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Full Length Research Paper

The impact of front office Sacco activity on Sacco performance in Kenya; A case study of Meru South and Maara district in Tharaka Nithi County in Kenya

Njagi Gabriel Matumo[1], Kimani E.Maina[2], Ngugi Nahashon Njoroge[3]

[1,2,3]JomoKenyatta University of Agriculture and Technology
gabrielmatumo@gmail.com, kimani_emaina@yahoo.com, nahangugi!yahoo.com

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While Savings and Credit Co-operative Societies (Saccos) are an autonomous Association of Persons united voluntarily to meet their economic and social needs, their performance has been affected by low capital base. Their capital base is low, thus limiting loanable funds to members. To cope with this problem, many Saccos have introduced Front Office Sacco Activity (FOSA), in order to strengthen their capital base and liquidity level. FOSAs offer simple banking services to members/customers, thus improving their working capital. This study is meant to find out the impact of FOSA operations on Sacco performance in Kenya; A Case of Meru South and Maara Districts in Tharaka Nithi County. The Research Design was descriptive in nature. The intended population of the study was the three Saccos with Front Office Sacco activity in the two districts. The county has four SACCOs with FOSAs but one started operation with FOSA since inception. The researcher used Secondary Data in this study for a period of six years. This included three years before and after operating FOSAs. Correlation analysis was used to analyze the data. The findings of the study revealed that FOSAs can improve the performance for Saccos.

Keywords: Sacco, FOSA, Performance and Capital Base

INTRODUCTION

A cooperative is an autonomous association of persons united voluntarily to meet their common economic and social needs (International Co-Operative Alliance). Cooperative societies are both economic units for mobilization of resources and social organizations serving members' social needs. The cooperative movement began in Europe in the 19th century, primarily in England and France, although the Shore Porters Society claims to be one of the world's first cooperatives, being established in Aberdeen in 1498. The first consumer cooperative was founded on March 14th, 1761 in a barely furnished cottage in Fen wide, East Ayshire.

By 1830, there were several hundreds cooperatives. Some were initially successful but most cooperatives founded in the early 19th century failed by 1840. It was not until 1844 when the Rochdale Society of Equitable Pioneers established the Rochdale Principles on which they ran their cooperative that the basis for development and growth of the modern cooperative movement was established.

Corresponding author Email: jeoffrey8@yahoo.co.in

Credit Unions (Saccos)

A credit union (Sacco) is a cooperative financial institution that is owned and controlled by its members. It is operated for the purpose of promoting thrift, providing credit at reasonable rates and providing other financial services to its members. Many credit unions exist to further community development or sustainable international development on local level. Worldwide credit union systems vary significantly in terms of total system assets and average institutional asset size.

Credit unions exist in a wide range of sizes ranging from volunteer operations with a handful of members in assets and hundreds of thousands of members. Credit Unions are "not for profit cooperative institutions" (The World Council of Credit Unions). In practice however, legal arrangements vary by jurisdiction, for example in Canada, Credit Unions are regulated as for profit institutions, and view their mandate as accruing reasonable profit to enhance services to members and ensure stable growth. Credit unions are 'not for profit' because they operate to serve their members rather than to maximize profit. Credit unions are however not charities or similar organizations that rely on donations. To the contrary, Credit unions are financial institutions that must turn what is in economic terms a small profit (i.e. surplus) to be able to serve their members.

Sacco Sub-Sector and its Contribution to the National Savings

In Kenya financial sector is ranked highly and so is the Sacco sub-sector. The total Sacco sub-sector was worth Kshs. 210 billion in 2010 while deposit taking Saccos had about Kshs. 171 billion of this amount (Sacco Society Regulatory Authority 2010). The Kenya Sacco sub-sector comprises both deposit taking and non-deposit taking Saccos. There were 5,544 registered Saccos in Kenya at December 31st 2010. Out of the 3983 active Saccos in Kenya, 218 or 6% operate FOSAs that is they are deposit taking. The rest or 94% do not have FOSAS. There is an effort to develop regulations to take care of the remaining non-deposit taking Saccos to ensure that the whole sector is prudentially regulated (SASRA, 2010). According to the Kenya Economic report 2009, of the 20 million Kenyan Adult Population, 22.5% are served by commercial banks and MFIs while 17.6% are served by Saccos. Saccos are distributed widely across the counties in the country and therefore better positioned to bring more Kenyans under financial inclusion compared to other financial service providers.

Statement of the Problem

Saccos are financial institutions operated for the purpose of promoting thrift and providing credit at reasonable interest rate to members. Sacco membership has increased as well as demand for loan (SASRA, 2010). Although membership and demand for loan has increased, Saccos are experiencing the problem of low capital base. Unless Saccos look for other sources of funds, members may be tempted to move to other financial institutions because many Saccos cannot meet their members' loan demand.

General objectives

To carry out a survey on how FOSAs can be used to improve the performance of Saccos.

Hypotheses

The study was guided by the following hypothesis.

H_1: The difference between Average Return on Equity for sample Saccos before and after FOSA operations is statistically significant.

H_2: The difference between Average Return on Assets for sample Saccos before and after FOSA operations is statistically significant.

H_3: The difference between Average Net Interest Margin for sample Saccos before and after FOSA operations is statistically significant.

Theoretical Literature

In wisdom of the new institutional economies, Societies involve a variety of institutions that permit the transaction of information and reduction of transactions cost (Johnson, 1999). According to Rukunga (2000), in every community there are people with very bright ideas of business opportunities. They may be honest, hardworking, innovative and confident, but due to lack of startup capital, their great ideas never see the light of the day. Savings and credit cooperative societies mobilize savings from members through monthly contributions usually deducted by the employers at source and handed over to the society. They then provide credit facilities to the members (Rukunga, 2000). According to Kimuyu and Omit (2000), credit markets are partly shaped by lenders strategies for screening potential borrowers and for addressing opportunities behaviour encouraged by the inter-temporal nature of loan contracts. The study by Moyi (2000) has shown that among the MSEs involved in manufacturing, credit related information needs are second only to market information needs. The results based on the baseline survey show that lack of credit is

Table 1. Society 'A' balance sheet extract

YEAR	BEFORE			AFTER		
	1995 Kshs. (Million)	1996 Kshs. (Million)	1997 Kshs. (Million)	1998 Kshs. (Million)	1999 Kshs. (Million)	2000 Kshs. (Million)
Income	5.1	7.3	8.5	11.7	17.7	24.1
Equity	50	70	94.8	119.5	157.5	193
Assets	45	68.6	96.6	124.7	159.5	195.6
Net Interest Income	5.9	7.1	8.3	9.5	12.7	15.7
Net Interest Expenses	-	-	-	0.052	0.094	0.163

Table II. Society 'B' Balance Sheet Extracts

	BEFORE			AFTER		
Year	1998 Kshs. (Million)	1999 Kshs. (Million)	2000 Kshs. (Million)	2001 Kshs. (Million)	2002 Kshs. (Million)	2003 Kshs. (Million)
Income	1.2	1.3	1.4	2.2	5.2	5.3
Equity	12.5	14	17.2	20.3	23.8	27.4
Assets	15.9	17.3	21.4	25.3	32.3	38.8
Net Interest Income	1.2	1.3	1.2	1.8	2.6	3.2
Net Interest Expenses	0.75	0.77	0.64	0.505	0.825	2.8

Table III. Society 'C' Balance Sheet Extract

	BEFORE			AFTER		
YEAR	1998 Kshs. (Million)	1999 Kshs. (Million)	2000 Kshs. (Million)	2001 Kshs. (Million)	2002 Kshs. (Million)	2003 Kshs. (Million)
Income	1.5	2.2	3.7	8.1	11.3	11.0
Equity	12.8	16.5	20.6	26.1	30.6	31.7
Assets	17	22.5	27.1	33.6	39.8	43.4
Net Interest Income	1.5	2.2	3.7	8.0	11.1	10.9
Net Interest Expenses	0.26	0.34	0.49	0.47	0.98	0.64

the second severest problem faced by MSEs the most important being lack of markets and competition. According to G.O.K (1992), the existing MSE financing policy framework shows a different trend from the above agreement by Kimuyu and Omit. It sought to increase credit flow to MSEs by encouraging commercial banks to charge higher interest rates to reflect the cost of advancing credit to small firms. However, this has not worked because of adverse selection whereby a larger pool of risky firms is likely to be attracted, thereby increasing potential loss to the lender. Akoten (2007). The low supply of credit from the mainstream banking sector coupled with the high demand for credit by small firms led to the establishment of micro-finance institutions by NGOs and some Churches that are modeled in line with the Grameen Bank of Bangladesh that was founded by the 2006 Nobel Peace Laurete Prof. Muhammad Yunus. Akoten (2007), Argues that The Vicious Cycle of Credit in Accessibility by limited or total accessibility to credit (also commonly referred to as credit rationing) occurs when lenders are unwilling to provide a loan to a borrower or the amount that lenders are willing to disburse is limited even if the borrower is willing to pay a higher interest rate than other borrowers of comparable risk who are getting loans. Stiglitz, and Weiss (1981) were the first to advance the theory behind rationing in credit markets. According to their thesis, in the short-term when there is temporary disequilibrium prices of capital (or interest rates) tend to be sticky resulting in credit rationing. Schumpeter (1911) argued that services

Table IV. Average Return on Equity

BEFORE FOSA OPERATIONS	10.2	10.4	8.9	9.6	9.2	8.1	11.7	13.3	17.9
AFTER FOSA OPERATIONS	9.7	11.2	12.4	10.8	21.8	19.3	31.0	36.9	34.7

Total (E_1) 99.3 T_{calc}= -23.9 T_{crit} = 2.120 $\sum E_1^2$ = 1168 E_1 = 11 h = 9
Total (E_2) 187.8 E_2^2 = 4864.3 E_2 = 20.8 n = 9

provided by financial intermediaries and financial institutions facilitate technological innovation and economic development, thereby growth, by mobilizing resources, mobilizing savings, evaluating projects, managing risks and monitoring projects implementation.

Empirical Literature

SASRA (2010) shows that Kenya Sacco Sector has come of age, ready to effectively play its role of financial provision to Kenyans. The Sacco subsector is part of the massive Kenyan Cooperative Movement comprising of both financial and non-financial cooperatives. Kenya Sacco sub-sector is the largest in Africa contributing 67% of the total assets and 62% of the total deposit for the entire continent (MCD & marketing). The uniqueness of the Sacco movement is its geographical distribution across Kenya. Anne et *al* (2005) argues that micro-finance institutions (MFIs) in sub-Saharan Africa include a broad range of diverse and geographically dispersed institutions that offer financial services to low-income clients; non-governmental organizations (NGOs), non-bank financial institutions, cooperatives, rural banks, savings and postal financial institutions, and an increasing number of commercial banks. African MFIs appear to serve the broad financial needs of their clients. Unlike trends in most regions around the globe, more than 70 percent of the reporting African MFIs` offer savings as a core financial service for clients and use it as an important source of funds for lending. Bagehot (1920) asserts that the distinguishing characteristics of English financial Markets to mobilize savings to finance a variety of long-term illiquid investment opportunities led to industrialization in England. The cooperative movement has played a very big role in the development of our country by pooling resources for investment and wealth creation. The movement remains the most important vehicle through which poor Kenyans can pull resources and eventually grow to cover various economic areas. The movement controls 43% of our gross domestic product and contributes Kshs. 210 billion towards our national savings. At the same time, the cooperatives sector today, employs over 300,000 Kenyans directly and many more indirectly (Ministry of Cooperative Development & Marketing, 2010).

DATA AND METHODOLOGY

Research Design

The research adopted descriptive research design. The researcher used content analysis as a method of collecting data. The study used balance sheet and Accounts of selected Saccos to extract the required data for analysis purposes. The research was carried out in Tharaka Nithi County (Kenya). The study sought to evaluate how FOSAs can be used to improve the performance of Saccos.

Target Population

The target population for the study comprised three (3) Saccos with Front Office Sacco Activity. There were 60 co-operative societies in the County with eleven (11) Saccos but only four (4) had Front Office Sacco Activity (FOSA).

Sampling Procedure

The study used non-probability sampling method. Purposive sampling method was used. In this sample method, the researcher purposely targeted a group of objects believed to be reliable for the study (Orodho and Kombo 2002). In this case the three Saccos with Front office Sacco activities.

Data Analysis

The data collected was edited, coded, classified and tabulated to make it amendable for analysis. The objective of data analysis was to prepare raw data for statistical and presentation. The researcher used qualitative data analysis technique. The data was

Table V. Average Return on Assets

BEFORE FOSA OPERATIONS	11.3	10.3	8.7	7.5	7.5	6.5	8.8	9.7	13.6
AFTER FOSA OPERATIONS	9.3	11.0	12.3	8.6	16.0	13.6	24.1	28.3	25.3

Total (A_1) 83.9 $T_{calc} = -2.78$ $T_{crit} = 2.120$ $\sum A_1^2 = 820.7$ $A_1 = 9.3$ n = 9

Total (A_2) 148.5 $\sum A_2^2 = 2895.4$ $A_2 = 16.5$ n = 9

Table VI. Average Net Interest Margin

BEFORE FOSA OPERATIONS	11.3	10.6	8.9	2.8	3.0	2.6	7.2	8.2	11.8
AFTER FOSA OPERATIONS	9.3	11.0	12.2	5.1	5.4	1.0	22.4	25.4	23.6

Total $(M_1) = 66.4$ $T_{calc} = 15.312$ $T_{crit} = 2.120$ $\sum M_1^2 = 601.1$ $M_1 = 7.3$ n = 9

Total $(M_2) = 115.4$ $\sum M_2^2 = 2116.3$ $M_2 = 12.8$ n = 9

analyzed through descriptive statistics such as ratios, percentages and averages (means).

EMPHIRICAL RESULTS

The Survey Response

The research process was based upon a database of 11 Saccos in Tharaka Nithi County. Only four Saccos operate Front-office Sacco Activity. Three Saccos were chosen using non-probability sampling method. Purposive sampling method was used. The data was obtained from the Ministry of Cooperative Development and Marketing at the County. The balance sheets and accounts were used to extract the data needed from sample saccos.

The information extracted from the balance sheet and accounts included Income, Equity, Assets, Net Interest Income and Net Interest Expense for six years. The same was done for society B and C as shown in the following tables.

Hypothesis Testing

Three (3) hypotheses were tested based on the Sacco performance measurements related to the sample Saccos. The specific industry performance measurements used for this research study were: The six year average Return on Assets, the six year Average Return on Equity, and the six year Average Net Interest Margin. Each of the three variables were tested using mean student's t-test to determine if there was or was not any statistical difference between the performance for sample Saccos before and after FOSA operations for each variable.

Hypothesis H_1

The difference between Average Return on Equity for sample Saccos before and after FOSA operations is statistically significant. Table iv illustrates the analysis of the test 'on the mean-students-test, performed to determine the relationship of financial performance as measured by the Average Return on Equity. As can be seen from (Table iv) the calculated t_c value was less than the critical value of t at 0.05 level. Therefore, Hypothesis H_1 was accepted that the difference between Average Return on Equity for sample Saccos before and after FOSA operations is statistically significant.

Hypothesis H_2

The difference between Average Return on Assets for sample Saccos before and after FOSA operations is statistically significant.
Table V, illustrates the analysis of the test on the mean-students' t-test , performed to determine the relationship of financial performance as measured by the Average Return on Assets. As can be seen from (Table v) the calculated t_c value was less than the critical value of t at 0.05 level. Therefore Hypothesis H_2 was accepted, that the difference between Average Return on Assets for sample Saccos before and after FOSA operation is statistically significant.

Hypothesis H_3

The difference between Average Net Interest Margin for Sample Saccos before and after FOSA operations is statistically significant. Table vi illustrates the analysis of the test on the mean S-student's t-test performed to determine the relationship of financial performance as

measured by the Average Net Interest Margin. As can be seen from (Table Vi) the calculated t_c value was less than the critical value of t at 0.05 level. Therefore, Hypothesis H_3 was accepted, that the difference between Average Net Interest Margin for sample Saccos before and after FOSA operation is statistically significant.

All the three variables tested; Average Return on Equity, Average Return on Assets and Average Net Interest Margin gave similar results. The results indicate that there is a statistical difference between Saccos operating FOSAs and those that do not offer FOSA services.

The general trend of ratios reveal that Saccos operating FOSAs are doing better than those that are not operating FOSAS, without considering other factors.

CONCLUSIONS AND RECOMMENDATIONS

The study concluded that FOSAs, if operated can improve the members' welfare. FOSA operating Saccos have strong Capital base and therefore can serve their members better. The main activity of Saccos is offering credit to their members after accumulating savings. Front Office Sections attract non-members who open savings accounts, thus improving customer deposits. The membership of the Sacco grows both in FOSA and Back Office Sacco Activity (BOSA). This improves the volume of transactions, thus improving the revenue income of the society.

Recommendations / Suggestions

i) Saccos that do not operate FOSAs should be encouraged to open so that
members can benefit from FOSA services.
ii) Sacco Society Regulatory Authority (SASRA) should assist Saccos to open Front Office Services and bring them on regulatory authority.

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