corresponding p value is much higher than 0.05 at 0.229,

indicating that there is a 22.9% chance of the null hypothesis being true. When size and marketing expenditure were controlled for, the F statistic increased to 8.445 with the probability for the overall regression relationship dropping to 0.003. This indicates that there is a statistically significant relationship between agency costs and the financial performance of the SACCOs when both size and expenditure on marketing are controlled.

The coefficient of determination (r^2) after controlling for both size and expenditure on marketing was 0.772 indicating that 77.2% of the financial performance of the SACCOs was determined by a combination of agency costs, size of the loan portfolio, size of the members' funds and expenditure on marketing. This relationship was found significant at 5% level with an F statistics of 8.445 with only a 0.3% probability of this relationship not holding.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter focuses on the summary, conclusion, recommendations, limitation and suggestions for further research.

5.2 Summary

The study aimed at determining the relationship between agency costs and performance of SACCOs in Githunguri. This was accomplished using correlation and regression analysis to test the relationship between the two variables for the years 2007-2011. In the first model, agency costs alone were considered as the independent variable. The results indicated a very weak positive relationship between agency costs and the financial performance of the SACCOs with a correlation coefficient of 0.331 and a regression coefficient of 0.173. The coefficient of determination (r^2) was 0.11 indicating that only 11% of the SACCOs financial performance could be explained by agency costs.

In the second model, size (as measured by average loan portfolio and members funds) and expenditure on marketing were controlled for. The results showed that size did not have a major impact on performance but expenditure on marketing had a strong positive and significant relationship with performance. The overall relationship between the variables indicated that there is a statistically significant relationship between agency costs and the financial performance of the SACCOs when both size and expenditure on marketing are controlled. The coefficient of determination (r^2) for the model indicated that 77.2% of the financial performance of the SACCOs was determined by a combination of agency costs, size of the loan portfolio, size of the members' funds and expenditure on marketing with only a 0.3% probability of this relationship not holding.

5.3 Conclusions

From the results of this study it can be concluded that close monitoring of the hired management by the SACCO boards may not necessarily lead to improved financial performance. The processes, systems, structures and resources expended by the board in order to monitor and align their interests with those of the hired management could have resulted in expenses which were higher than the managerial excesses they were supposed to check. There is also a possibility that close monitoring of management by the board could have hampered their ability to make decisions which would maximize the welfare of the SACCOs as a result of restrictions imposed on them by the principals (Jensen and Meckling, 1976). As noted by Lauterbach and Vanisky (1999), the costs of monitoring and metering the manager may be too excessive and the advantages of professional management very minor and in-sufficient to outweigh the associated agency costs.

The study shows that agency costs alone do not have a significant impact on the financial performance of SACCOs but that interplay between a combination of factors determine the actual performance.

5.3 Recommendations

Whereas monitoring of SACCO management by the BOD is important to ensure that the former do not work against the mission and objectives of the members, there is no evidence that this necessarily results in better performance. From the results of this study which are similar to those of Jensen (1993), while regular board meetings, as the BOD monitors the hired management, are essential for good performance, they do not necessarily enhance firm financial performance. Too many of the meetings only add to the operating expenses of the SACCOs without necessarily leading to performance improvement.

The directors of SACCOs should concentrate less on operational day to day activities but more on strategic issues and thus offer leadership to the SACCOs. This would result in less board meetings, less costs and also less conflicts between the directors and the hired management. All stakeholders in the SACCO fraternity including the government should

enhance the governance mechanism in the SACCO sub-sector to ensure that there is less board interference with the operational day-to-day activities of the SACCOs. Managers should be given more autonomy to manage the SACCOs while being held accountable for the results. The boards on the other hand should concentrate more on the strategic issues and thus offer leadership to their SACCOs. In addition, the SACCOs should engage in extensive research in order to identify the factors that are most important in determining their financial performance. This is necessary so as to ensure that more effort is put in more important issues while less effort is put on the less important issues.

5.4 Limitations of the Study

One of the greatest limitations of this study was the fact that it was carried out on only three SACCOs and therefore the findings may not be generalized to other SACCOs. Had more SACCOs been included the results could have been more conclusive. The study period of five years may also not have been representative enough of the performance of the SACCOs.

The use of the financial statements of the SACCOs to draw the conclusions of this study presents another limitation of the study. The statements are internally prepared by SACCO management using internally agreed policies which vary from SACCO to SACCO. This therefore makes financial statements a less objective measure of performance.

The research also used the monetary expenses of the directors as the proxy for agency costs. This may not capture all the agency costs expended by principal as the costs may be both monetary and non-monetary including opportunity costs which were not included for this study.

ROA is also only a subset of the various measures of performance for an organization.

5.5 Suggestions for Further Research

Similar studies should be carried out in other SACCOs in different settings to determine the universality of the conclusions of this research. The study period in future research should be increased to ensure that trends over time are captured.

Financial performance is only one of the measures of performance in a SACCO. Future research could be carried on the relationship between agency costs and other measures of performance including service delivery, product range, and dividend payout and member satisfaction among others.

A more inclusive proxy for agency costs should be explored that will incorporate both monetary, non-monetary and opportunity costs hence a clearer picture.

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APPENDICES

APPENDIX 1: LETTER OF INTRODUCTION- SELF

26TH JULY 2012

THE CHIEF EXECUTIVE OFFICER

..... SACCO SOCIETY LTD

P.O.BOX

GITHUNGURI

DEAR SIR/MADAM

RE: REQUEST FOR RESEARCH PROJECT DATA COLLECTION IN YOUR SACCO

I am a student from the University of Nairobi undertaking an MBA degree course. As part of my course requirements, I am undertaking a research project on the the relationship between agency costs and the financial performance of SACCOs offering FOSA in Githunguri district.

Yours is one of the SACCOs I have chosen for my research.

For this project, I will need data from your SACCO's financial statements for the years 2006 to 2011. Kindly assist me with this data to help me carryout my research:

All data obtained will be treated with strict confidence and for the purpose of this research only.

A copy of the results will be availed to your SACCO on request.

Kind Regards;

Michael K Njenga

University Of Nairobi

REG No D61/70928/2008

APPENDIX 2: LETTER OF INTRODUCTION- UoN

APPENDIX 2: LETTER OF INTRODUCTION- UoN



UNIVERSITY OF NAIROBI
SCHOOL OF BUSINESS
MBA PROGRAMME

Telephone: 020-2059162
Telegrams: "Varsity", Nairobi
Telex: 22095 Varsity

P.O. Box 30197
Nairobi, Kenya

DATE.....19/7/2012.....

TO WHOM IT MAY CONCERN

The bearer of this letter.....MICHAEL KAMBUI NJENGI.....

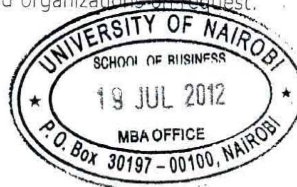
Registration No.....061/70928/2008.....


is a bona fide continuing student in the Master of Business Administration (MBA) degree program in this University.

He/she is required to submit as part of his/her coursework assessment a research project report on a management problem. We would like the students to do their projects on real problems affecting firms in Kenya. We would, therefore, appreciate your assistance to enable him/her collect data in your organization.

The results of the report will be used solely for academic purposes and a copy of the same will be availed to the interviewed organizations on request.

Thank you.




IMMACULATE OMANO
MBA ADMINISTRATOR

APPENDIX 3: SUMMARY DATA FROM THE SACCOS

GITHUNGURI DAIRY & COMMUNITY SACCO					
	2007	2008	2009	2010	2011
	Kshs	Kshs	Kshs	Kshs	Kshs
Surplus After Tax	2,257,609.00	1,880,410.00	11,971,419.00	5,483,266.00	4,497,296.00
Average Assets	65,082,228.00	112,420,078.50	183,771,632.00	249,056,802.50	313,066,884.50
ROA	0.03	0.02	0.07	0.02	0.01
Agency Costs	885,130.00	2,003,520.00	2,489,164.00	2,657,686.00	3,600,596.00
Total Expenses	7,288,274.00	13,577,972.00	22,954,826.00	46,123,168.00	51,365,508.00
A Costs/T Exp	0.12	0.15	0.11	0.06	0.07
Ave Portfolio	37,886,677.00	73,883,324.50	122,338,732.00	146,124,645.00	153,746,817.50
Ave M/funds	48,255,495.00	80,240,021.00	126,330,292.00	170,166,875.00	198,679,252.50
Marketing Exp	238,144.00	518,477.00	2,003,358.00	2,177,443.00	2,224,800.00
MrktExp/T Exp	0.03	0.04	0.09	0.05	0.04

TAI SACCO					
	2007	2008	2009	2010	2011
	Kshs	Kshs	Kshs	Kshs	Kshs
Surplus After Tax	2,144,348.00	1,699,082.00	1,186,648.00	12,402,485.00	11,772,879.00
Average Assets	290,230,321.50	381,476,579.50	479,587,823.50	549,078,301.50	635,889,984.50
ROA	0.01	0.00	0.00	0.02	0.02
Agency Costs	4,347,058.00	2,558,565.00	2,963,636.00	2,144,516.00	3,502,669.00
Total Expenses	49,368,825.00	57,232,633.00	59,848,336.00	61,398,201.00	79,909,437.00
Agency Costs/T Exp	0.09	0.04	0.05	0.03	0.04
Ave Portfolio	148,068,625.00	229,963,858.00	283,930,893.00	301,796,028.50	330,897,644.50
Ave M/funds	152,892,301.50	180,700,798.50	200,901,988.00	224,745,610.00	273,318,955.00
Marketing Exp	172,648.00	347,986.00	1,155,446.00	2,663,429.00	2,613,552.00
Mrkt Exp/T Exp	0.003	0.01	0.019	0.043	0.033

FARIJI SACCO					
	2007	2008	2009	2010	2011
	Kshs	Kshs	Kshs	Kshs	Kshs
Surplus After Tax	2,199,708.	3,713,000.00	1,825,478.00	861,264.00	(58,468.00)
Average Assets	170,785,116.	187,948,070.00	201,646,696.50	222,786,606.50	256,952,873.50
ROA	0.01	0.02	0.01	0.00	(0.00)
Agency Costs	1,860,428.	1,986,544.00	2,112,321.00	2,385,360.00	2,880,476.80
Total Expenses	19,573,789.	23,860,923.00	28,658,944.00	29,246,065.00	32,957,861.00
Agency Costs/T Exp	0.10	0.08	0.07	0.08	0.09
Ave Portfolio	97,658,220.	104,157,360.00	93,448,975.00	87,664,826.00	72,564,438.00
Ave M/funds	78,542,230.00	96,192,230.00	108,648,112.00	96,546,824.00	94,573,560.00
Marketing Exp	162,500.00	240,645.00	645,328.00.	525,460.00	475,325.00
Mrkt Exp/T Exp	0.008	0.01	0.023	0.018	0.014