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BOARD GOVERNANCE AND PERFORMANCE OF DEPOSIT TAKING SACCOS IN KENYA

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ABSTRACT

The purpose of this study was to examine the influence of board governance on performance of deposit taking SACCOs in Kenya. The contextual scope of this study was limited to the deposit taking SACCOs in Kenya. The study is based on the Stewardship theory. A conceptual framework is illustrated to show the relationship between the independent and dependent variables. This study was anchored to a positivist paradigm as well as descriptive-correlational-cross-sectional research designs. The target population of the study was 350 CEOs and chairpersons of the boards of the deposit taking Saccos in Kenya. The study used to select the subjects of study. Explanatory research design was used for this study as it sought to determine relationships between variables. The study used bivariate regression analysis to analyze the association between board governance dimensions and performance of deposit taking Saccos. The results revealed that board governance practices had a positive and significant relationship with performance of deposit taking Saccos in Kenya. The results support the current theories related to the study. Consequently, this study provides deposit taking Saccos on how to improve performance of Saccos through the adoption of appropriate board governance practices.

Keywords: Board Governance, Firm Performance, Deposit Taking Saccos

1.1. INTRODUCTION

Development of board governance relations is very crucial for any successful business because it enhance plausible leadership within the corporate sector, given that it has the following attributes; leadership for accountability and transparency, leadership for efficiency, leadership for integrity and leadership that respect the rights of all stakeholders (Osoro & Muturi, 2015). Regularization of this financial sector to safeguard the interests of the owners will indeed define the importance of having a prudent corporate regulatory framework. Prudent operational regulations coupled with standards are key elements to for any SACCO to be licensed (SACCO Supervision Report, 2017).

Board governance allows the firm to come up with a structure in which the firms can set up its objectives, implement them, and monitor at the same time (Kiambati & Mutunga, 2018).According to Herdjiono and Sari (2017), the corporate governance theory suggests a connection between business performance and company governance. Thus, the promotion of good corporate governance attracts more investors who brings more capital to the firm as well as reducing the operational risks to improve performance (Ahmed & Hamdan, 2015). From the agency perspective, corporate governance enhances the firm's performance through resolution of agency problems by monitoring the management activities, controlling management behaviors as well as inspection of financial reporting process (Melkamu, 2016).

The connection between company board governance and company performance has been extensively studied in different industries and countries across the world. In their study Buallay, Hamdan and Zureigat (2017) examined corporate governance effects on performance of quoted companies in Saudi stock exchange and found an insignificant effect between firm performance and corporate governance mechanism however, the study focused on listed firms. Ahmed and Hamdan (2015) examined corporate governance effects on corporate performance in Bahrain Stock Exchange and observed that corporate governance practices significantly affect firms' financial performance. The studies by Buallay, Hamdanand Zureigat (2017) and Ahmed and Hamdan (2015) and many other across the world focus more on listed firms and commercial banks.

2.0 STATEMENT OF THE PROBLEM

The overall performance of Deposit Taking Sacco in Kenya has been declining drastically as measured by assets and interest margin to gross income. According to the Sacco Supervision Report (2019) Non- performing loans increased from 5.12 percent in 2018 to 5.23 percent in 2019, indicating elevated effect of poor corporate governance. This was driven mainly by the increase on the non-performing loans from Kshs 13.21 Billion in 2015 to Kshs 15 and 57 Billion in 2016. Liquid assets to saving Deposits (Liquidity Ratio) reduced from 55.9 percent in 2015 to 49.95 percent in 2016, indicating the decline in liquidity thereby posing liquidity risk. Many DT Saccos are often unable to meet their short term obligations to their members, particularly the disbursement of loans. The interest spread has not been relatively stable from 2017 to 2019. Operating Expense to Total Assets Ratio increased from 5.13 percent in 2015 to 5.44 percent in 2016, indicating elevated operational challenges. These challenges faced by Saccos if not properly managed have the potentials to affect the performance of the Saccos and at extreme cases leads to their winding up.

Moreover, in Kenya, according to a report by SASRA (2017) shows that there is poor performance of deposit taking SACCOs and have shown a sharp decline in the last two decades unlike commercial banks despite adoption of corporate governance. A report by the IMF (2014), notes that despite adoption and implementation of corporate governance, the performance of deposit taking SACCOs is poor. Jacoby (2018) established that despite the implementation of corporate governance in the deposit taking SACCOs, there is poor membership growth, core capital, liquidity and credit management. Consequently, according to FSD Kenya (2016) survey which showed that Sacco performance was declining while banking sector performance was rising. In year 2015, bank and SACCOs usage by households were at 13.5% but by 2017, bank usage had risen to 17.1% while SACCOs operational performance had declined to 9.3%. This was attributed to board, managerial, risk and financial governance in the deposit taking SACCOs.

Empirically, studies by Oluwafemi, Israel, Simeon and Olawale (2014); Mahmoud and Ahmed (2014); Akindele (2012); Mugenda, Momanyi and Naibei (2012); Ariffin and Kassim (2009) established that there is a positive relationship between corporate governance and performance.

Findings of the empirical studies revealed that no study has been conducted to examine role of board governance on performance of DT Saccos in Kenya It is on this premise the current study sought to examine the role of board governance practices on performance in deposit taking SACCOS in Kenya.

RESEARCH HYPOTHESIS

$H_{01:}$ There is no significant relationship between board governance and performance of deposits taking SACCOs in Kenya

LITERATURE REVIEW

Theoretical Review

The stewardship theory, also known as the stakeholders' theory, adopts a different approach from the agency theory. It starts from the premise that organizations serve a broader social purpose than just maximizing the wealth of shareholders (Nwanyanu, 2013). The stakeholders' theory holds that corporations are social entities that affect the welfare of many stakeholders where stakeholders are groups or individuals that interact with a firm and that affect or are affected by the achievement of the firm's objectives (Huse, 2008). Successful organizations are judged by their ability to add value for all their stakeholders. Some scholars consider the natural environment to be a key stakeholder (Van, 2012).

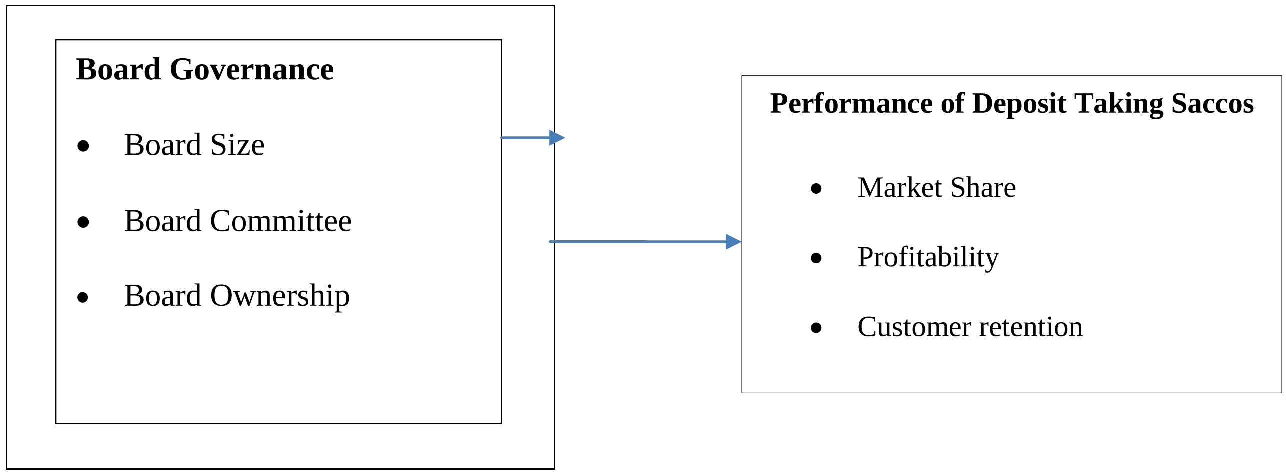
Stakeholders can be instrumental to success and have moral and legal rights (Donaldson & Preston, 1995). When stakeholders get what they want from a firm, they return to the firm for more (Freaman & McVea, 2001).Therefore, leaders have to consider the claims of stakeholders when making decisions (Blair, 1995) and conduct business responsibly towards the stakeholders (Manville & Ober, 2003; White, 2009). Participation of stakeholders in decision-making can enhance efficiency (Turnbull, 1994) and reduce conflicts (Rothman & Friedman, 2001).

According to Kaptein and Van Tulder (2003), corporations adopt reactive or proactive approaches when integrating with stakeholders' concerns in decision making. A corporation adopts a reactive approach when it does not integrate stakeholders into its decision making processes. This results into a misalignment of organizational goals and stakeholder demands (Mackenzie, 2007). Some authors attribute scandals such as those of Enron and WorldCom to the failure to consider stakeholder concerns in decision making (Currall & Epstein, 2003; Turnbull, 2002; Watkins, 2003; Zandstra, 2002).

In summary, the stewardship theory suggests that a firm's board of directors and its CEO, acting as stewards, are more motivated to act in the best interests of the firm rather than for their own selfish interests. This is because, over time, senior executives tend to view a firm as an extension of themselves (Clarke, 2004; Wheelen & Hunger, 2002). Therefore, the stewardship theory argues that, compared to shareholders, a firm's top management cares more about the firm's long term success (Mallin, 2004). This theory informs this study in that it asserts that the abilities of the stakeholders impact the performance of an organization directly. Thus, it is expected that financial reporting would translate to better organization performance.

Conceptual Model and Hypothesis

A conceptual framework is a concise description of the phenomenon under study accompanied by a graphical or visual description of the major variables of the study (Cooper & Schindler, 2008). Michelle (2017) states that a conceptual framework is a diagrammatical representation that shows the relationship between the dependent variable and independent variables. This study's conceptual framework sought to demonstrate the relationship between board governance and performance of deposit taking Saccos in Kenya. The conceptual framework is illustrated in Figure 1.



Independent Variables **Dependent Variable**

EMPIRICAL REVIEW

Zhu, Tian and Ma (2009) examined the relationship between executive compensation, board characteristics and firm performance in China: the impact of compensation committee based on the assumption that the independent directors of a board can impact CEO pay-performance more effectively if a compensation committee provides information and assist them in designing relevant executive pay schemes. On the basis of this idea, they developed and tested the hypotheses that Chinese firms with a compensation committee have a closer CEO pay link with performance when a larger proportion of independent directors serve on the board with primary focus on the effect of a compensation committee on CEO pay-performance relation as a consequence of its help for the board and found that board independence produces a stronger relationship between executive compensation and return on equity in Chinese listed firms. As reported in the study, this association is more evident in those firms which have a compensation committee than those without compensation committee. The findings as reported by Yuqing et al. (2009) also suggest that the interaction between independent directors on the board and compensation committee has important consequences for CEO incentive systems as well as corporate governance structures in China.

Similarly, Oyerogba, Alade, Idode and Oluyinka (2017) sought to establish the impact of board oversight functions on the financial performance of listed companies. The study covered the entire 186 companies listed on the Nigeria stock exchange for a period of five years between 2010 and 2014. Three aspect of board oversight function which includes the audit committee function, risk management committee function and remuneration/human capital committee function were considered in this study in line with the provision of (SEC) code of corporate governance and (OECD) code of corporate governance. Ammann and Ehmann (2017 also found out that the return on capital employed and earnings per share were used as the measures of firm financial performance. The impact of board oversight functions on the performance of listed companies in Nigeria relationship between board oversight function and firm financial performance cannot be rejected.

Moreover, Al-Matari, Al-Swidi and Fadzil (2014) examined the relationship between audit committee characteristics and firm performance which is considered an oversight function of the board of directors. It also attempts to explore the moderating effect of the board diversity on the association between audit committee characteristics and firm profitability and to fill the gap in the existing literature that examined the relationship between corporate governance and firm performance in the developing countries. This study revealed a positive association between audit committee size and audit committee meeting to firm profitability but not significant. On the other hand, a negative but insignificant relationship was found between audit committee independence and firm profitability. Moreover, Adebayo, Ayeni and Oyewole (2013) study revealed that the foreign members of the board have a significant moderating effect on the relationship between audit committee independence and firm profitability. Therefore, there is a significant relationship between board oversight function and firm performance of listed companies in Nigeria.

According to Albert (2015) who examined the effect of board committees on corporate financial performance among companies listed on the Ghana Stock Exchange (GSE), the quantitative research approach was adopted to study the prognostic effect of board committee on corporate financial performance for companies consistently listed on the GSE from 2006-2010 using data from the annual financial statement of listed companies with a static panel regression model used to analyze the presence of various committees on corporate financial performance. Albert (2015) finds that board committees had no statistical significant effect on the corporate financial performance of listed firms in Ghana. Specifically, nomination committee was negatively correlated with corporate financial performance and was statistically insignificant at the 5% level. Audit committee had no effect on corporate financial performance while remuneration committee produced positive correlation with corporate financial performance but also not statistically significant at 5% level of significance.

Finally, good oversight function according to Ashley and Patel (2013) encourages management to sit tight and generate value for the organization, in term of innovation, development, growth and also promote good accountability to the shareholder and other stakeholders in a company. It also mitigates the agency problem which in turn leads to reduction in agency fees thereby increase the performance. In support of this position, Ongore (2011) attributed 37% of the variation in the performance of listed companies in Ethiopia to the effective discharge of oversight functions by the board of directors. In like manner, the global research efforts identified the failure of directors in overseeing the management as the bedrock of the corporate failure (Creswell & Clark, 2011).

RESEARCH METHODOLOGY

The study adopted a descriptive research design. This was based on the hypothesis that was put forth by the researcher tested through statistical outcomes, and the choice of statistical tests was based upon the level of measurement of the data. Predictions can be made on the basis of the previously observed and explained realities and their inter-relationships. There were 175 deposit taking Saccos Kenya according to SASRA (2018) report. The managers and chairpersons of the board of the deposit taking Saccos were regarded as a suitable unit of observation. Therefore, the study population was 350 (CEOs and Chairpersons) of the deposit taking SACCOs in

Kenya. The study adopted a census method and analysis was carried out to test the significance of the model by the use of Analysis of variance (ANOVA) and R^2 was used to measure the extent of the goodness of fit of the regression model. The statistical significance of the hypothesized relationship was interpreted based on F and t-test values at a 95% confidence level.

RESULTS AND DISCUSSION

Regression analysis was conducted to determine the proportion of performance of deposit taking saccos (dependent variable) which could be predicted by public participation (independent variable). A univariate analysis was conducted to establish the role of role of board governance on performance of deposit taking Saccos in Kenya. The null hypothesis stated:

$H_{01:}$ There is no significant relationship between board governance and performance of deposits taking SACCOs in Kenya

The results of the regression are presented in Table 1 displays R (the correlation between the observed and predicted values of the dependent variable), which is 0.401. This is a moderate relationship between the observed and predicted values of the dependent variable. It also shows that there is positive correlation between board governance and performance of DTs Saccos in Kenya. Table 1 also displays R squared which is the proportion of variation in the dependent variable explained by the regression model, in this case, it is 0.161. This means that board governance can explain 16.10% of performance of DTs Saccos in Kenya. The remaining percentage (83.90%) can be explained by other factors excluded from the model. The adjusted R-square of 0.159 indicates that board governance in exclusion of the constant variable explained the change in performance of DTs Saccos in Kenya by 15.90%. The value of the standard error of the estimate is shown in the output as 0.33219. It shows the average deviation of the dependent variable (performance of DTs Saccos in Kenya) from the line of best fit.

Table 1summarizes the results of an analysis of variance, with the sum of squares, degrees of freedom, and mean square being displayed for two sources of variation, regression and residual. For the accounted for values, the mean square (the sum of squares divided by the degrees of freedom), is 287.103, the F statistic (the regression mean square divided by the residual mean square) is 54.780 and the degree of freedom (df) is 1 whereas the output for residual which displays information about the variation that is not accounted for by the model has the following values: sum of squares as 1783.325 d.f as 276 and a mean square of 5.241. The overall relationship was statistically significant ($F_{1,276} = 54.780$, $p<0.05$) It has a significance level of 0.000 this means that the chances are zero that the result of regression model are due to random events instead of a true relationship, which implies that the linear regression model is a good fit for the data and hence can be used to predict the influence of board governance on performance of DTs Saccos in Kenya.

Table 1 represents coefficients of the independent variable (board governance) and the dependent variable (performance of DTs Saccos in Kenya). These findings show that the performance of DTs Saccos in Kenya will be having an index of 5.879 when board governance is held constant. In addition, the Beta coefficient was 0.416 for the relationship between board governance and the performance of DTs Saccos in Kenya. This shows that a unit improvement in board governance would lead to a 0.416 improvement in the performance of DTs Saccos in Kenya. The t – value (2.809) of more than +1.96 indicates that the change in performance of DTs Saccos in Kenya by board governance is not by chance. The relationship is significant as the P-value (0.000) was less than the significance level (0.05). Thus yielding a regression model where $Y= \beta_0 + \beta_1 X_1 + \varepsilon$. The general form of the equation was to predict performance of DTs Saccos in Kenya; X_1= Board Governance; $Y= 5.879+ 0.416X_1$. This indicates that performance of DTs Saccos in Kenya = 5.879 + 0.416* Board Governance. Therefore we can conclude that board governance positively and significantly influence performance of DTs Saccos in Kenya .

Table 1: Regression Statistics (Board Governance and Performance of DTs Saccos in Kenya)

Model Summary

R	R Square	Adjusted R Square	Std. Error of the Estimate
.401	.161	.159	.33219

ANOVA Statistics

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	287.103	1	287.103	54.780	.000
	Residual	1496.222	276	5.241		
	Total	1783.325	277			

Regression Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	**Std. Error**	**Beta**	**T**	**Sig.**
1	(Constant)	5.879	1.223		4.807	.000
	Board Governance	.416	.148	.401	2.809	.000

Hypothesis Testing

The study hypothesized **H_{01}:** *There is no significant relationship between board governance and performance of DTs Saccos in Kenya.*

The study results of the survey in Table 4.24 revealed that there was positive and significant relationship between board governance and performance of DTs Saccos in Kenya (β_1=0.416, t_{cal}= 2.809> $t_{critical}$ =1.96, p-value < 0.05). To test the relationship the Regression Model fitted was $Y= \beta_0 + \beta_1 X_1 + \varepsilon$**,** that is $Y= 5.879+ 0.416X_1$. The null hypothesis (H_{01}): board governance has no significant relationship with performance of DTs Saccos in Kenya or ($H_{01:}$ $\beta_j \neq 0$) is therefore rejected (β_1=0.416, t_{cal}= 2.809> $t_{critical}$ =1.96, p-value < 0.05) and concluded that board governance (X_1) positively and significantly influences performance of DTs Saccos in Kenya (Y) .

CONCLUSION AND RECOMMENDATIONS

The study concluded that there exists a positive significant relationship between board governance and performance of deposit taking Saccos in Kenya. The results reveal that board governance is statistically significant in explaining performance of deposit taking Saccos in Kenya. The study recommends that management of deposit taking Saccos should put in place a set of deliberate and proactive processes, policies and structures that supports improvement of board governance. The management should review existing policy on board governance with a view of improving board functions. Additionally, the study recommends that the management of the deposit taking Saccos should come up with strategic interventions to promote board independence to enhance performance of the deposit taking Saccos.

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