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# The Influence of Corporate Governance Practices and Financial Performance of Saccos In Nakuru County, Kenya

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***Abstract***
*Cooperative saccos face diverse challenges that undermine their financial performance. To date, the cooperative sector in Kenya still experiences many challenges just like other businesses. Moreover, governance of cooperative societies has constrained their ability to reach full potential. Amongst the challenges faced include constant wrangles, corruption and mismanagement resulting in poor service delivery and becoming bankrupt. These constant wrangles are because of poor governance systems amongst the saccos. The poor governance challenges include members receiving less money than the loans approved by authorities, poor management of loan portfolio, appraisal of loan applicants, and subsequent loan monitoring. Other aspects include poor governance and limited transparency in the management of cooperatives, lack of capacity in management, market intelligence and market research, weak capital base and infrastructure weaknesses, high deployment and maintenance costs, inadequate financing or adoption of financing models among others. This study seeks to examine the role of corporate governance practices on financial performance of saccos in Nakuru County, Kenya.*

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## I. Background of the Study

Corporate governance is the process and structure used to direct and manage the business affairs of the company towards enhancing business prosperity and corporate accountability with the ultimate objective of realizing long-term shareholder value, whilst taking into account the interest of other stakeholders(Miniga, 2013). According to Langat (2013), corporate governance includes the structures, processes, cultures and systems that engender the successful operation of the organizations. Corporate governance is seen as the whole set of measures taken within the social entity (enterprise) to favor the economic agents to take part in the productive process, in order to generate some organizational surplus, and to set up a fair distribution between the partners, taking into consideration what they have brought to the organization(S. Achchuthan & Kajananthan, 2013). The Cadbury Committee defines a governance system as the system by which companies are directed and controlled.

Corporate governance systems may be thought of as mechanisms for establishing the nature of ownership and control of organizations within an economy. In this context, corporate governance mechanisms are economic and legal institutions that can be altered through the political process - sometimes for the better(Kasim, 2015). The impact of regulation on corporate governance occurs through its effect on the way in which companies are owned, the form in which they are controlled and the process by which changes in ownership and control take place. Ownership is established by company law, which defines property rights and income streams of those with interests in or against the business enterprise(Ochola, 2013). Fathi (2013) view corporate governance from the perspective of the investor as both the promise to repay a fair return on capital invested and the commitment to operate a firm efficiently given investment. This suggests that corporate governance has an impact on a firm's ability to access the capital market

In the banking industry, corporate governance involves the way banking institutions' business and affairs are managed by the board of administration and the top management, which affects how the bank works out the bank's objectives, plans and policies, taking into consideration making appropriate economic returns for founders and other shareholders, day-to-day work management, protection of the rights and interests of recognized stakeholders (shareholders and depositors), companies' commitment to sound and safe professional behaviors and practices which are in conformity with regulations and legislations(Aliza, Stephen, & Bambang, 2011). Recently there has been considerable interest in the corporate governance practices of modern corporations, particularly since the high-profile collapses of large U.S. firms such as Enron Corporation and WorldCom(Miniga, 2013).

## II. Statement of the Problem

Cooperative Saccos have been playing a key role in improvement of socio economy of citizens of different countries in the world. The Saccos members are able to save and access cheaper credit. Members are able expand their businesses with the ultimate goal of elevating their living standards. Thus, corporate governance in cooperative societies is necessary to promote better standards of management through observance of core principles, values and procedures. The success of a cooperative enterprise is positively related to effective leadership.Cooperative societies in Kenya have assisted several thousands of disadvantaged people and communities to create effective solutions to social and economic challenges.

However, certain challenges continue to face the Sacco movements that undermine their financial performance. To date, the cooperative sector in Kenya still experiences many challenges just like other businesses. Moreover, governance of cooperative societies has constrained their ability to reach full potential. Amongst the challenges faced include constant wrangles, corruption and mismanagement resulting in poor service delivery and becoming bankrupt. These constant wrangles are because of poor governance systems amongst the saccos. The poor governance challenges include members receiving less money than the loans approved byauthorities, poor management of loan portfolio, appraisal of loan applicants, and subsequent loan monitoring. Other aspects include poor governance and limited transparency in the management of cooperatives, lack of capacity in management, market intelligence and market research, weak capital base and infrastructure weaknesses, high deployment and maintenance costs, inadequate financing or adoption of financing models among others. This study seeks to examine the role of corporate governance practices on financial performance of saccos in Nakuru County, Kenya.

## III. Objectives of the Study

i) To examine the influence of risk management practices on financial performance of saccos in Nakuru county, Kenya
ii) To establish the influence of the independence of the board on the financial performance of saccos in Nakuru county, Kenya
iii) To establish the influence of the frequency of the board meetings on the financial performance of saccos in Nakuru county, Kenya

## IV. Theoretical Analysis

**Risk Management Practices and Financial Performance of Saccos**

Financial Risk Management refers to the practice of creating economic value in a firm by using financial instruments to manage exposure to risk, particularly Credit risk and Market risk. Just like in the case for general Enterprise Risk Management, Financial Risk Management requires identifying its sources, measuring it, and plans to address them(Langat, 2013). Therefore, Financial Risk management practices are those activities and procedures that are employed by managers in an effort of safeguarding an organization from Credit risks, Liquidity risks and Market risks. These practices fall into three major categories; Credit Risk Practices, Liquidity Risk Practice and Market Risks Practices(Kiarie & Minja, 2013).

Narwal & Jindal (2015) argues that Financial Risk Management Practices should be in conformity with the general development strategy of the organization and also match the general financial strength of the firm. In addition, there should be an interaction and conversion of Financial Risk Management Practices and other risks. These findings concur with those of Nyatichi (2017) that Financial Risk Management Practices should be a top priority for firms' managers. Commercial SCs are required to put in place Financial Risk Management thresholds as part of the overall Enterprise Risk Management Framework

Governance risk management practices are geared towards enhancing the efficiency and effectiveness of the organization with the help of proper supervision and control, thereby plating a very important role in aligning the interest of shareholders and management to reduce the agency conflict(Njoroge, 2012). Firms with good Governance risk management practices face less agency problems as management is stimulated to take actions for the best interest of shareholders and increase shareholders wealth managers(Kasim, 2015).

Good governance is necessary in order to attract investors, create competitive and efficient companies and business enterprises, enhance the accountability and performance of those entrusted to manage corporations and promote efficient use of limited resources(Sala, 2011). The Kenya Capital Market Authority (CMA) provides guidelines on corporate governance practices by the public companies in Kenya. The guidelines were developed in recognition on the role of good governance in corporate performance, capital formation and maximization of shareholders values and protection of investors' right. Any state corporations can enhance its governance risk practices to promote the standards of self-regulations so as to bring the level of governance in line with international risk management standards(S. Achchuthan & Kajananthan, 2013).

Aliza et al., (2011) defines Strategic Risk Management Practices as actions targeted towards detecting and mitigating the risk to earnings or capital arising from adverse business decisions or improper implementation of those decisions. There risks in this case are a function of the compatibility between an organization's strategic goals, the strategies developed to achieve those goals the resources deployed against these goals and the quality of implementation. Strategic risk management ensures the resources (tangible and intangible) needed to carry out business strategies including communication channels, operating systems, delivery networks and managerial capacities and capabilities are availed(Ochola, 2013). Yap, Saleh, & Abessi (2011) adds that strategic risk management practices focus is on how plans, systems and implementation affect the franchise value while incorporating how management analyzes external factors that impact on the firm's financial performance.

**Independence of the Board and Financial Performance of Saccos**

Similarly, independence is also considered important for a board committee to be an effective monitor. Achchuthan & Kajananthan (2013)report empirical evidence showing that the presence of monitoring committees (audit, nomination, and compensation committees) is positively related to factors associated with the benefits of monitoring. However, the presence of insiders in the compensation committees increases the probability of making decisions in favor of the CEO‟s interests. Moreover, when the CEO sits on the nominating committee or when no nominating committee exists, firms appoint fewer independent outside directors and more gray outsiders with conflicts of interest(Njoroge, 2012). In addition, the stock market's reaction to appointments of independent outside directors is more positive when the director's selection process is viewed as relatively independent of CEO involvement(Ochola, 2013).

One of the most important changes in corporate governance practice concerns the issue of board independence. This independence is to ensuring that the board is objective enough to act in the best interests of the company's stakeholders. Furthermore, independence is a key in ensuring that the board is able to exercise its primary responsibility of oversight of the company without being overly involved in its day to day management(Nyaga, 2012).

A board of directors is considered more independent if it has a number of non-executive directors. The presence of independent directors can improve the quality of supervision, as it is not affiliated with the company so freely in the decision making process. This theory is often referred to as the theory of control effect.

**Frequency of the Board Meetings and Financial Performance of Saccos**

Corporate boards of directors carry out critical roles, and thus deemed to be an important CG mechanism. Specifically, it been suggested that corporate boards advise (expert advice), supervise (monitor) and seek accountability (discipline) from management to ensure that managers pursue the interests of shareholders(Miniga, 2013). An important proxy for measuring the intensity and effectiveness of corporate monitoring and disciplining is the frequency of board meetings. However, there are mixed theoretical views as to the effect of corporate board meetings on corporate performance(Njoroge, 2012).

One theoretical proposition is that the frequency of board meetings measures the intensity of a board's activities, and the quality or effectiveness of its monitoring. All else equal, a higher frequency of board meetings can result in a higher quality of managerial monitoring, and thereby impacts positively on corporate financial performance(Kiarie & Minja, 2013). Also, it has been contended that regular meetings allow directors more time to confer, set strategy, and to appraise managerial performance. This can help directors to remain informed and knowledgeable about important developments within the firm, and thereby place them in a better position to timely address emerging critical problems(Achchuthan, 2013). In fact, Makokha (2014)suggests that regular meeting attendance is considered a hallmark of the conscientious director. Further, frequent meetings intermingled with informal sideline interactions can create and strengthen cohesive bonds among directors, and thereby impact positively on corporate performance.

An opposing theoretical view is that board meetings are not necessarily beneficial to shareholders. Firstly(Wanjama, 2015)argues that normally the limited time directors spend together is not used for the meaningful exchange of ideas among themselves. Instead, routine tasks, such as presentation of management reports and various formalities absorb much of the meetings, and this reduces the amount of time that outside directors would have to effectively monitor management which can impact negatively on corporate performance. Secondly, and board meetings are costly in the form of managerial time, travel expenses, refreshments and directors' meeting fees that can negatively influence corporate performance.

In fact, Weigand & Audretsch (1999)contends that boards in well-functioning companies should be relatively inactive and exhibit little conflicts. He suggests that rather than necessarily organising frequent board meetings, it will be more profitable for corporate boards to establish a system that is responsive to their specific challenges. For example, directors can increase the frequency of meetings during crisis or when shareholders' interests are visibly in danger, such as when replacing the CEO or fighting hostile takeovers. One implication of this is that the association between board meetings and performance can be non-linear whereby either a small or large number of meetings can equally impact positively on corporate performance. In this case, it is the flexibility with which corporate boards are able to either decrease or increase the number of board meetings to deal with emerging issues rather than the mere frequency that can influence corporate performance. Consistent with Jensen's (1993) suggestions, Vafeas (1999a) argues that companies that are efficient in setting the right frequency of board meetings, depending on its operating context, will enjoy economies of scale in agency costs, and thereby enhance corporate financial performance.

## V. Empirical Review

Langat (2013) examined the influence of corporate governance practices on financial performance of small holder tea companies.This study investigated the impact of corporate governance on firms' financial performance using 20 tea factory companies with data covering five years for the financial periods from 2007/2008 – 2011/2012. Based on the results of the descriptive statistics, correlation and regression analysis the researcher made the following conclusions.The correlation analysis indicates that most of the tested corporate governance variables on Board composition of the sampled small-holder tea factory companies have a correlation with the financial performance. The regression results show that Age of Board members has negative effect on return on assets. This negative relationship implies that there is a converse relationship between the average Ages of Board members and financial performance. However, this relationship is subject to interpretation of other various aspects relating to the Board members. This subsisting position from the results of this study need to be further evaluated.

Wairimu (2014) examined the influence of corporate governance on financial performance of SMEs in Nairobi County, Kenya. Out of the 200 SMEs sampled, 84.77% of them had board of management due to the realization that it was a necessity to proper governance that will have an impact on the farm's financial and overall performance. Some SMEs however had not embraced the existence of board of management as a corporate governance practice. Majority of the SMEs had board of managers with 2-5 members at 53.32% and this seemed to be the ideal board number due to their relatively small size. The board meetings were held 4-6 times in any given year as indicated by the majority where the boards exists. The study also found that financial monitoring by the sub-committees affected the financial performance of the SME‟s positively as shown by a mean of 4.69; number of meetings held by the sub- committee affected the financial performance of the SME‟s to a very great extent as shown by a mean of 4.50.The sub-committees held meetings once every month as indicated in the findings.

## VI. Theoretical Model

Jensen and Meckling (1976) proposed the agency theory based on the conflict of interest of the various contracting parties within an organization such as the shareholders and the corporate managers. They defined the agency relationship as a contract under which one party (the principal) engages another party (the agent) to perform some service on their behalf. As part of this, the principal will delegate some decision-making authority to the agent. Agency theory explains how best the relationship between agents and principals can be tapped for purposes of governing a corporation to realize its goals. Interest on agency relationships became more prominent with the emergence of the large corporation. Since the owners of capital (principals) have neither the requisite expertise nor time to effectively run their enterprises, they hand them over to agents (managers) for control and day-to-day operations, hence, the separation of ownership from control, and the attendant agency problems of the enterprise.

Achchuthan & Kajananthan (2013)argues that the scope of each type of agency conflict will differ from one firm to another, as was the effectiveness of governance mechanisms in reducing them. What is required is a more detailed understanding of what makes these mechanisms important for some firms and ineffective for others.

Historically, definitions of corporate governance also took into consideration the relationship between the shareholder and the company, as per agency theory, i.e. director-agents acting on behalf of shareholder-principals in overseeing self-serving behaviors of management. However, broader definitions of corporate governance are now attracting greater attention. Indeed, effective corporate governance is currently understood as involving a wide number of participants. The primary participants are management, shareholders and the sub-committees of directors, but other key players whose interests are affected by the corporation are employees, suppliers, customers, partners and the general community and thus, applicable to the SMEs.

## VII. Recommendations& Conculsions

The study found the risk management practices, independence of the board, and frequency of the board meeting had an influence on the financial performance of saccos in Nakuru. The study thus recommended that these practices should be embraced in the saccos.The study concludes that risk management, frequency of board meeting and independence of board meeting are critical for financial performance of saccos.

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