Corporate Governance And The Financial Performance Of Deposit-Taking Savings And Credit Co-Operative Societies In Nairobi City County, Kenya

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Abstract- Corporate governance is the backbone of transparency, accountability, integrity and security of shareholders' interest in an organization. An organization with poor corporate governance structure is likely to fail to achieve its objectives as well as have exposure to financial losses. The purpose of this study is to examine the effect of corporate governance on the financial performance of Deposit-taking Savings and Credit Co-operative Societies in Nairobi City County, Kenya A purposive sampling method integrating qualitative and quantitative design methods was employed in this study. The target and sample population were all the 42 Deposit-taking Savings and Credit Co-operative Societies in Nairobi City County, Kenya while a sample of 30 deposit-taking SACCOS was used for this study. For the 30 deposit-taking SACCOS, the company secretaries and other two executive top management members were each subjected to the study through the administration of questionnaires, hence three respondents per deposit-taking SACCOS. The published annual reports of the of 30 deposit-taking SACCOS were used to collect secondary data. SPSS research analysis tool was used emphasizing on the Multiple Regression Analysis and the Spearman Correlation Coefficient among others to assess the magnitude and relationship and thus come up with a finding of the relationship of the independent and dependent variables. The research found that corporate governance practices greatly affect Deposit-taking Savings and Credit Co-operative Societies in Nairobi City County, Kenya

Index Terms- Corporate governance, financial performance, Deposit-taking Savings and Credit Co-operative Societies

I. Introduction

Corporate governance refers to a system of policies, set of policies, and set of rules that mandate how an organization's management (Board of directors & Board of management) oversees the operations of the organization. Corporate governance also refers to the way the management of a corporate organization uses the power at its disposal in the organization. Good corporate governance practices in an organization are vital in minimizing management misconduct risks that may lead to financial misappropriations and poor performance of an organization (Akdogan & Boyacioglu, 2022). The primary concern of corporate governance is the practices, processes, rules, policies a,nd procedures set out in an organization to govern how management uses its power to direct and control the use of resources.

According to Ahmed (2016) , The main concern of corporate governance the way power is used in an organization in a manner that maintains the best interest of the organization.. Corporate governance also targets the members of organizations. These are primarily shareholders in companies; whether public or private, listed or unlisted. Members are the owners or part owners of the organizations. They are often the people whose money is invested in the organizations (Clark, 2004). This means shareholders are the paramount beneficiaries and paramount losers of well-governed organizations and poorly governed organizations respectively, therefore, they are the ones faced with the burden of ensuring that the organizations are governed in a way that takes care of their interests.

Good corporate governance is indispensable in an organization that strives to ensure that managerial power is exercised in a manner that ensures efficiency, effectiveness, fairness, discipline, responsibility, accountability, probity, and good social responsibility and independence (World Bank, 2015). Adherence to good corporate governance practices does aim at ensuring that organizations are sustainable in the long run (Barako, Hancock, & Izan, 2006).

II. Literature Review

1.1 EMPHIRICAL LITERATURE REVIEW

Majority of the previous researches have focused on the composition of board of directors and particularly the importance of outside directors. Outside directors are expected to represent the interests of shareholders by mitigating agency problems between management and shareholders (Fama, 1980). This careful thought may lead one to assert that firms perform better when they are being monitored by a board dominated by independent outside

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directors. Contrary to this proposition, (Liang & Li, 1999) carrying out a research on Singapore firms, which looked at whether boards dominated by independent outside directors performed financially better, plays down the importance of boards dominated by independent outside directors rather stressing the importance of business experience and entrepreneurship to influence the better financial performance. According to them, firms managed by dynamic CEO's tend to perform financially better than other categories of firms on the assumption that foreign firms are managed by more experienced CEOs.

A large boardroom size may also be inimical to the decision-making pattern of a firm (Yermack, 1996) hence less performance. Yermack posits in a study carried out in Turkey that the smaller the board size the better the financial performance and proposes an optimal board size of 10 or fewer. This study looked at the board size and its effect on firm's financial performance for banks in Turkey. The findings by Tanko and Oladale (2008), in a similar study in Nigeria on the board size and its effect on firm's financial performance, supports the negative relationship between the board size and bank's financial performance. Following their work, it was suggested that on an average 10-15 board members for a firm is large. I totally agree with these findings as smaller boards are more cohesive and can be better controlled and managed.

During the 2007-2008 economic crisis period, a study to establish whether firms with more independent board and higher institutional ownership perform was carried out by Erken, Hung, and Motos (2006) using a sample of 296 financial firms from 30 countries in Europe and the Americas, it was established that firms with more independent boards and higher institutional ownership experienced worse stock returns as a result of taking more risk which led to loss of many shareholders (Erken, Hung, & Motos, 2010). However, Bekaert and Harvey (2002) argue that firms with more independent boards raised more equity capital during the crisis, which led to a wealth transfer from existing shareholders to debt holders. This research was carried out in the USA which aimed at establishing the financial performance of firms with more independent boards and higher institutional ownership.

Although the value of the firm increases with foreign ownership, firm performance decreases with state ownership (Hung & Chen, 2009). This study was conducted in China to establish the influence of firm performance when the firm ownership structure is foreign owned or state owned. The study noted that state owned majority firms have directors with less keen interest in the firm and hence are more likely to make decisions affecting the firm that are not well thought out.

2.2 THEORITICAL LITERATURE

2.2.1 Agency Theory

Agency theory refers the relationship between one person called the principal and another person called the agent, in which the principal instructs the agent to act on his or her behalf regarding certain matters (Jensen & Mackling, 2016). In an organization, the principal is the shareholder who appoints managers as his agents to act on their behalf on matters relating to the management of the company (Clark, 2004). The proponent of this theory argued that shareholders who are the principals hire managers who become agents to make decisions and perform key duties in an organization. Shareholders delegate the running of the organization to the managers who act as the shareholder's agents in all business activities (Fama, 1980).

In this agency relationship, the agents may at times be self-centered and act out of self-interest which brings friction and conflict between the principal and the agent. The divergence from the aspirations of the principal by the agent in pursuit of the personal interest of the agent may bring conflict between the principal and agent. This agency relationship create separation between ownership and control of resources in an organization which generates concern on how to effectively align the actions of the managers with the interest of the shareholders.According to Smith (1776), who suggested that the separation of ownership and control of -business resources leads to poor management of the organizations since managers and directors mostly pursued their self-interest in the management of the affairs of the firm.

There have been various theoretical underpinnings in the current framework of corporate governance, for instance, Ansari (2014) argued that the agency problem has become prevalent in the recent past and in modern firms and has majorly been caused by the separation of ownership and control of organizations. In a business setting the shareholders to provide and raise finances for acquiring assets, while managers are tasked by the shareholders to ensure that they use the assets to generate revenues. The main premise for shareholders appointing managers is shareholders' wealth maximization and growth through the management of business resources and finances provided by the shareholders. The manager's dilemma is how to use the funds provided by the shareholders and making the right decision on how to effectively utilize the funds. (Ansari, 2014). The agency theory has been criticized as it identifies shareholders as the only interest group of an organization. This has led to the development of the stakeholder theory (Cuevas-Rodriguez, Gomez-Mejia, & Wiseman, 2012).

2.2.2 Stakeholder Theory

This theory was pioneered by Freeman (1994) who asked two key questions: |What is the purpose of the firm? What is the responsibility of the management of the firm to its stakeholders?. In regard, to the first question the proponent argued that managers of every firm should ensure that there is a shared purpose for the firm. The main purpose of the firms revolves around the reason why shareholders invest funds in a business, that is, shareholders invest with a purpose and the purpose is to have stake in the earnings of the firm. This question implied that a business goal is to ensure all stakeholders of the business benefit from the firm.

The second question of the proponent on the responsibility of the management of the firm to its stakeholder implied that managers need to define how to contact the business in a manner that caters for the interest of the shareholders, that is, clearly understand what needs to be done and how it should be done. The managers also needed to understand what type of relationship was needed with the stakeholders for smooth running of the business (Adams, & Mehran, 2015).

Even though, the current legal framework under which most companies operate dictates that directors are accountable to shareholders as the primary stakeholders in the business such argument does not take care of the other stakeholders in a business.

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III. RESEARCH METHODOLOGY AND MODEL SPECIFICATION

This study integrated both qualitative and quantitative design methods. For the purposes of this study. The target population of the study was also the 30 deposit-taking SACCOS was used for this study. For the 30 deposit-taking SACCOS. The research study was carried out at the various head offices since this is where the company secretary and other senior executive management, the target respondents in the deposit-taking SACCOS are based. Structured questionnaires were used to collect data and were administered to the company secretaries and top executive management staff. The study also utilized secondary data that was obtained from the 2019 to 2021 annual reports of the deposit-taking SACCOS

IV. PRESENTATION AND DISCUSSION OF RESULTS

4.1 Descriptive Statistics

Table 1 : Source Financial Reports (2019-2021)

	N	Minimum	Maximum	Mean	Standard Deviation
Measure of financial performance (ROE)	11	.10	.27	.2127	.05503
Valid N (list wise)	11				

The data analysis revealed that the lowest earner 30 deposit-taking SACCOS returned 10 cents for every one shilling of shareholders equity while the highest earner returned 27 cents for every shilling of shareholder's investment. The mean was 21 cents with a standard deviation of 0.055. The data was analysed from the ROE of the years 2019 through to 2021. The interpretation of the data revealed that deposit-taking SACCOS over the three years varied, hence the need to carry out the study to reveal how corporate governance practices impacted on this variance.

4.2 *Correlations*

Table 2 : Correlations matrix between the dependent variable and the independent variables

		Mean ROE	SRR	CGPR	CGPO	DPP
Mean_ROE	Pearson Correlation	1	0.753**	0.404	0.614*	0.668*
	Sig. (2-tailed)		0.007	0.217	0.045	0.025
	N	11	11	11	11	11
SRR	Pearson Correlation	0.753**	1	0.009	0.420	0.646*
	Sig. (2-tailed)	0.007		0.978	0.198	0.032
	N	11	11	11	11	11
CGPR	Pearson Correlation	0.404	0.009	1	0.002	0.529
	Sig. (2-tailed)	0.217	0.978		0.995	0.094
	N	11	11	11	11	11
CGPO	Pearson Correlation	0.614*	0.420	0.002	1	0.209
	Sig. (2-tailed)	0.045	0.198	0.995		0.536
	N	11	11	11	11	11
DPP	Pearson Correlation	0.668*	0.646*	0.529	0.209	1
	Sig. (2-tailed)	0.025	0.032	0.094	0.536	
	N	11	11	11	11	11

**. Correlation is significant at the 0.01 level (2-tailed).
*. Correlation is significant at the 0.05 level (2-tailed).

With N being the number of financial data collected from the deposit-taking SACCOS, the matrix above gives the correlation of the financial performance against the four corporate governance indices.

The matrix indicates that there was a significant correlation between the return on equity and shareholder's rights and responsibilities, corporate governance policies and disclosure policies and practices. There was also a correlation between return on equity and corporate governance practices though it was not to a statistically significant level. The correlations indicate that as the response value increased from strongly disagreed to strongly agreed, the return on equity also increased. Shareholder's rights and responsibilities showed a particularly strong correlation of 0.753 significant at the 0.01 level as was the finding by Miseda (2012).

Corporate governance policies recorded a correlation value of 0.614 with P value of 0.045 which is statistically significant at the 5% level. This indicates that there is a statistically significant correlation between corporate governance policies and the deposit-taking SACCOS's profitability. As the responses

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increased from strongly disagreed to strongly agreed, the mean return on equity value also increased.

Disclosure policies and practices recorded a Pearson's correlation value 0.668 with a P value of 0.025 which is statistically significant at the 5% level. This also shows that as the responses on disclosure policies and practices increased from strongly disagree to strongly agree, the mean return on equity also increased and this correlation was statistically significant as was the finding by Miseda (2012).

Corporate governance practices recorded a Pearson's correlation value of 0.404 which means that as the responses grew from strongly disagreed to strongly agreed, the mean return on equity also increased but it had a P value of 0.217 which infers that it was not statistically significant at the 5% level.

4.3 Regression Analysis

The statistics above were made clearer with the regression model below:

ROE= $ß_0 + ß_1$ CGPR + $ß_2$ SRR + $ß_3$ CGPO + $ß_4$ DPP + u

Where;

ROE: Return on equity

$ß_i$ = coefficient estimators of the predictor variables

u = error

CGPR: Corporate governance practices

SRR: Shareholders rights and responsibilities

CGPO: Corporate governance policies

DPP: Disclosure policies and practices

Table 3: Regression model summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.913[a]	.833	.722	.02902

a. Predictors: (Constant), SRR, CGPR, CGPO, DPP

The R Square in the model summary indicates how much of the variance in the response is explained by the predictors. The R square 0.833 shows a relationship between the observed and predicted values of the dependent variable. In conclusion it can be authoritatively said that the CGPP, CGPO, DPP and SRR account for about 83.3% of the variance observed in the mean return on equity. Therefore this informs the fact that corporate governance practices play a big role in the financial performance of deposit-taking SACCOS.

Table 4: ANOVA: Analysis of Variance

Model		Sum of Squares	Df	Mean Square	F	Sig.
	Regression	.025	4	.006	7.488	.016[b]
	Residual	.005	6	.001		
	Total	.030	10			

a. Dependent Variable: ROE

b. Predictors: (Constant), SRR, CGPR, CGPO, DPP

Table 5: Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
	(Constant)	1.612	.463		3.485	.000		
	CGPO	.053	.027	.361	1.948	.039	.811	1.233
	CGPR	.300	.170	.406	1.766	.128	.527	1.896
	DPP	-.004	.085	-.014	.048	.002	.305	3.281
	SRR	.771	.348	.607	2.216	.000	.371	2.698

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The table 5 above shows the B column which are the beta values and they give the coefficient estimates of the predictor variables for the regression model. The table shows that three of the variables namely corporate governance policies, disclosure practices and policies and shareholders rights and responsibilities have P values which were significant at the 5% level (0.05).

Interpreting the values of the beta coefficients, it shows that holding all other factors constant, every positive unit change in corporate governance policies will increase the mean return on equity by 0.053 while still holding all factors constant, a unit change in shareholders rights and responsibilities will increase the mean return on equity by 0.771 units. However, a unit increase in disclosure policies and practices will bring about a negative change by 0.04.

Collinearity statistics is used to check for correlation between the predictor variables. For each predictor variable, the tolerance level is more than 0.1 and the VIF value is less than 10, it shows that there is no correlation between the predictor variables.

4.4 Summary of Findings

Corporate governance policies recorded a correlation value of 0.614 to the mean return on equity showing that similarly, as the responses under this category rose from strongly disagree to strongly agree, the mean return on equity increased and as the responses decreased, the mean return on equity increased. This correlation value was significant at the 0.05 level as it had a significant F value of 0.045.

Corporate governance practices showed a correlation of 0.404 to the mean return on equity but it had an F value of 0.217 which is not significant at the 0.05 level. In the regression matrix, corporate governance practices also recorded an F value of 0.128 which is not significant at the 0.05 level.

From table 3 which gives a summary of the regression model, it was found that the four group indices analyzed (the independent variables), the independent factors accounted for 83.3% of the variance in the rate of change from the Mean of the ROE. Of the four indices, three factors namely corporate governance policies, disclosure policies and practices and shareholder’s rights and responsibilities were the most significant with shareholders rights showing high significance.

Though corporate governance showed strong correlation, it did not show any statistical significance as it had a p value of 0.128 which is greater than 0.05. In table 2, a collinearity test performed to test if there was any correlation between one independent variable and another showed that there was no correlation indeed between one predictor variable and another. This was ascertained since all the tolerance levels were greater than 0.1 and the TIF values were all less than 10. This is a strong indication that the regression model was valid.

V. Conclusion and Recommendation

The study concluded that corporate governance practices cannot be down played as they indeed do play a very vital role on the financial performance of deposit-taking SACCOS. From the regression results, it is important to note that the extent of the firm’s performance is dependent on the predicators examined.

Corporate governance is very important to the deposit-taking SACCOS as it involves the way the deposit-taking SACCOS business and affairs are managed by the board and the top management, thus affecting how the deposit-taking SACCOS objectives are arrived at, plans and policies.

The core of the study proves that good corporate governance structures are very important to the financial performance of deposit-taking SACCOS. The further upshot of this study is that it does not only aim at ensuring that deposit-taking SACCOS observe sound corporate governance practices, but equally important is to emphasize the need to ensure that the collapse of deposit-taking SACCOS as a result of unsound corporate governance practices is nipped at the bud.

The study recommended that deposit-taking SACCOS should also ensure that shareholders and other stakeholders are timely provided with relevant information regarding the financial performance of the deposit-taking SACCOS and also the management analysis as shareholders rights and responsibilities showed a significant correlation with the financial output of the deposit-taking SACCOS

The study also recommended that the The SACCO Societies Regulatory Authority (SASRA) should further monitor compliance with the corporate governance codes and guidelines by them as this will ensure that deposit-taking SACCOS are well aligned in observing good corporate governance practices, which shall correlate in good performance of the deposit-taking SACCOS. The ICPSK should ensure that all company secretaries of deposit-taking SACCOS in Kenya are registered certified public secretaries, so that they can ensure that good corporate governance practices as they are the custodians of good corporate governance practices.

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