CORPORATE GOVERNANCE PRACTICES : A CASE STUDY OF THE KENYA UNION OF SAVINGS AND CREDIT CO-OPERATIVES LIMITED

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DECLARATION.

This project is my original work and has not been presented for examination in any other universit

22-02-2005

Mary Mburu Date

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

28/2/2005

Prof. Evans O. Aosa Date

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DEDICATION.

To my late mother, Gladys Gakenia, and my father, Joseph Wanui who encouraged me right from an early age to get Education up to the highest level.

To my husband, Mburu Kamau, and my children, George, Loise and Linda for being there for me. Even when I felt like giving up, they were a constant source of inspiration.

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May God shower His blessing to you all.

TABLE OF CONTENTS PAGE

DECLARATION..I

DEDICATION..II

ACKNOWLEDGEMENT..III

TABLE OF CONTENTS..IV

LIST OF ABBREVIATIONS..VI

ABSTRACT..VII

CHAPTER ONE: INTRODUCTION..1
1.1 Background.. 1
1.2 Governance 3
1.3 Kuscco 4
1.4 Cooperative legal frame work..5
1.5 Statement of the problem..7
1.6 Objective of the study 7
1.7 Importance of the study..7

CHAPTER TWO: LITERATUR REVIEW
2.1 Introduction 9
2.2 What is corporate governance 9
2.3 Importance of good governance 10
2.4 Pillars of good governance 11
2.5 Principles of good corporate governance 12
2.6 Governance in co-operatives 13
2.7 Management and control of co-operatives 14
2.8 Good governance guiding questions in co-operatives 16

CHAPTER THREE: RESEARCH METHODOLOGY
3.1 Introduction 18
3.2 Research Design 18
3.3 Data Collection 18
3.4 Data Analysis 19

CHAPTER FOUR: FINDINGS AND ANALYSIS 20
4.1 Introduction 20
4.2 Organizational purpose 20
4.3 Board roles, duties and responsibilities 21
4.4 Board composition, skills and code of ethics..23

4.5 Appointment of C.E.O. 25
4.6 Duties of members 26
4.7 Structure and organization 27
4.8 Internal controls 28
4.9 Corporate compliance 29
4.10 Management of corporate risks..30
4.11 Performance Evaluation 32

CHAPTER FIVE: SUMMARY AND CONCLUSION..34
5.1 Introduction 34
5.2 Summary 34
5.3 Conclusion........ 35
5.4 Recommendations..35
5.5 Limitation of the study 38
5.6 Recommendations for further research 38

Appendix: 1 KUSCCO Pearls Ratios..39

REFERENCES 42

LIST OF ABBREVIATIONS

AGM................................Annual General Meeting

BOD................................Board of Directors

BSR................................Business for Social Responsibility

CEO................................Chief Executive Officer

CCG................................Center for Corporate Governance

CCD................................Commissioner for Cooperative Development

ICA................................International Cooperative Alliance

KUSCCO...........................Kenya Union of Savings and Credit Cooperatives Ltd

KPCU..............................Kenya Planters Cooperative Union

PSCGT............................Private Sector Corporate Governance Trust

PSICG............................Private Sector Initiative for Corporate Governance

SACCO............................Savings and Credit Cooperatives

SCCULT...........................Savings and Credit Union League of Tanzania

WOCCU...........................World Council of Credit Unions

ABSTRACT

Over the last two decades there has been an increasing desire to make organizations more visibly accountable, transparent and responsible not only to the owners but also to the other stakeholders and the community in general. Corporate governance is about promoting corporate fairness, transparency and accountability. The focus has been on strengthening the boards so that they can be in a position to direct the affairs of the corporation as a distinct body separate and independent of the management.

In the SACCO sub sector, the issue of corporate governance is increasingly becoming a matter of concern. This has arisen due to the huge amounts of funds and diversified financial products that have been introduced, which calls for boards to be transparent and accountable on the use of such resources. The regulation of the SACCOs has not ensured the highest standard of governance.

This study was conducted with the objective of establishing the current governance practices within the Kenya Union of Savings and Credit Co-operatives Ltd (KUSCCO). KUSCCO is the umbrella body for all SACCOs in the country and is charged with the responsibility of providing products and services and ensuring proper internal management of SACCOs. This is a case study that has tried to establish the prevailing governance practices in KUSCCO.

The pillars and principles of corporate governance as postulated by the private sector initiative for the corporate governance (1999) were explored in the study. The study found out that whereas there is an independent governance body separate from management, in practice this body does involve itself in management. This arose because some board members did not clearly distinguish between what are board and what are management roles and responsibilities.

The study also found out that the legal framework in terms of holding the board accountable and ensuring transparency was weak and that members were not quite aware of the systems and procedures required to hold the board accountable. It was also established that the level of member participation was rather low. The board, it was established has endeavored to put into practice good corporate governance: However there are still several areas that need attention. These include the criteria for board election, evaluation of performance for the board members, the CEO and the organization in general, human resource practices, assessment and mitigation of risks and the policies and procedures in general.

Arising from the above findings, several recommendations have been put forward. In terms of the board minimum academic and professional criteria should be set and a system be put in place to ensure that there is a balanced mix in the board skills. Criteria should also be developed to evaluate the performance of the board collectively and individually, the C.E.O, and the organizational performance in general. It is further recommended that the human resource be thoroughly evaluated in order to attract and retain the right caliber of staff. This should be coupled with a proper structure, systems and procedures that ensure proper internal controls in order to minimize the operating risk. It is also recommended that the union's internal audit be strengthened and that the union gives the C.E.O power to operate professionally without political influence.

For further research it is suggested that replicative studies could be carried out after a few years to determine what practices may have changed, or studies to determine the relationship between corporate governance and organizational performance. Cross sectional studies could also be carried out to compare corporate governance practices among the national cooperative organizations in Kenya.

CHAPTER ONE: INTRODUCTION

1.1 Background

The International Cooperative Alliance (1995) defines a cooperative as an autonomous association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations through a jointly- owned and a democratically controlled enterprise. Cooperatives are based on the values of self-help, self-responsibility, democracy, equality, equity and solidarity. In the spirit of their founders, cooperatives believe in the ethical values of honesty, openness, social responsibility and caring for others. The ICA recognizes seven principles of cooperatives: voluntary and open membership; democratic member control; member economic participation; autonomy and independence; education, training and information; cooperation among cooperatives and concern for community.

Cooperatives the world over are in a state of flux. They face one or more of the following crises: capital, ideology, credibility or management. The collapse of the planned model, rapid globalization of the world economy, rise of multinational corporations, formation of trade blocks, integration of world markets e.t.c have forced cooperative leaders to pause, ponder and devise ways to strengthen their flanks. Thus the central challenge for co-operatives is to find constructive ways to build and retain comparative advantages in the market place. This is only possible if they incorporate good governance practices in their institutions. (CCG, 2003)

While the co-operative movement had proved to be a formidable vehicle for wealth creation among its members prior to, and after, independence in Kenya, recent developments suggest that something has gone wrong. Large coffee co-operatives societies are collapsing or being split-up. Nearly all the cotton co-operatives have collapsed, land buying co-operatives are alleged to have swindled their members or just benefited the leaders, and many savings and credit co-operatives have experienced problems arising from favoritism in approval of loans, fraud practiced by leaders and management, failure by employers to remit deductions etc. Poor governance practices in some co-operative societies have impacted negatively on sustained growth in this sector. (CCG,2003)

The SACCOs themselves have experienced tremendous growth, which has seen an introduction of various new financial services similar to those offered by banks and micro Finance institutions. However this growth has not been matched by an upgrade of the needed skills, nor has the legislation adequately provided for the needed accountability to the members. For instance the Co-operative societies Act No. 12 of 1997 has limited the role of government in regulating, controlling and monitoring the development of these institutions. This created a vacuum and left Co-operators and their representatives with a responsibility they were ill prepared for. (Kibanga 1998).

One of the factors, which has been crippling Co-operatives business, is swindling, embezzling and non-accountability of monies. This has been the case because management in Co-operatives in many cases has played on the ignorance of members and has taken up powers beyond their mandate. (Kiwanuka 1998).

The SACCO sub- sector like other sectors has experienced governance problems. The Kenya Union of Savings and Credit Co-operatives (KUSCCO) was not spared. Between 1983 and 1986 the Union had been put under a caretaker committee arising from issues of mismanagement. Other SACCOs, ranging from medium to large have suffered similar fate. Harambee SACCO, the biggest in Kenya and Africa, for instance was run by a commission from 1992 to 1996.

Little research has been carried out in the field of corporate governance in Co-operatives. Oyoo (2002) studied the financial performance of SACCOs before and after deregulation. Ongore (2001) looked at management response of Co-operative sector to deregulation. The center for Corporate Governance (2003) conducted a stratified study of governance practices applied in Co-operatives, while Wangombe (2003) did a survey of corporate governance practices in SACCOs in Nairobi. While these studies identified the governance issues in general, no study has been done for a specific organization. This study looks into detail the governance practices in KUSCCO.

1.2 Governance

Broadly speaking, corporate governance generally refers to the process by which organizations are directed, controlled and held accountable. It encompasses authority, accountability, stewardship, leadership, direction and control exercised in companies and corporations. Governance is concerned with structures and processes for decision-making, accountability, control and behavior at the top of organizations. Good governance is participatory, consensus oriented, accountable, transparent, responsive, effective and efficient, equitable and inclusive and follows the rule of law. It assures that corruption is minimized and the views of the minorities are taken into account in decision making.

Participation is a key cornerstone of good governance whether direct or through representation. It also requires fair legal frameworks that are enforced impartially. Transparency means that decisions taken and their enforcement are done in a manner that follows rules and regulations and that information is freely available and accessible. Good governance also requires that institutions produce results that meet the needs of the stakeholders by making the best use of the resources at their disposal. Accountability is a key requirement. However accountability cannot be enforced without transparency and the rule of law. (CCG, 2003)

1.3 KUSCCO

The Kenya Union of Savings and Credit Co-operatives Ltd was registered in 1973 under the cooperative societies act. It began operations the following year, 1974. The major objectives were to promote SACCOs and disseminate information concerning them, coordinate their operating methods and practices, maintain uniformity in bookkeeping, and foster education and training of members, officials and employees. It was also meant to create a system to protect the funds of SACCOs, promote a common code of ethics, and help improve the internal management.

As at December 2003 there were 1582 SACCOs affiliated to the Union with a share capital of Kshs 82. 4 million. These SACCOs can be categorized into employee based, farmer based, traders, transport, jua kali and community based. Affiliation to the union is by way of payment of a membership fee and the prescribed minimum share holding as may be determined from time to time.

The Union is managed by an elected board of thirteen members and a management team led by the managing director. In its annual meetings the union uses the delegate system that is elected at the provincial meetings, which are held prior to the annual general meeting.

Currently the Union offers different types of products which include financial services, risk management services, education and training, research and consultancy, mortgage financing and other specialized products as may be demanded by the members. The provision of these services is confined to the affiliated SACCOs.

KUSCCO has been identified for this study because it is the national organization of SACCOs. As such it has a significant contribution to make not only to the SACCO movement but also to the Kenyan economy. Given the complexity of its services it forms a good basis for the study and it can be used as blue print for the SACCOs.

1.4 Co-operative legal framework in Kenya

Since independence, it has always been the responsibility of the government to formulate policy. The first government action was in 1965 through sessional paper no. 10 on "African socialism and its application to planning in Kenya". This was then followed closely by the first Co-operative societies Act, 1966, which indicated that the government would take a leading role in cooperative development, but that as cooperatives matured, they would take up the responsibility. The major objective of the 1996 Act was concerned with the constitution, regulation and other incidental purposes. The Act bestowed upon the commissioner for Co-operatives with a lot of powers. The 1980s however saw a period of global economic changes. Thus a new global thinking about government was emerging which meant the roles would be reversed - with the government taking a backseat in people owned organizations and the owner taking fore front. Thus, in line with these changes, it was felt necessary to repeal the Act and hence place more emphasis on co-operators themselves. (Kibanga, 1998)

Consequently, sessional paper No. 6 of 1997 on "Co-operatives in a liberalized economic Environment" was put in place to enable the repeal of the Act. The theme of this paper was that Co-operatives must be run by their own members. This then saw the birth of the Co-operative Societies Act No. 12 of 1997. Whereas the 1996 Act had created a situation of fear of removal from office by CCD, the 1997 Act created a shift of emphasis from government to member control. Co-operative had prior to 1997 enjoyed government protection from the competitive economic environment. The 1997 Act meant that leaders had therefore to take a more proactive role, acting as agents to steer their Co-operatives through the changes, and generally operate professionally in order to handle the threats of the competitive environment. With the withdrawal of government control serious malpractices were witnessed in the sector. They include gross mismanagement, misuse, stealing and embezzlement of member's funds, splits of Co-operatives, unsanctioned investments, corruption, unauthorized payment etc. Arising from these and with the reinstatement of the Ministry of Co-operative development in 2003 it was found necessary to review the 1997 Act, which led to the Co-operative societies (amendment) Bill, 2004. The expected outcomes of the amendments include improved governance in Co-operatives; Elimination of corruption; Enhanced accountability; Enhanced facilitative role of government; enthused membership if they can get value for their money and creation of a vibrant co-operative movement. (Kibanga 2004)

This bill generally addresses all types of cooperatives and thus the legislation of SACCOs in Kenya is not specialized. Equally there is lack of a strong and effective official supervision, weak corporate structure, and a lack of deposit protection mechanism. In a Co-operative leader's conference on 'the future of the Co-operative movement in Kenya' (2000) the need for a specialized SACCO legislation was unequivocally expressed in the following terms: -
" Recognizing the potential threat posed to the Co-operative financial systems by the effects or liberalization and realizing the existence of competition within the sector, the Co-operative sector appreciates the need for a financial system that is sustainable and has linkages from the apex to the grassroots Co-operative organizations and vise versa" (Kibanga 2004).

Arising from these proposals of the cooperative leaders conference, a proposed SACCO bill has been drafted. This bill incorporates important aspects such as ownership and governance which should include separation of powers between the AGM, the Board of Director and the Supervisory committee; allow deposit taking; allow for regulation and supervision by the minister for cooperative development; Establish a central liquidity fund; establish a savings guarantee fund and improve on accounting and audit of SACCOs. The bill has been debated by SACCO leaders but is yet to be presented to parliament.

1.5 Statement of the problem

The quality of governance at all levels is increasingly being seen as the most important factor in the success of any organization. As indicated above poor governance practices have impacted negatively to the growth of the co-operative sector. Thus the need for good governance practices is critical if the sector has to have sustained growth. KUSCCO as the National Union of SACCOs should take a lead in the SACCO sector to spear- head good governance practices. This study shall address the question: What are the governance practices found in KUSCCO as apex the Union of SACCOs?

1.6 Objective of the Study

To establish the governance practices in the Kenya Union of Savings and Credit Co-operatives Ltd (KUSCCO).

1.7 Importance of the Study

It is anticipated that the study will provide valuable information to the following groups of people: -

i. The management, leadership and membership of KUSCCO by highlighting the type of Governance practiced within the organization. Typical governance problems will be analyzed and recommendations made for improvement.

ii. The leadership and membership of SACCOs affiliated to KUSCCO. The SACCOs look at the Union as a model and the findings and recommendation of the study shall form a valuable basis for governance practices in SACCOs.

iii. To the entire Co-operative movement, there shall be a better appreciation of the need to practice good corporate governance and form a blue print upon which SACCO governance can be based.

iv. To the government and in particular the Ministry of Co-operative Development it could form a basis of future re review of the Co-operative Act and the institution of any regulatory issues in the sector.

v. In Africa, Kenya has the largest SACCO movement which is represented at the National and Regional level by KUSCCO. This research shall be useful as a case study to be emulated by the other National SACCO organizations in other African Countries.

vi. To the academicians, the study will seek to improve understanding of corporate governance in the sector and a replicative study can be carried out after a few years to find out any changes that may have occurred.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter contains a review of available literature on corporate governance. It includes the meaning, importance and the pillars and principles of good governance. It further outlines how cooperatives are managed and controlled including the legal framework.

2.2 What is Corporate Governance?

Corporate governance can be seen as the manner in which power is exercised in the management of economic and social resources for the sustainable human development. It is a vital ingredient in the maintenance of a dynamic balance between the need for order and equality in society, and the efficient production and delivery of goods and services, accountability in the use of power, the protection of human rights and freedoms, and the maintenance of an organized corporate framework within which each citizen can contribute fully towards finding innovative solutions to common problems. (PSICG,1999)

Corporate governance is the system by which companies are directed and controlled. It is a measure of the way power is exercised over corporate entities (Cadbury report 1992). Johnson and scholes (2002) describe a governance framework, which specifies whom the organization is there to serve and how the purpose and priorities of the organization should be decided. They advance the view that corporate governance has been driven by the need to separate ownership and management of enterprises. This arises from the principal (owners)/agent (management) relationship. While owners may be keen for the long-term sustainability of the organization, managers may opt for short-term goals, especially where they are pegged to their compensation package. The business for social responsibility (BSR) on the other hand, defines corporate governance as the range of rules, regulations, and policies and practices that boards of directors use to manage themselves and fulfill their responsibilities to investors and other stakeholders.

2.3 Importance of good governance

Good corporate governance aims at the increased profitability and efficiency of business enterprises and their enhanced ability to crate wealth for their shareholders, increased employment opportunities with better terms for workers, and increased benefits to shareholders. The transparency, accountability and probity of business enterprises make them acceptable as caring, responsible, honest, and legitimate wealth creating organs of society. The credibility of business enterprises enhances their capacity to attract investment in an internationally competitive environment. The enhanced legitimacy, responsibility and responsiveness of business enterprises within the economy and improved relationships with their various stakeholders comprising shareholders, managers, employees, customers, suppliers, providers of finance and the environment enhance their market standing, image and reputation. (PSCGT, 2002)

According to BSR, 2002, global investor opinion survey indicates a close positive relationship between organizational performance and corporate governance. They cite improved financial performance, increased attractiveness to investors and strengthened relationships with external publics as some of the benefits accruing from corporate governance.

2.4 Pillars of good governance

The key components of, and the fundamental concerns of governance are accountability, transparency, predictability and participation. Accountability is the capacity to call officials to account for their actions. It has two components, namely *answerability and consequences*. Answerability is the requirement to respond periodically to questions concerning ones official actions. There is also a need for predictable and meaningful consequences, without which accountability is only a time consuming formality (PSICG 1999).

Transparency entails the provision of complete, reliable, timely, relevant information that is understood and at low cost to enable members and stakeholders assess the efficiency and effectiveness of those they entrust to govern. Predictability implies there are clear laws, regulations and procedures that are known in advance, uniformly and effectively enforced. Most importantly, the application of those laws, rules, procedures and any economic regulations must be effective, fair and uniform. Participation implies the active involvement of the governed- being consulted and engaged in the formulation of the governance procedures and rules and allowed to provide feedback on the operational efficiency and quality of the services as a means of monitoring and evaluation of performance (PSICG,1999).

The instrumental nature of governance implies that the four governance pillars are universally applicable regardless of the economic orientation, strategic priorities, or policy choice of the government in question, (CCG, 2003). In all fields of human endeavor, good governance is founded upon the attitudes, ethics, practices and values of the society regarding accountability, democratic values, the sense of right and wrong, effective and efficient use of resources, the protection of human rights and freedoms and recognition of the government as the only entity to which the society gives authority to use coercive power, PSICG (1999).

2.5 Principles of good corporate governance

The private sector initiative for corporate governance (1999) summarizes the following as the principles of good corporate governance. Authority and duties of members (shareholders), which entails the duty to protect, preserve, and actively exercise supreme authority in order to ensure the right people are elected to the board and that the board is held accountable and responsible for the management of the organization. The leadership principle requires that the organization is headed by an effective board that leads in the best interest of the organization based on transparency, accountability and responsibility, and that appointment to the board should be done through an effective process that ensures a balanced mix of proficient individuals. It is also expected that the board should determine the purpose and values and the strategies to achieve that purpose. Thus it should ensure that a proper structure in terms of systems and people is in place. The board should also monitor and evaluate performance and review the viability and financial sustainability of the enterprise, as well as to comply with all relevant laws, regulations, accounting and auditing standards. It should also ensure effective communication with all its stakeholders and that no one person or group of persons has unfettered power in order to create a balance of power within the board.

The board should ensure there is an effective internal control system. There should also be accuracy in reporting and regularly assess its performance and effectiveness. This would require the board members to be inducted into their roles and to continuously strengthen their governance skills. They should equally identify key risk areas and monitor them. The appointment of the C.E.O and the senior staff should also be a role to be performed by the board and ensure they are adequately motivated. The board should define, promote and protect corporate ethos, ethics and beliefs and operate within the mandate entrusted to it by the society. (CCG, 2003)

2.6 Governance in Co-operatives

For co-operatives the underlying business principles of user - owned, user - control, and user - benefit spells how a co-operative has to be governed. Governance is a reflection of the quality of management, it relates to the quality of relationship between co-operatives and members. It is the way those with power use that power. For co-operatives and companies it is both a political as well as an economic dimension (Prakash, 2000).

Co-operative corporate governance is about the system by which co-operative are directed and controlled. It calls upon for adherence of the basic values and principles of co-operatives. It is about accountability, transparency, predictability, and participation. Boards represent members and are the steward of interests – they should consider what is best for the co-operative membership as a whole (Chambo and Kaleshu 2002).

WOCCU identifies four most serious challenges to the financial sustainability and outreach of cooperatives as governance, delinquency, business orientation and lack of external supervision or authorizing legislation. Ironically it is the complexity of managing financial institutions that kills good corporate governance in cooperatives. As SACCOs become larger, they engage in more sophisticated operations and officials lose the member/client interface. As SACCOs grow larger most of the decisions are delegated to hired professionals, which demand a new approach to governance (Branch, 2002).

Leadership in a Co-operative society is different from leadership in capital based organizations. In Co-operatives, the Board members are shareholders and they are emotionally connected to the organization on the basis of solidarity. Moreover Co-operative leaders are people who must be led by the members. In terms of supervision of management there are four problem areas where board members have fallen short:

- Insufficient knowledge of internal working systems of their SACCOs
- They are not interested in dealing with the hard facts and figures of their Co-operative
- They lack a formal system of supervision of management with input - outputs-consequence- decision.
- There is lack of internal audit services and supervisory committees are weak and compromised as part of the board.

With such weaknesses the Board members are facing the traditional directorial dilemma "you cannot know everything, but ultimately you will be held responsible for everything by the members "(Chambo 2002).

2.7 Management and Control of Co-operatives.

Co-operatives are democratic organizations controlled by their members, who actively participate in setting their policies and making decisions, men and women serving as elected representations are accountable to their membership. In primary cooperatives, members have equal voting rights (one member one vote) and Co-operatives at other levels are also organized in a democratic manner. This principle of democratic member control leads us to put the control of co-operatives into three basic levels; Members who set the goals, policies and related decisions; elected management who are charged with the execution of policies and related decisions; contracted management who are charged with the execution of operations and responsible to the board of directors. Thus cooperatives are pyramidical in nature. Members give authority to the board of directors to manage on their behalf and the Board passes this function to contracted management. This is an essential ingredient of Co-operative management as individuals who later create and implement subsequent Co-operative opportunities are not necessarily identical with those who initiated them (Chambo and Kaleshu 2002).

Co-operatives are not owner/managed organizations. The owner delegates management to the board of directors. The elected board has the responsibility to lay to the member's correct accounts, provide financial regulations and lay before the general meeting audited financial statements. However, the major question arises as to whether laying of such accounts does really indicate that there is accountability and responsibility. This would lead us to the issues of companies like Enron and World Com. In both cases audited accounts were presented and companies were viewed as exemplary in performance, yet they collapsed under the combined weight of falsifying accounts, heavy directors remuneration, and sheer and deliberate negligence of shareholders' rights to maximization of share value (SCCULT, 2003).

In the corporate world, often the relationship between auditors and board of directors has been called to question. Auditors in some cases have succumbed to pressure from directors especially where fees are huge and material. This scenario is no different in Co-operatives. In Kenya we had the case of Kenya Planters Co-operative Union where two different auditors produced two different sets of accounts. In companies as in co-operatives the Board is responsible for corporate governance. The link between directors and members/shareholders is therefore the auditors who should provide the external objective check on the directors produced financial statements (Chambo, 2002).

Corporate governance in co-operatives arises due to the fact that members are duty bound to exercise direction and control of their societies. However, experiences in Co-operative show that there is a big distance between members and their Co-operative, which creates a major governance problem. First this is attributed to low education of members on cooperatives and cooperation. Most of the members are interested in the services; they do not undertake their obligations as members. Secondly they transfer their right to delegates on the assumption that the delegates will exercise the same rights as members. Thirdly there is low rotation of elected delegates and Board members, thus leadership becomes a perpetual organ with no change (ICA, 1996)

On the other hand, some Board members lack the ability to lead and monitor complex business operations. This, coupled with the twin problem of hired management that provides information with vital gaps, does not aid the decision making process. Consequently decisions are either postponed or made with inadequate information, which leads to poor decisions. This is not the only problem – sometimes the balance of power is inappropriate. A lot of power lies with the CEO, who has monopoly of information and agendas about the business. Moreover employed staff may not bother with the member's rights. Equally, younger and active members are rarely elected into the board (Chambo & Kaleshu, 2002).

2.8 Good governance guiding questions in Co-operatives.

Co-operative corporate governance calls for collective and participatory management. It also enables members to evaluate directors. The internal and external environments should be conducive for accountability, answerability, transparency, predictability and participation to ensue and reassert member control. The best indicators for good governance could be provided by answers to the following issues/questions.

i. How much of awareness the leaders and the members have about the principles of Co-operative philosophy
ii. How clearly do they understand the ethical and moral elements that are essential components of Co-operative philosophy as a whole?
iii. How different is the co-operative enterprise from private or parastatal organization?
iv. How conscious are board members about their rights and responsibilities?
v. To what extent do the board members realize that they are accountable to members?
vi. How smooth are the communication channels between the board and the CEO?
vii. How much of the operational power is delegated to the CEO?

viii. Is the code of conduct or ethics developed and accepted by both the co-operative and its members?

ix. How smooth is the communication between the Co-operative and its members?

x. Is there any discipline outlined in the use of assets of the co-operatives

xi. How often are the meetings held on schedule and in accordance with the relevant regulations?

xii. Are the costs of the board so high in relation to the quality of, and how expensive is it to assert the principles of the accountability?

xiii. What are the roles of the audit committee? (CCG, 2003)

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter explains the research design that was adopted. It also explains the methods that were used in collecting the data and finally it covers the data analysis methods.

3.2 Research design

This study will be a case study of KUSCCO. The case study approach has been chosen because it has considerable ability to generate answers to the question 'what?' It is also useful when the intention is to gain detailed and in-depth information and a rich understanding of the phenomenon being studied.

3.3 Data collection

The data was collected by use of personal interviews. This method is flexible and is particularly useful when it is known at the onset what information is needed. The board of directors, the C.E.O. and departmental heads were interviewed as they were in a position to give detailed information on the organization. Secondary data was also used which involved an assessment of available documentation in the office. These included the procedures manual, policy manual, the by-laws, organizational chart, board minutes, code of conduct for board members, the current strategic plan, and various accounting documents and reports.

3.4 Data analysis

The data collected was analyzed by use of content analysis. Most of the data collected was qualitative which is based on meanings expressed through words and results in non-standardized data that does not require classification. Content analysis is a more suited form of analysis for this type of data.

CHAPTER FOUR: FINDINGS AND ANALYSIS

4.1 Introduction

This chapter contains the research findings and analysis and includes the board composition, their roles and responsibilities and their code of ethics. It also covers the appointment of the C.E.O and senior staff, the duties of the C.E.O and the role of members. The findings also include the organization purpose, internal controls, organizational risks and performance evaluation.

4.2 Organizational Purpose

The basic purpose of the union was seen as helping the mobilization of savings with a view to making the organization more profitable, have equitable distribution and ultimately maximize the benefits accruing to individual members of the SACCOS. The development of the organization purpose is done through a process that begins by development of regional strategic plans at the provincial level. The SACCO leaders who are elected delegates within the province hold strategic planning workshops that are facilitated by experts in this area. During these workshops a thorough SWOT analysis is carried out. These regional strategic plans are then brought together by the BOD who use them to develop the overall organization strategic plan. This is also done through a workshop held jointly by the BOD and senior management staff and guided by an external facilitator. Thus the development of the organization purpose is not a one man or BOD affair, rather it is a joint effort from all the members as represented at the grass-root level. This process is aimed at ensuring ownership by the members. Equally the members assist in developing the strategies to be used to achieve the organization purpose.

During the strategic planning workshop held in October 2003, the vision mission and the organizational values were reviewed. Consequently their vision is "to be the national co-operative organization for SACCOS in Kenya" while the mission is "To be the leading provider of quality and diversified financial and technical services to SACCOS in Kenya in accordance with the co-operative principles." The Organizational values were developed to include respect for all members, volunteers and staff; trust, honesty and integrity; inclusiveness, fairness and equity; creditability and professionalism; service orientation; respect and concern for the members; and co-operation and strategic alliance.

In the strategic plan 2004-2008 the strategic corporate objectives were also reviewed. The objectives include the achievement of a conducive policy and legal framework for SACCOs; to protect the interests of SACCO movement in Kenya; to have an enlightened, knowledgeable and empowered SACCO membership which understands SACCO approaches, principles, values and business; to provide the necessary support to all levels and sizes of SACCO societies on the basis of needs; to promote, recruit and sustain saving and credit societies; to ensure the unions prudent business and product portfolio; and to be sustainable financially, technically and professionally.

4.3 Board roles, duties and responsibilities

As outlined in their code of ethics the role of the board of directors is to formulate policies and ensure appropriate decision making for the organization; to perform an advisory function for both the management and the SACCO societies; to act as a trustee for member societies, creditors and the general public for the effective administration of the union; to ensure continuity of the organization and that capable management is employed for effective administration of the union and to motivate staff and SACCO societies for the achievement of their goals.

In relation to the members the board has a duty to educate and inform members of their rights, run the union efficiently by being accountable, responsible and transparent, and to run the union profitably and plan effectively to build stability and self sustainability in line with the union vision and mission statements.

The board is divided into three sub-committees namely the executive board, the business sub-committee and the audit and budget committee. The role of the executive board include execution of urgent matters that require immediate policy guidelines or decisions, planning and advice on board meetings, international and national activities and the general administration of the union business. The business committee on the other hand deals with formulation of sound policies on appropriate business practices for the various union products and services, and evaluating the performance of the various departments. They also approve new business opportunities or closure of non-viable activities. The audit and budget subcommittee is charged with the responsibility of reviewing financial statements, compliance with accounting standards, disclosure and legal requirements, recommendation or dismissal of external auditors, review of internal controls and review of budgets for approval by the full board.

The board also ensures the implementation of the resolutions of the annual delegates meeting. However in their operations they do not have a structured work-plan, rather their plans are picked out from minutes of their meetings. The decisions by the board are made through consensus. However in the event that disagreements do arise then the decisions are made in accordance with the co-operative principle of the majority view. Whereas the bulk of the communication is done by management the board has a responsibility to constantly seek feedback from the members. These they do by visiting the SACCOS and collecting both their views and complaints.

While the board has to a large extent performed their roles relatively well, the level of staff motivation was seen as wanting. According to one senior manager, the human resource systems needed a thorough review. The staff morale could be described as below average and this is clearly indicated by the levels of staff turnover. for the period June 2002 to 2004 staff had left the union, out of which had resigned terminated and through an early retirement initiated by management. Some of the reasons for low morale included duplication of duties, lack of proper guidelines, discriminatory implementation of policies etc.

4.4 Board composition, skills and code of ethics

The BOD is limited in the mix of skills available. It is composed of 2 administrators, 4 teachers, 1 clinical officer, 1 auditor, 1 accountant, 1 chemist, 1 plantation manager, 1 tax officer and 1 public relations officer. As earlier indicated, these board members are elected by and from the delegates who are elected at the grass-root level. Some of the leaders come from SACCOS that handle very small volume of business without any complex operations. Once they get into the board there is no system or procedure of converting these leaders into policy makers. The situation is made worse by the fact that there are no minimum professional and ethical standards set out as a pre-requisite to becoming a board member. This leads to the board becoming the worst enemy of the institution. This is because they make decisions that favor them rather than those that benefit the membership, they want to be seen as bosses, in other words they do not act professionally. The situation is made worse by the fact that there is no direct supervision of the board. As the chairman put it "there is no one to guard the guardians.

In terms of the board powers, there is unequal distribution of power among the members. According to the chairman this inequality arises due to differences in financial standing, exposure and level of knowledge. The environment in which KUSCCO operates is no different from the general Kenyan environment in which the electorate is to a large extent influenced by the funds available to lure members into electing a given candidate. In other instances, those who have had long years of service may command more power than new comers. Others have commanded power based on their extensive knowledge on various aspects thus attracting a following. It is therefore difficult to create a power balance within the board. However, the chairman sees limiting the period of service as one way to reduce these inequalities. Another way is to extensively train and expose the leaders so that none feels left out or lacking in knowledge

As per the KUSCCO by-laws (No. 39) the board members are required to take oath of office to hold in the strictest confidence all transactions of the union. In addition the union has a code of ethics for the board members, which is used as a strategy for prudential management of the union. This is a comprehensive document whose objectives are to set down and promulgate the basic ethical principles which board members should observe, secure adherence to principles of good practice, promote and maintain confidence in the SACCO system, resist and prevent the development of undesirable practices and to harmonize the concepts of the profitability and social responsibility.

As indicated earlier the board is lacking in the mixture of skills of the members. However once new board members are elected they are inducted through briefs by the managing director and also through board workshops that are held annually to train the board members on the relevant skills.

The current board has been trained in various aspects, which include corporate governance their duties and responsibilities, strategic management, group dynamics and team building as well as the relevant co-operative legislation.

The KUSCCO code of ethics for board members outlines it objectives as stated above, the role of board members, personal standards and moral integrity, conduct of board members and individual board members, minimum qualifications of a board member, loyalty and fiducially responsibility, confidentiality and trust. It further indicates the relationship between board members and staff, inter-relationships between the sub committees, procedures to meeting out disciplinary action, compliance with the law, and compliance with the code.

Thus as per the recommendation of the private sector initiative for corporate governance on the important aspects of the code of ethics, the KUSCCO code does contain these aspects.

4.5 Appointment and duties of C.E.O

The procedures for recruiting the C.E.O and senior management staff is documented. It does follow the necessary steps required from advertising, short listing, interviewing and placement. However, in the case of the C.E.O this has not been followed in practice. This is because the appointments have been circumstantial. As mentioned in the background, KUSCCO was under commission from 1983 to 1986. The C.E.O who was appointed then by the Ministry of Co-operative Development served until 2001 when he abruptly resigned. This was a time when the organization was undergoing through a major restructuring and the board appointed the then deputy to take over as C.E.O without following the procedure mentioned above. In the case of senior staff, to a large extent the procedures have been followed. However there are a number of cases that were cited where the rules were not strictly followed. In some cases the positions were filled internally through promotions.

The roles of the CEO were found to include policy formulation, advisory to the board, staff and members, ensuring acquisition of appropriate human resources, sound financial management practices, secretary to the board, representation of the union in various fora, focusing on organization vision, charting the way forward and the day to day management of the organization. He is also charged with the responsibility of ensuring that the affairs of the union are managed in a competent manner and that all directives of the board are complied with. He is custodian of all funds and property belonging to the union, he maintains correct and current accounts of all receipts, disbursements, assets and liabilities of the union, recommends to the board appointments of staff, and submit quarterly reports to the board on the financial condition of the union.

In his duties the CEO operates with a work plan where all routine events are predetermined by the beginning of the year. This includes all board meetings, provincial council meetings, the annual general meetings, international co-operative days, WOCCU forums and regional meetings. A diary containing all those activities is circulated to board members to enable them prepare adequately for the meetings. Another major role played by the CEO is to ensure documentation for all meetings are availed to board members before such meetings take place. As secretary to the board he also prepares minutes and circulates the same within a week of the meeting. It was noted that though infrequent there are cases of role conflict between the managing director and the chairman to the board. For instance this has occurred where staff below the CEO level are consulted by the chairman or board members and their perceptions differ from those of the CEO. In such cases the conflict in resolved by the CEO raising the issues with the executive board or the full board.

4.6 Duties of members

In line with the co-operative principles, members enjoy equal rights in the union. Some of their duties include participating in the democratic process i.e. voting, demanding quality services, attending and participating in the union business forums like the annual general meeting and education days. Members also have a duty to question all aspects in relation to the management of the union, which may directly or indirectly affect them. Such aspects include the right to receive loans without any inducement, the right to quality and efficient services, the right to safety of their investment including returns on those investment as well as aspects related to elections into leadership positions for the union. However, this is usually limited by the fact that a lot of members are ignorant and they do not participate particularly at the grass root level.

Equally there is a lot of canvassing by interested individuals who may not necessarily be the best leaders. There is no specific criteria adopted by member in electing the leaders. The delegates at times may elect board members based on their personal perceptions of the leader, or how heavily the candidate has campaigned. This method of election has led to a board that lacks a mix of skills.

In terms of holding the board accountable they use both the organization by-laws and the co-operative societies act No 12 of 1997. However, most members are not conversant with the provisions of these two legal documents. They also check on the level of implementation of the annual delegates resolutions. Where the board falls short of the members demands the members call upon them to explain the reasons or factors contributing to such shot falls. In the event that the members are not satisfied it may even lead to removal of such board members.

4.7 Structure and organization

According to the managing director the representation of the union countrywide by 120 delegates and 13 board members is sufficient. However the election of delegates may not be quite representative, as some SACCOS do not attend the provincial council meetings during which these delegates are elected. Moreover the individuals hardly know each other and sometimes delegates are elected by virtue of coming from a given SACCO rather than the personal qualities of the individuals.

According to the chairman, the KUSCCO structure is rigid, stereo typed and bureaucratic. It is more of a primary SACCO structure rather than a more complex organization, which the union is. In addition, it does not have the right people in place particularly the staff. This has a lot to do with the way they were recruited, in his words he sees them as "round pegs in square holes." he sees them as people with fixed mindsets, rigid and a replication of the civil service attitude. Moreover most of the staff are people of the same career who have been basically drawn from the same profession in the co-operative sector. This limits the diversity of opinions and ideas that are very critical in the success of any dynamic organization. Whereas the current structure may serve to meet the needs of the union the managing director felt that implementation issues need to be improved. This is particularly so in terms of the people element both on the leaders and employees.

The other issue that arose in terms of structure is the duplication of duties. Some managers felt that the division of duties, in some cases was not distinct leading to overlap of responsibilities. Whereas the union has an operations manual, in practice there were cases of duplication of duties. It was established that the levels of staff satisfaction and motivation was low. The managers cited the main reason to be lack of uniformity in the implementation of procedures and policies. This could account for the high rate of staff turn over. For instance for the three years, June 2001 to June 2004, forty six members of staff had left the union either through resignation, early retirement, or dismissal. For a total work force of one hundred and ten, this translates to about a turn over rate of 15 %, which is rather high.

4.8 Internal controls

Documentation available includes a procedures manual that details the operations of each operational department as well as the accounting procedures. The manual details the purchasing procedures, recording of sales receivables, payments etc. However it was evident that quite a number of the details in the procedures manual were not being adhered to. The situation is made worse by the fact that there is no auditor to inspect the procedures.

In terms of data security, there is no specific policy on restriction and access to specific computerized information resources like 'read only' 'adding only' updating and erasing etc. As at the time of data collection however the organization was in the process of acquiring some modern software that would incorporate all the security measures. It was also noted that there is no security available against environmental damage. One case was cited where data had to be reconstructed when computer hardware was transferred from one office to another. There were also cases where computers did not have the necessary equipment to protect them from power fluctuations.

A check on staff handling sensitive areas was also done. It was noted that no enquiries are done about the past of such candidates. In one instance the organization lost funds through the housing fund where an employee collected the same without remitting to the office. While he was sacked, it was later discovered he had left his previous employer under similar circumstances. In the normal day-to-day operations it was noted that in a majority of cases, expenses are incurred without reference to the budget provisions. While periodic budget utilization in presented, it is not always acted upon.

The budget and audit subcommittee sees its role as streamlining the organization operations in terms of investments, income, expenditure, assets, staff remuneration visa vis the numbers and positions, finances and budgetary provisions. In order to effectively do their work, the chairman of this sub-committee, felt that the input of the internal audit is very important.

The importance of internal audit for an organization the size of KUSCCO cannot be over emphasized. However it is interesting to note that this position was abolished in 1998 only to be re-introduced in 2002 and to be manned by an audit assistant, who then left the organization in 2004. As at the time of data collection the position of internal audit was vacant and had been for over six months. This is a clear indication that the position had not been given the attention and importance it deserves.

4.9 Corporate compliance

In general the organization does comply with the co-operative legal requirements in terms of the co-operative societies act no. 12 of 1997, the co-operative societies rules of

1998 and the internal by-laws. The accounting and auditing standards have also been complied with to a great extent.

As a member of the world council of credit unions, the union is expected to comply with the PEARLS performance standards. As discussed under performance evaluation it is clear that there are quite a number of areas that the union has not complied with.

4.10 Management of corporate risks

The union is faced with a number of risks. They include operating risk, credit risk, liquidity risk and marketing risk. Operating risk is the potential for loss caused by internal or external events as a result of systems or procedural failures, errors, fraud or natural disaster. As mentioned earlier, there is quite a number of staff that does not have the right qualifications for the duties they perform. Clearly this leads to errors and procedural failures. Cases of erroneous records were observed from the documentation, which is a very big risk as it may lead to loss of funds. For example in a case where a members statement reflects more deposits than they actually hold, then KUSCCO is bound to refund the amount in excess of what the SACCO actually holds. Also in cases where the recording of the debtor's position is erroneous, money owed to the organization may never be collected. As indicated under internal controls, the computer back up systems also pose a major operational risk.

Another aspect that poses an operational risk is purchasing. Whereas there is a procurement committee, the laid out procedures are not adequately followed. Cases of purchases without quotations and single sourcing were cited. This is a big risk as high prices may be paid or goods of substandard quality purchased.

Credit risk is the risk of financial loss resulting from the failure of a debtor, for any reason, to fully honor financial or contractual obligations. It usually arises from traditional lending and investment activities. In terms of lending KUSCCO does not usually call for tangible security. They rely on the members' deposits, which consist of a minimum of 40% of the loan amount. This means that 60% of the loans taken are unsecured. However there are certain parameters that are used which include the SACCOs audited accounts for three years, the financial viability of the project, the SACCO sustainability for the next two years and the minutes of the management committee that approved the borrowing. Individual calls are made to the committee members to ensure that the minutes are authentic. Loan repayments must be through irrevocable bankers orders.

In spite of the above the non-repayment of loans stands at 5% in 2004 which is an improvement from 17% in the year 2000. This was a part of the efforts to meet the prudential standards. Loan defaulters have been taken to the co-operative tribunal, which has contributed to other SACCOs improving on their repayments.

The union has not quite adhered to the prudential standards in as far as provisioning for loan losses is concerned. The provisions are based on the statistics of the previous years. The limitation on provisioning arises because the procedures for write off are very bureaucratic and could take 2-3 years before it is effected. This does have a political angle because it means reduced profits, which would negatively affect the financial results and reflect negatively on the leaders leading to their removal.

Liquidity risk arises from fluctuations in cash flow. The union does not have in place liquidity management policies and in many instances they cannot meet their obligations as they fall due. For instance several of their accounts are on overdraft for a better part of the year. Cases of creditors, whose credit period is thirty days, were cited as unpaid due to cash flow problems. The union has not been able to match their inflows to the outflows and this has cost them huge amounts on bank charges on the overdraft facilities. In some cases the union has not been fast in invoicing and this contributes to the delayed payments.

In the central finance programme, it is quite difficult to have accurate cash flow projection due to school fees loan demands on the part of the SACCOs. This affects the loans demand on KUSCCO as well as repayments. Consequently there is always a loan backlog averaging two months. In the KUSCCO housing fund, the cash outflow is usually heavy since members borrow at five times their deposits and the loans are long term for up to fifteen years. Thus the inflows can hardly meet the outflows in the expected time. The union has incorporated a credit control section that is charged with the responsibility of ensuring that the union debts are collected as they fall due. However no policy was in place to control the use of overdraft facilities.

Market risk is the potential impact of fluctuations in market rates, including changes in interest rates and foreign exchange rates. In the year 2000 the union engaged in off shore borrowing. The money was borrowed in euros to be repaid at an interest rate of 9%. As at the time of borrowing the Euro was changing at Kshs.69. By 2004 the exchange rate had moved to Kshs. 103. This in effect means that the loan was being repaid at about 13.4% a loss of 4.3%. It is clear that this risk is very high and has caused heavy financial loss to the union. This is compounded by the fact that the money is lent out to SACCOs at 11%, which is lower than the 13.4%. borrowing rate.

To mitigate the union against this risk the union has resulted to internal borrowing from its members and also engaging in market intelligence in order to align their interest rates to those prevailing in the market.

4.11 Performance evaluation

There are various ways of evaluating performance. However in this section three methods have been explored which include qualitative, quantitative and the PEARLS prudential standards.

Qualitative evaluation involves an evaluation of other aspects of an organization that cannot be measured in quantitative terms. This may include the quality of goods and services, the level of customer satisfaction, the organizational image, the quality of staff the level of staff motivation and satisfaction etc. Other measures according to the MD would include the confidence level of members, the turnover of the board of directors, the number of products and services, comparison with other organizations within the industry the caliber of personnel, financial management practices, cost control, costing and pricing of products and services, institutional capacity building, compliance with policies and procedures, and availability and appropriateness of job descriptions and staff appraisal. It was noted that while there are bits and pieces of information that give indications on these areas, there is no formal system of qualitative evaluation for the union.

In using quantitative evaluation, on a monthly basis, the accounts department prepares an income and expenditure account. The operational departments also prepare quarterly reports that are discussed with the business sub-committee. These reports are aimed at comparing the targets against the projections with a view to making the necessary decisions. The same evaluation is done at the end of the trading period, which runs from January to December. The quantitative measures include the levels of turnover, expenses, and returns in terms of dividends, shareholding and membership. A trend analysis as well as comparison with annual projections is then carried out to determine whether the performance is within acceptable limits. If not the contributory factors are assessed and corrective action taken.

PEARLS is a performance evaluation tool that was developed by the world council of credit unions (WOCCU) for use by credit unions worldwide. It is an acronym that stands for protection, effective financial structure, asset quality, rates of return, liquidity and signs of growth. The tool has a total of 46 ratios and the organization uses its annual accounts to calculate these ratios, which are then compared with what the tool recommends. The information contained in figure I shows the KUSCCO's calculated ratios for four years, 2000 – 2003. (Appendix I)

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter summarizes the findings and makes conclusions on the study of corporate governance practices in KUSCCO. It also includes the study limitations, recommendations arising from the findings and recommendations for further research.

5.2 Summary

The pillars of good governance include accountability, transparency, predictability and participation. In terms of participation the level of member participation is rather low given the number of SACCOS and the mode of representation. Consequently the mode of accountability and transparency is rather limited. This is compounded by inadequate member enlightment on the available mechanisms of holding the board accountable and the limited communication between the members and the board. The legal framework is itself a hindrance and more so the members are not very conversant with the legal provisions.

Although several principles of corporate governance have been practiced some have been partially implemented while others have not been practiced at all. The process of board appointment for instance does not ensure a balanced mix of proficient individuals. Equally the structure and systems in terms of people need improvement. The internal control systems are also not quite effective as is the staff motivation. However the board is actively involved in determining the purpose, values and strategies to achieve the organization purpose. The board has also ensured compliance with the various laws and regulations and where the expected standards have not been attained the organization has put mechanisms towards such compliance.

The performance and effectiveness of the organization has not been adequately measured. There is also no system in place to evaluate the chief executive, the individual board members and the entire board performance. Although the union is aware of the key risk areas they have not done enough to mitigate the union against these risks. This is more so in terms of operating and liquidity risks.

The organizational political element does at times influence the board election process and consequently the business decisions for the organization. This does indeed affect prudent business management as certain decisions are made to satisfy political aspirations rather than to improve shareholder value.

5.3 Conclusion

The study revealed key weaknesses in the governance practices in KUSCCO. This is particularly so in operationalizing the principles of good corporate governance and ensuring that the pillars of good governance are up-held. The board, management and members are involved in determining the organization purpose although the main players are the board and management.

In conclusion it is noted that the study variables were relevant to the study of governance practices in KUSCCO, and revealed current practices which brought out both the weakness and strengths particularly on the principles of good governance. The recommendations given to improve good governance practices and particularly those given on board leadership need to be given due consideration. The legal framework should also be enhanced to ensure transparency and accountability of board members.

5.4 Recommendations

Minimum professional academic and ethical standards should be set out to form criteria for election of board members. Other consideration like the success of the SACCOs they manage, the volume and complexity of the operations should be taken into account. In other words the experience and track record would be critical in this respect. The union should ensure that the board selection process does not encourage a campaigning process where candidates willing to compete for member support rely on the self-interest of members to support their election but design a process that focuses on expertise and qualifications thus creating real pressure on candidates to promise and indeed deliver specific results. The criteria should also aim at ensuring that there is a proper mix of the board in terms of skills. Since to a large extent the quality of board governance is within the board, they should regularly devote attention to evaluating their own capacity and effectiveness

In terms of evaluation there is need to develop criteria to evaluate the performance of the chairman, the individual board members, and the C.E.O. distinctively separate from the organizational performance. There is also need to design a system of qualitative evaluation as this would clearly indicate how the organization is viewed by its internal and external stakeholders. This is important in determining the type of staff and clients the union would like to attract and it's standing in the society

There is need to focus on the staffing with a view to not only have the right number but also the right caliber of staff with the relevant qualifications and who can match the fast changes in the business world. KUSCCO should open up to recruit from the business world and avoid over emphasis on candidates with a co-operative background. This will inject new ideas and different methods of doing business as opposed to the co-operative way. Duplication of duties should at all costs be avoided in practice in order to improve on staff morale. The board should design incentive systems to ensure staff retention and reduce the rate of staff turn over.

To minimize operating risks, the appropriate infrastructure, control systems and people must be put in place. This should include the segregation of duties, delegation of authority, risk monitoring, and financial and managerial reporting. The liquidity risk should be seriously considered. In order to meet the prudential standard on liquidity the union needs to re-look at its credit policy coupled with the expenditure pattern with a view to creating a match between the cash inflows and cash outflows. The record keeping on debtor's position needs to be strengthened as is debt collection. It may also consider investments in liquid assets that could be converted into cash at short notice. Where there is need for external borrowing the market rates and interest rates should be carefully considered to avoid losses. To meet the prudential standard on asset quality the union has two options, either reduce the level of non-earning assets by disposing of them or convert them into income earning assets.

There is need to seriously re-evaluate the structure and existence of the internal audit with a view to streamlining the organization internal control system. The appointment of an officer at a senior position should be considered as well as a fully-fledged audit department. This will ensure that the budget and audit committee works more effectively as they would basically rely on audit reports produced in this department. It would also create checks and balances in policies and procedures implementation in the areas of purchasing, payments, collections and record keeping.

There is need to regularly review policies and procedures to ensure their adequacy to the changing needs of the union. Such reviews should include asset valuation, capital management, credit management, investment management, asset/ liability management, liquidity management and internal controls. This would ensure compliance with the international accounting standards and the PEARLS prudential standards.

There is need to separate business decisions from the co-operative politics. The chief executive should be given more power to professionally do business without political interference. This is more so in terms of staff recruitment and compliance to accounting and auditing standards.

5.5 Limitation of the study

Then main limitation was in data collection where some managers were reluctant to give detailed information on their operations, particularly in areas that would expose weaknesses in the departments. The time available and access to certain documentation was also a limitation.

5.6 Recommendations for further research

This case has explored the current corporate governance practices in KUSCO. A replicative study could be carried out after a few years to establish what practices may have changed over time. A study could also be carried out to determine the relationship between corporate governance and organizational performance. Also, specific aspects of corporate governance for example the role of members in co-operative organizations in Kenya could be studied. A cross sectional study could also be carried out to compare corporate governance practices among the national co-operatives organizations in Kenya.

FIGURE I KUSCCO PEARLS RATIOS

KUSCCO LIMITED

P-E-A-R-L-S RATIOS

Based on Local currency

P-E-A-R-L-S RATIOS	Goals (Excellence)	31-Dec-99	31-Dec-00	31-Dec-01	31-Dec-02	31-Dec-03	Annual Goal	% Complete
Number of Credit Unions in this Report		0	0	1	1	1	1	
P *PROTECTION*								
1. Loan Loss Allowances / Delinq. >12 Mo.	100%	0.00%	NA	100.00%	100.00%	100.00%	-6.17%	-1621%
2. Net Loan Loss Allow. / Allow. Required for Delinq. 1-12 Mo.	35%	0.00%	NA	100.00%	100.00%	100.00%	0.00%	NA
3. Complete Loan Charge-Off of Delinquency > 12	Yes	0	NA	Yes	Yes	Yes	No	NA
4. Annual Loan Charge-offs / Average Loan Portfolio	Minimized	0.00%	NA	0.00%	0.00%	0.00%	0.00%	NA
5. Accum. Charge-Offs Recovered / Accum	>75%	0.00%	NA	NA	NA	NA	NA	NA
6. Solvency	Min 111%	0.00%	NA	107.13%	108.12%	107.12%	93.60%	114%
E *EFFECTIVE FINANCIAL STRUCTURE*								
1. Net Loans / Total Assets	70-80%	0.00%	NA	75.20%	76.03%	79.10%	76.75%	103%
2. Liquid Investments / Total Assets	10-18%	0.00%	NA	0.71%	0.00%	0.00%	0.00%	NA
3. Financial Investments / Total Assets	Max 2%	0.00%	NA	1.09%	1.03%	0.89%	0.58%	153%
4. Non-Financial Investments / Total Assets	0%	0.00%	NA	0.00%	0.00%	0.00%	0.00%	NA
5. Savings Deposits / Total Assets	Between 70 - 90%	0.00%	NA	77.75%	77.60%	81.71%	82.11%	100%
6. External Credit / Total Assets	0-5%	0.00%	NA	10.49%	8.30%	5.03%	3.64%	138%
7. Member Share Capital / Total Assets	10-20%	0.00%	NA	4.79%	5.61%	5.64%	6.42%	88%
8. Institutional Capital / Total Assets	Minimum 10%	0.00%	NA	0.00%	0.00%	0.00%	0.00%	NA
9. Net Institutional Capital / Total Assets	Minimum 10%	0.00%	NA	-0.26%	-0.62%	-0.59%	-12.29%	5%
A *ASSET QUALITY*								
1. Total Delinquency / Gross Loan Portfolio	Less Than or Equal To 5%	0.00%	NA	0.00%	0.00%	0.00%	12.86%	0%
2. Non-Earning Assets / Total Assets	Less Than or Equal To 5%	0.00%	NA	23.00%	22.94%	20.02%	22.67%	88%
3. Net Zero Cost Funds / Non-earning. Assets	Greater Than or Equal To 200%	0.00%	NA	29.15%	34.28%	35.15%	-19.68%	-179%
R *RATES OF RETURN AND COSTS (ANNUALIZED)*								
1. Net Loan Income / Average Net Loan Portfolio	Enterprenurial Rate	0.00%	NA	9.94%	12.16%	11.55%	0.00%	NA
2. Liquid Inv. Income / Avg. Liquid Investments	Market Rates	0.00%	NA	3.98%	6.75%	NA	NA	NA
3. Fin. Investment Income / Avg. Fin. Investments	Market Rates	0.00%	NA	0.00%	0.00%	0.00%	0.00%	NA
4. Non-Fin. Inv. Income / Avg. Non-Fin. Investments	Greater Than or Equal to R1	0.00%	NA	NA	NA	NA	NA	NA
5. Fin Costs: Savings Deposits / Avg. Savings Deposits	Market Rates, > Inflation	0.00%	NA	4.98%	5.40%	5.05%	0.00%	NA
6. Fin Costs: External Credit / Avg. External Credit	Market Rates	0.00%	NA	2.73%	9.97%	8.29%	0.00%	NA
7. Fin Costs: Member Shares / Avg. Member Shares	Market Rates, > R5	0.00%	NA	0.00%	0.00%	0.00%	0.00%	NA
8. Other Fee Income / Gross Income	Pending	0.00%	NA	34.11%	26.88%	30.22%	NA	NA
9. Gross Margin / Average Assets	Amount Needed to Cover R11,	0.00%	NA	8.03%	8.18%	8.84%	0.00%	NA
10. Operating Expenses / Average Assets	<5%	0.00%	NA	7.81%	7.87%	8.74%	0.00%	NA
11. Provisions for Risk Assets / Average Assets	Sufficient for Estimated Losses	0.00%	NA	0.14%	0.23%	0.06%	0.00%	NA
12. Other Income or Expense / Average Assets	Amount Needed	0.00%	NA	0.00%	0.00%	0.00%	0.00%	NA
13. Net Income / Average Assets (ROA)	Enough to reach the goal for E8	0.00%	NA	0.08%	0.08%	0.04%	0.00%	NA
14. Net Income / Avg. Inst. Cap (ROE)	More Than Inflation	0.00%	NA	1.25%	1.11%	0.54%	0.00%	NA
L *LIQUIDITY*								
1. Liquid Assets - ST Payables / Total Deposits	Minimum 15%	0.00%	NA	4.79%	1.85%	1.41%	-0.32%	-441%
2. Liquidity Reserves / Total Savings Deposits	10%	0.00%	NA	0.00%	0.00%	0.00%	0.00%	NA
3. Non-Earning Liquid Assets / Total Assets	Less Than 1 %	0.00%	NA	3.58%	2.07%	1.61%	0.17%	947%
S *SIGNS OF GROWTH (Year-To-Date Growth Rates)*								
1. Net Loans	Sufficient to Achieve Goal in E1	0.00%	NA	NA	7.03%	20.76%	15.76%	132%
2. Liquid Investments	Sufficient to Achieve Goal in E2	0.00%	NA	NA	-100.00%	0.00%	0.00%	NA
3. Financial Investments	Sufficient to Achieve Goal in E3	0.00%	NA	NA	0.05%	0.00%	-21.49%	0%
4. Non-Financial Investments	Sufficient to Achieve Goal in E4	0.00%	NA	NA	0.00%	0.00%	0.00%	NA
5. Savings Deposits	Sufficient to Achieve Goal in E5	0.00%	NA	NA	5.64%	22.23%	19.89%	112%
6. External Credit	0%	0.00%	NA	NA	-16.26%	-29.69%	-13.70%	217%
7. Member Shares	Sufficient to Achieve Goal in E7	0.00%	NA	NA	24.08%	16.59%	35.87%	46%
8. Institutional Capital	Sufficient to Achieve Goal in E8	0.00%	NA	NA	0.00%	0.00%	0.00%	NA
9. Net Institutional Capital	Sufficient to Achieve Goal in E9	0.00%	NA	NA	-153.80%	-10.19%	-2375.69%	0%
10. Membership	Minimum 15%	0.00%	NA	NA	2.46%	2.06%	3.20%	64%
11. Total Assets	More Than Inflation + 20%	0.00%	NA	NA	5.85%	16.08%	19.30%	83%
Inflation Rate (Annualized)				17.00%	15.00%	7.00%	4.00%	

Protection

It is important to note that the loan delinquency report was not properly maintained and hence ratios P_1 and P_2 are not quite correct. In terms of solvency the union is technically insolvent as indicated by ration P_6. While the minimum should be 111%, the highest the union attained in the four years was 108.12 in 2001.

Effective Financial Structure

The ratio of net loans to total assets E_1 is okay but the union scores very poorly on E_2. This is an indication it has very little in liquid assets in relation to its total assets. While the total external credit stood out 10.49% in 2000 against the maximum recommendation of 5% the union did manage to bring this down to 3.64% in 2003. Both the members share capital and institutional capital, E_7, E_8 and E_9 are far below the recommended standard.

Asset Quality

The asset quality as measured by A_2 and A_3 is far below the recommended standard. This is attributed to some land that the union acquired with a view to put up a commercial building that would also serve as its office headquarters. While the land stands in a prime area, the union has not put up any building for income earning purposes.

Rate of return and costs

The operating expenses to average assets ratio should be below 5%. as per the prudential standards. However for KUSCCO this rate is above 5% and has been gradually increasing. This is a clear indication that the operating costs are rather high.

Liquidity

The organizations liquidity is far below the prudential standard. A look at available documents indicates very high levels of receivables. This has led to a situation where the union operates on bank overdraft facilities for most of the time. The ratio of liquidity reserves to total savings deposit should be 10%. The union rate has remained at 0%.

Signs of growth

The signs of growth are indicated by growth in shares deposits, institutional capital, membership, total assets, loans and investments. While the recommended standards have not been met the union has experienced growth in all the above aspects and is working towards attaining the expected standards.

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