

Effect of investment policy on the financial performance of savings and credit cooperative societies (SACCOS) in the banking sector in Kenya

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Abstract

Co-operatives are a major contributor to national growth and development and account for over thirty percent of the National Domestic Saving in Kenya. This study sought to establish the effects of investment policy on the financial performance of Savings and Credit Co-operatives (SACCOs) in the banking sector in Kenya. This study adopted a descriptive survey design. The target population was Co-operatives in the banking sector in Kenya. Stratified sampling and simple random sampling were used to obtain the sample items. A Likert scale questionnaire was used to gather primary information and a secondary data collection sheet was used in gathering secondary information on financial performance. Data was presented in the form of tables, graphs and descriptive statistics and was analyzed using inferential statistics. The study revealed that the investment policy of SACCOs in the banking sector ensured that surplus funds are used in giving loans to members and where returns were guaranteed such as in Government bonds. Any other investments must be approved by members during the annual general meeting. Members were also encouraged to plough-back their dividends. The results indicated that there was a positive relationship between investment policy and the financial performance of SACCOs in the banking sector in Kenya with a correlation coefficient (r) of 0.679, coefficient of determination (r^2) of 0.461 and with a t -value of 0.000. The study concluded that investment policy is statistically significant in explaining the financial performance of SACCOs in the banking sector in Kenya. The study recommended that SACCOs should have a sound investment policy so as to boost their financial performance and for economic sustainability. Further, the managerial team and especially the board members and the supervisory committee should be trained on managerial skill so as to effectively oversee the implementation of the policies.

Key Words: Banking sector, savings and credit co-operative Societies, investment policy, financial performance, sustainable development

INTRODUCTION

The co-operative movement plays a crucial role in economic and social transformation (Satgar & Williams , 2008). One form of cooperatives are the Savings and Credit Cooperative Society (SACCO), whose primary objective is to mobilize resources through member savings and advance loans to members at reasonable interest rate, for economic empowerment. Investment decisions of an organization are guided by its investment policy. In Kenya, the investment policy of a SACCO is formulated in accordance with the Cooperative Society's Act and SACCO Societies Act. Section 42 of the (Cooperative Society's Act Chapter 490, 2012) and section 38 of the SACCO Societies Act (2012) stipulates that, the property and funds of a co-operative society shall only be applied for the benefit of the society and its members. Further, section 45 of the Cooperative Societies Act and section 38 of the SACCO Societies Act give guidance on the areas where societies may invest or deposit their funds which include; trust funds, shares of any other co-operative society or in any other manner approved by a resolution at a general meeting. Section 38 further states that "a SACCO society shall not purchase or acquire any land or any interest or right therein except as may be reasonably necessary for the purpose of conducting its deposit-taking business and where such investments do not exceed such proportion of the total assets of the society as the Authority may prescribe".

PROBLEM STATEMENT

In the recent past, we have witnessed giant SACCOs in Kenya, such as Mwalimu National SACCO investing corrosive amount of money in 2015 to acquire Spire Bank using members' deposits and borrowed funds which had been over-valued thus putting to risk the members' savings (The East African April 28, 2021). On the other hand, the decision by the vibrant Moi University SACCO to buy a piece of land in Eldoret town to build Musco Towers in 2007 caused serious liquidity problems to the SACCO such that members received loans in bits which also made members to withdraw their membership (Kimunge, 2019). Since policies are anchored on established statutes, the question arises as to why SACCOs fail. There is a possibility that something goes wrong during the policy formulation stage or during the implementation. According to the (Ministry of Industry, Trade & Co-Operatives, 2017), the adoption of good governance practices is a challenge to the Cooperative sector. This calls for deliberate efforts to put in place governance structures and enforcement mechanisms. Different scholars have identified the factors that contribute to the failure of co-operatives which include; lack of members' participation (Bhuyan, 2007), economic factors, education

of management committee and the staff (Nyoro & Ngugi, 2007) debt burden, wrangles, hostility, lack of institutional transparency and weak management (Chando *et al.*, 2009) and liquidity problems (ILO, 2009). Makori, Munene & Muturi (2013) cited high dependency on short term borrowing, lack of liquidity monitoring system, political interference, investment in non-earning assets and inadequate managerial competences. A research by Aura & Mwangi (2013) cited the lack of competitive advantage of SACCO products and services as compared to other financial service providers. Kilonzo (2010) cited shocks interjecting on the economic system and the lack of proper policy to mitigate the effects of these shocks. The failure of SACCO to deliver on their primary mandate of economically empowering their members through mobilizing members' savings and provision of loans prompted the study to investigate the effect of investment policy on the financial performance of SACCOs in the banking sector in Kenya.

Research objective

The objective of the study was to examine the effect of investment policy on the financial performance of SACCOs in the banking sector in Kenya.

Research hypothesis

The study sought to test the following hypothesis;

H₀: Investment policy had no effect on the financial performance of SACCOs in the banking sector in Kenya

H₁: Investment policy had an effect on the financial performance of SACCOs in the banking sector in Kenya

LITERATURE REVIEW

Theoretical reviews

Information content of dividends (Signaling) hypothesis

The signaling hypothesis advances that managers usually possess information about a firm's current and future prospects that is not available to outsiders. This informational gap between insiders and outsiders may cause the true intrinsic value of the firm to be unavailable to the market and hence, the share price may not always be an accurate measure of the firm's value. In order to close this gap, managers may need to share their knowledge with outsiders so they can more accurately understand the real value of the firm. Therefore, dividends provide a useful tool for managers to convey their private information to the

market because investors use actual cash flows to equity as a way of valuing a firm. Hence, according to the signaling hypothesis, investors can infer information about a firm's future earnings through the signal coming from dividend announcements, in terms of the stability of, and changes in, dividends (Aldin, Al-Malkawi, Rafferty & Pillai, 2010).

Empirical review

Co-operatives are complex social organizations with many interests conjoining in one place and with a focus on inclusive decision-making. Members want more than just a financial return from co-operatives and they thus require more involvement, clarity of purpose and competent leadership clearly focused on the agreed upon (Mayson, 2002). A study by (Makori, Munene & Muturi, 2003) on the challenges facing SACCOs in Gusii region in Kenya revealed that the high investment in non-earning investments and inadequate managerial competence contributed to the failure of SACCOs in Kenya. The study used structured questionnaires, interviews and focused discussion. A study by (Olando, Jagongo & Mbewa, 2003) on the contribution of financial stewardship to the growth of SACCOs in Kenya indicated that SACCOs did not adequately cover their costs on investments undertaken. According to Mwaura (2015), the annual delegates meetings and the ministry of co-operatives are to blame for poor investment activities undertaken by SACCOS as they approve the same investment. Muchemi (2005) notes that non profitable investments should be discouraged because, despite the enormous amount of resources input in such projects, returns are almost nil, hence, reducing the capital base from where interest is drawn. A report by (KUSCCO, 2003) noted that Co-operative Management Committees are notorious for diverting members' funds into investments of dubious value. It should clearly prohibit investments that are not related to the core objective of the society. A Research by (Hesse & Cihák, 2007) noted that co-operative financial institutions have a lesser tendency to invest in high risk financial markets when compared to other forms of commercial banks. A study by (Aullah & Kavindah, 2018) indicated that resource allocation, performance targets, strategy communication and strategy supervision practices had a positive and significant influence on the performance. Operating and financial ratios have long been used as tools for determining the condition and the performance of a firm (Ogilo, 2012). Similarly, financial performance of SACCOs can also be viewed in light of their overall profitability and return on investment (Parast and Fini, 2010).

METHODOLOGY

The study adopted a descriptive survey design. The target population was employees and members of SACCOs in the banking sector in Kenya. Stratified sampling and simple random sampling techniques were used to obtain a sample for the study. Primary information was gathered by use of a questionnaire. Secondary data was gathered from the annual reports of the SACCOs and reports from the Ministry of co-operative development and marketing using a data collection sheet. Information was sorted, coded and input into the statistical package for social sciences (SPSS) version 21.0 for production of tables, descriptive statistics and inferential statistics. A multiple regression model was used to test the significance of the influence of the independent variables on the dependent variable. The t-test was used to test the direction of the relationship between the independent variable and the dependent variable. F-test was used to test the significance of the overall model at a 5 percent confidence level, while the p-value for the F-statistic was applied in determining the robustness of the model. The conclusions were based on the basis of p value.

FINDINGS AND DISCUSSIONS

Descriptive Analysis

Sixty seven percent of the respondents agreed that their SACCO invests surplus funds in income generating avenues, 64% agreed that their SACCO invests its surplus income in land and buildings and 84% agreed that the majority of the SACCO surplus earnings are reinvested in loans to members. Fifty three percent of the respondents agreed that their SACCO has prohibited avenues of investment, 61% agreed that all capital investments of their SACCO must be approved by members during the annual general meeting by way of voting and 55% agreed that margin was a key decision parameter in SACCO investment decisions. In addition, 52% of the respondents agreed that long terms investments are more preferred in SACCO because they normally have long term view in their decisions, 60% agreed that short term investments are preferred in their SACCO because members need their returns in a short period and 60% agreed that members are encouraged to plough back their dividends as capital. Finally 54%, 52 % and 48% of the respondents agreed that investment in Government bonds, corporate bonds and stocks was highly preferred respectively due to their good returns and reliability. The mean score for the responses was 3.55 which indicates that many respondents agreed that investment policies were a key determinant of financial performance of SACCOs. The results revealed that investment policies influenced the

financial performance of SACCOS in Kenya. The findings imply that there are strategic plans for investment policy in SACCOs which guide the investment plans.

The findings agree with those in (Mayson, 2002) who asserted that co-operatives are complex social organizations with many interests coalescing in one place and with a focus on inclusive decision-making. The findings corroborate with those in (Hesse & Cihak, 2007) who advanced that the investment patterns of co-operatives is such that they use the capital of members in ways that best serve their long term needs and interests. Further, cooperatives have a lesser tendency to invest in high risk financial markets when compared to other forms of commercial banks. Further, the findings of the study agree with that by (Muchemi , 2005) which noted that non- profitable investments should be discouraged since, despite the enormous amount of resources input in such projects they reduce the capital base from which interest is drawn.

Financial performance

The results indicated that there was improved financial performance of SACCOs over the years under considerations as indicated by the; profit before tax, total assets, loans disbursed to members, member savings, dividends disbursed to the members and membership as shown in table 1 below.

Table 1: Financial Performance

INDICATORS	2007	2008	2009	2010	2011	2012
Profit before tax	22,503,435	31,085,901	43,487,267	49,154,859	53,762,458	47,054,282
Total assets	3,948,217,996	4,718,340,180	6,119,680,121	6,198,759,226	8,079,668,453	8,503,918,376
Loans(Ksh)	3,199,347,562	3,733,475,437	4,1127,227,041	4,391,116,953	5,887,585,450	6,252,931,457
Members deposits	2,976,612,295	3,494,384,581	4,088,832,693	4,492,111,749	4,970,561,724	5,601,357,097
Dividends/interest	298,993,982	423,893,603	484,836,881	532,254,888	564,118,402	667,286,241
Membership	19,113	22,896	25,792	27,334	29,601	32,609
Operating costs	7,506,469	11,489,095	82,688,108	100,129,349	110,416,028	111,059,330

Pearson's Correlation - Investment Policy and Financial Performance

Table 2 displays the results of correlation test analysis between the dependent variable (financial performance) and investment policy. The results indicated that the financial performance was positively correlated, with investment policy with a correlation coefficient of 0.342. Thus, any positive change in investment policy led to improved financial performance.

Table 2: Pearson Correlation - Investment Policy and Financial Performance

Variable		Performance	Investment policy
Performance	Pearson Correlation	1	
	Sig. (2-tailed)		
Investment policy	Pearson Correlation	0.342	1
	Sig. (2-tailed)	0.000	

Regression Analysis - Investment Policy and Financial Performance

Regression analysis was conducted to empirically determine whether investment policy was a significant determinant of financial performance. Regression results in Table 3 indicate the goodness of fit for the regression between investment policy and financial performance was satisfactory in the linear regression model. An R squared of 0.117 indicates that 11.7% of the variances in financial performance in banking SACCOs are explained by the variances in investment policy. The correlation coefficient of 34.2% indicates that the combined effect of the predictor variables have a strong and positive correlation with financial performance. However with the combination of linear and non- linear components the R square improved to 46.1% which implied that the variances in financial performance of SACCOs in the banking sector were explained by the variances in investment policy. The non- linear regression model was statistically significant with an F statistics of 170.042 and P value (0.000)

The model being estimated took the form of;

$$Y = \beta_0 + \beta_1 X_1 + \beta_{11} X_{11}^2 + \mu$$

Where Y= Financial performance, X_1 = Linear composition of investment policy and X_{11}^2 = non- linear composition of investment policy

The above quadratic model was supported by the value of R- square of 0.461 which was a stronger explanatory power than that given by the linear model with R-square of 0.111, thus validating the model used as indicated in Table 3 below.

Table 3: Model Summary – Investment Policy and Financial Performance

Model	R	R Square	Std. Error of the Estimate	R Square Change	F Change	df1	df2	Sig. F Change
1	.342a	0.117	0.49439	0.117	35.454	1	267	0.000
2	.679b	0.461	0.38686	0.344	170.042	1	266	0.000

a Predictors: (Constant), Investment policy
b Predictors: (Constant), Investment policy, Investment policy squared

Table 4 displays the regression coefficients of the independent variable (investment policy). The results reveal that investment policy was statistically significant in explaining financial performance of SACCOs in the banking sector in Kenya. This was supported by (b= -0.516, p value = 0.000).

Table 4: Regression Coefficient for Investment Policy

Model		B	Std. Error	T	Sig.
1	(Constant)	6.682	0.152	43.91	0.000
	Investment policy	0.25	0.042	5.954	0.000
2	(Constant)	0.312	0.503	0.621	0.535
	Investment policy	3.95	0.286	13.829	0.000
	Investment Policy Squared	-0.516	0.04	-13.04	0.000

a Dependent Variable: Performance

The regression model is as summarized below,

$$Y = 0.312 + 3.95 X_1 - 0.516 X_{11}^2$$

ANOVA - Investment Policy and Financial Performance

The overall model significance was presented in Table 5. An F statistic of 113.972 indicated that the combined model was significant. This was supported by a probability value of (0.000). The reported probability of (0.000) is less than the conventional probability of (0.05). The probability of (0.000) indicated that there was a very low probability that the statement “overall model was insignificant” was true and it was therefore possible to conclude that the statement was untrue.

Table 5: ANOVA - Investment Policy and Financial Performance

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	8.666	1	8.666	35.454	.000b
	Residual	65.26	267	0.244		
	Total	73.925	268			
2	Regression	34.115	2	17.057	113.972	.000c
	Residual	39.811	266	0.15		
	Total	73.925	268			

a Dependent Variable: Performance

b Predictors: (Constant), Investment policy

c Predictors: (Constant), Investment policy, investment policy squared

CONCLUSION AND RECOMMENDATIONS

The study concluded that the investment policy was effectively implemented which enhanced the financial performance of SACCOs in the banking sector in Kenya. This is because the SACCOs have annual savings targets for the members and SACCO performs well because members have huge savings. It can therefore be concluded from this study that there exists a positive and significant relationship between investment policy and financial performance of SACCOs in the banking sector in Kenya. The null hypothesis that the investment policy had no effect on the financial performance of SACCOs in the banking sector was rejected. The study recommends that studies be carried out on the effect of investment policy on the financial performance of other forms of organizations. Further, the managerial team and especially the board members should be trained on managerial skill so as to effectively oversee the implementation of policies, thus ensuring that they remain committed to the organizational goals.

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