Effect of Control Functions on the Financial Performance of Saccos in Meru County

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Abstract

Purpose: To examine the effect of control functions on the financial performance of Saccos in Meru County.

Methodology: The study adopted a cross-sectional mixed design method. The study targeted a sample size of 96 respondents arrived by multiplying 4 respondents in the 24 Saccos as a basis of analysis who were operation managers, senior risk managers, internal auditors and accountants in the 24 Saccos selected Saccos in Meru County. Data was collected through use of closed-ended questionnaires and the output presented descriptively by use of mean and standard deviation. Inferential statistics such as correlation coefficient $\beta$, coefficients of determination $R$ and $P$-values was used from a multiple regression equation to measure the direction, strength and significance of the relationship between control activities and financial performance of Saccos. ANOVA was utilized to verify the goodness of fit of the model.

Results: The study indicated that there was significant relationship between control functions and financial performance of Saccos in Meru County.

Unique contribution to theory, policy and practice: The study contributed uniquely that there was a positive effect of control functions on the financial performance of Sacco banks in Meru County. The control functions should be readily available and continually updated by Sacco managers as they are the heart of the Saccos. If the functions are not working then it means the operations will eventually be paralyzed. This can be achieved by ensuring the guiding policies and guidelines are always available at the disposal of the user. Reviews should also be done regularly by Sacco regulators such as SASRA so as to ensure they are not outdated and to match the changing needs of the market and functional requirements. It is also recommended that physical control should always be done by operations heads in Saccos to avoid laxity from the operations. The approach of contingency theory to the study explained how the design and function of organizations are affected by conditional factors such as technology, organization customs, and the external environments. Different organizations have different organizational structure and their effectiveness is determined by a blend of the right type of organizational structure, organization size, environmental volatility, and technology. When the functions are well controlled by Sacco boards, updated performance of the entire system is enhanced.
Keywords: Control functions, financial performance, Sacco, Meru county

1.0 INTRODUCTION

1.1 Background of the Study

In the current business world, all businesses are struggling to come up with strategies that enable them outperform their competitors. SACCOs are also not an exception and therefore the reason as to why most SACCOs are adopting internal control systems. Their main aim is to enable them control the activities within the SACCO to enhance their financial performance. In North America, cooperative movement is traced form farmers who teamed up in tilling the land, for plantations as well as during harvesting periods. United States began its first cooperative movement in 1752 nearly a quarter-century before the Declaration of Independence was signed. Currently, Cooperatives have grown tremendously over the years. International monetary fund estimated the total assets of Cooperatives be 14% of the total banking sector market share in 2004 (Hussaini & Muhammed, 2018). Comparatively Cooperative movements have been ranked fare than commercial banks due to their resilience in times of financial crises (Cook, Chaddad, & Iliopoulos, 2004) This is explained by the fact cooperative banks investments tends to be less predictive and therefore their returns are more stable compare to commercial banks (Da Silva, Leite, Guse & Gollo, 2017). Cooperatives in developed countries have sustainable source of funding and not significantly affected by monetary policies and prices in the financial. Further, the interest rates by the cooperatives are more favorable compared to commercial banks in the developed countries (Shonubi, 2016; Mary, Albert & Byaruhanga, 2014).

According to Kiaritha (2015) in Africa, Sacco’s have grown at least 7% of the African population belongs to a SACCO. However, despite the growth, the SACCOS are faced with challenges i.e. poor representation of people in the society. Pollet (2009) as quoted in (Kiaritha, 2015) noted a division of society by classes due to economic capabilities that acts as hindrance to further growth. However, by 2008 savings in SACCOs entirely in Sub-Saharan Africa grew by 31.9% on average a lower growth compared to past years. The credits given grew by 12% on average a lower level compared to the past years (Bett, 2017). For example, in 2007 credits offered SACCOs increased by 35.3%; while in 2006 credits increased by 21.2%. There has been low growth in members al this implying that throughout Africa SACCO management has been trying to minimize risk associated with loan request so that they reduce losses (Bickel, 2007).

The Kenya SACCO sub-sector comprises both deposit taking (FOSA operating SACCOs) and non-deposit taking SACCOs. The general trend is that SACCO start as non-deposit taking Sacco business and grow to deposit taking Sacco business (DT-SACCO) to expand the range of financial services to members. SACCOS that operate front office services are licensed, supervised and regulated by Sacco society regulatory authority (SASRA) (Kiyieka & Muturi, 2018). In Kenya SACCO Banks account for 45% of the country’s GDP. To date, the sector has managed to mobilize over Ksh 200 billion in deposits and control assets amounting to Ksh210 billion (MCD &M 2010). These vast resources amassed by SACCO banks should allow them to compete in an open environment. Wanyama (2009) asserts that following the change in the economic landscape in Africa in the 1990s saw the development of new policies and regulations in Kenya in 1997 that
sought to liberalize co-operatives. Nevertheless, the SACCO banks in Kenya are faced by an array of challenges such as poor record keeping, loan backlogs, high illiteracy level among the SACCO members, audit arrears, managerial deficiency, inadequate capital and heavy taxation.

Most Saccos in Meru are agriculturally based where for instance tea, coffee farmers or daily farmers unite to save and borrow form the cooperatives. Other groups include teachers, hospital staff, business people in organization like transport sector and university among others. Different groups pool together to save and get financing for school fees, business, health and other economic activities. The SACCO Societies Act 2008 established the SACCO Societies Regulatory Authority (SASRA) that carries out the licensing, supervision and regulation of deposit taking institutions. SACCOs are categorized as either deposit-taking that are regulated by SASRA and non-deposit taking that are regulated by the Commissioner for Cooperatives. For Saccos to get SASRA licenses, they must be registered under the Cooperative Societies Act CAP 490. This regulatory framework guides the development of Saccos. Co-operatives in Kenya play a key role in the development of the country both socially and economically (Kiyieka & Muturi, 2018). According to the Ministry of Co-operative Development and Marketing, Cooperatives encompasses all sectors of the economy and provide a platform for mobilizing resources

1.2 Statement of the problem

The establishment of the SACCO Society Regulatory Authority (SASRA), was in part as a response to growing challenges affecting Sacco banks. Ideally, Sacco banks were established with the aim of improving the living standards of citizens both economically and socially through provision of services at a lower cost as compared to other lending and savings facilities. However, limited returns on investments continue to be a challenge to Sacco banks in Kenya (Chahayo, 2013; Kambura, 2018). Inadequate internal management capacity and operational controls is a major problem in Kenya’s Sacco banks. This is heightened by poor structures of control, technological changes, fraud and misuse of assets, leading to revenues losses and poor performance. There is Lack of controls thus making organizations fail to achieve their objectives as corruption has become rife and increased collusion between management and external auditors. Technological advances have brought about challenges in control systems and prompting new ways of controlling organizations.

The Kenya Financial Sector Stability Report, 2010 states some of these challenges include: poor governance structures, competition, low adoption of information and computer technologies, inadequate legislation to accommodate diversified products, weak internal control systems, inadequate performance standards, lack of disclosure requirement standards, poor human resources practices leading to poor quality of staff and high staff turnover (Ibrahim, Diibuzi & Abubakari, 2017). Despite the importance of the internal control structure, an actual measure of its performance within the organization is almost non-existent and the topic remains relatively unexplored by researchers Kinney (2000). This is also true in Kenya as there is little evidence linking internal controls to the profitability levels of the SACCO banks by controlled by SASRA (Kibui, 2014).

Keitany, (2000) studied the implication of internal audit control function on risk assessment by the external auditor while Kibet, (2008) examined how internal audit enhanced corporate governance in state-owned enterprises.(Ondieki, 2013) studied internal control systems effect on financial
performance on SACCO’s in Nyeri county. (Onyango, 2018) studied effect of capital adequacy on the financial performance of deposit Taking Savings and Credit Societies in Meru County, Kenya. However, no study has focused on effect of internal controls on the financial performance of Sacco sub-sector especially in Meru County. This is therefore the gap this study seeks to fill through examining how internal controls and financial performance of licensed Sacco’s in Meru County relate (Mutange & Datche, 2016)

1.3 Purpose of the study

To examine the effect of control functions on the financial performance of Saccos in Meru County.

1.4 Hypothesis

H₀: Control functions do not significantly affect financial performance of Saccos in Meru County.

2.0 LITERATURE REVIEW

2.1 Theoretical Review

Contingency theory directed the study. The approach of this theory to the study of organizational behavior is by explaining how the design and function of organizations are affected by conditional factors such as technology, organization customs, and the external environments. The assumption is that there is no one size fits all structure for organizations. Different organizations have different organizational structure and their effectiveness is determined by a blend of the right type of organizational structure, organization size, environmental volatility, and technology. These theories owe their origin from the social theories of the structure of the organization.

An example of these social theories includes “structural approaches to organizational studies” by woods (2009). This theory explains the relationship between the success of the internal control structure and performance of the organization in monetary reporting. Cadez and Guilding (2008) explain that firms achieve organizational effectiveness where the internal auditors refined in roles; they drive the internal control structures to efficiency. They further stated those elements of an organization such as the level of technology, the structure adopted; its size, external environment and strategy affect the systems control and their management. The theory suggests that strategies that harmonize and manage internal activities arise from the increasing demands by the technical task in the organization.

The source of information in an organization with respect to the advents of technology and its surroundings is key in shaping the structure of an organization. Where the situation is unsure, with poor technology then the information is sourced from within whereas where there is certainty coupled with technology, then the source of information is external. Decentralized authority, therefore, works best in an unsure environment whereas, in certain environments, Centralized authority is more appropriate. In contingency theory, the adoption of a particular control system is dependent on the organizational situation with which these controls would operate (Fisher, 1998). This theory, therefore, states that the adoption of a particular system of control is dependent on determinants such as the level of technology, the size of the organization, external surroundings and structure in place.
2.2 Empirical Review

Establishing frameworks for the bank activities and different departments of the Saccos alone is not enough for management as they ought to see to it that policy framework is complied with and that these frameworks remain adequate. This role falls under the internal audit arm (Kamande, 2017). According to the study by Kiyieka and Muturi (2018) there is a strong relationship between internal control activities and financial performance in that firms with good control systems are able to assess and mitigate the likely risk therefore improving their Muthusi (2017) noted that control activities ensure that strategies and processes are implemented to reduce the risk in order to achieve organizations growth.

According to Ratcliffe and Landes (2009) control activities include authorization, adequate documents, processing of information, physical controls, duty segregation, information processing, reconciliation, verification, review of operation performance and supervision. All these activities are geared towards minimizing risk to enable achievements of organizations goals (Saidu & Zabedah, 2013) as quoted in (Shabri et al., 2016). The fourth component of internal control is controlled activities, the procedures, and policies that ensure how management directives have executed that help ensures that appropriate corrective and preventive measures are taken to address risks associated to ensure achievement of the organizational goals and objectives (Frazer, 2012; Ndamenenu, 2011).

According to Hussaini and Muhammed (2018) control activities may either be automated or manual but both have the objective of minimizing risk that delays organizational success. The most essential control activity according to audit is performance review processing of information and diversifying of duties. Verifications are done before making payments, reconciliation, review operation, and supervision (Yogo, Marangu, Kiongera & Okaka, 2016). Among the benefits of control is timely and effective internal and external communication, easy achievement of organizations objectives, communication of objectives, enhanced decision making and use of information’s systems to reduce manual inaccurate reports. Among the control activities are, address segregation of duties; establish relevant technology acquisition, development, and maintenance process control activities; establish relevant technology infrastructure control activities; establish relevant security management process control activities; determine dependency between the use of technology general controls and technology in business processes.

According to Hussaini and Muhammed (2018) the control activities must be aligned with organizational policies. The study proposed a control model that encourages re-assessment of policies and procedures, take corrective action; perform promptly; perform using competent personnel; establish accountability and responsibility for executing policies and procedures; and establish policies and procedures to support the deployment of management’s directives (Hussaini & Muhammed, 2018; Janvrin et al., 2012). According to Mary, Albert, and Byaruhanga, (2014) Control Activities are necessary since they enable mitigation of risk through enforcement of organizational directives to address entity’s objectives. Further notes that apart from performance review activities such as budgets, forecasts must be monitored to ensure deviations are corrected.
3.0 RESEARCH METHODOLOGY

The study adopted a cross-sectional mixed design method. The study targeted a sample size of 96 respondents arrived by multiplying 4 respondents in the 24 Saccos as a basis of analysis who were operation managers, senior risk managers, internal auditors and accountants in the 24 Saccos selected Saccos in Meru County. Data was collected through use of closed-ended questionnaires and the output presented descriptively by use of mean and standard deviation. Inferential statistics such as correlation coefficient $\beta$, coefficients of determination $R$ and P-values was used from a multiple regression equation to measure the direction, strength and significance of the relationship between control activities and financial performance of Saccos. ANOVA was utilized to verify the goodness of fit of the model.

4.0 FINDINGS AND PRESENTATIONS

4.1 Reliability statistics

Reliability was conducted in the study as a proxy for internal consistency of the questionnaire measured during the piloting phase of data collection. The reliability test was performed on the 10 pilot study responses in Saccos in Embu county (Orotho, 2002). Cronbach’s Alpha determined the reliability whereby an alpha of 0.7 and above was required to conclude that the questionnaire section was reliable as shown in Table 1.

Table 1: Reliability Test Statistics

| Cronbach's Alpha | N of Items |
|------------------|------------|
| 0.867            | 10         |

The values for control functions was 0.867, which was above 0.7 hence deeming the questionnaire reliable in regards to control functions.

4.2 Response rate

The researcher issued 96 questionnaires to various respondents. The collected 75 questionnaires formed 78 percent of the sample size. According to Mugenda and Mugenda (2003), a response rate of 70% is appropriate for generalizing the sample results to the population.

4.3 Demographic information

The study provided descriptive statistics on academic qualification and work experience information as given in Table 2.

4.3.1 Academic Qualification

The study was interested in knowing how educated respondents were as pertaining to either being holders of certificate/diploma, undergraduate degree or a master’s degree. Table 2 indicated the results.
Table 2: Respondent’s Highest Academic Qualification

| Academic Level      | Frequency | Percent |
|---------------------|-----------|---------|
| certificate/diploma | 15        | 20.0    |
| undergraduate degree| 56        | 74.7    |
| master's degree     | 4         | 5.3     |
| Total               | 75        | 100.0   |

Table 2 shows that the majority of the respondents (80 percent) had at least an undergraduate degree whereas 20 percent had at most a diploma qualification. This shows that the respondents processed basic qualification to work in the SACCOs and furthermore, they possessed knowledge of the questions asked under this study.

4.3.2 Working Experience

The study also inquired on the number of years the respondents had worked in their respective Saccos. The results were tabulated on Table 3.

Table 3: Working Experience in the Sacco

| Period             | Frequency | Percent |
|--------------------|-----------|---------|
| 6 months-1 year    | 13        | 17.3    |
| 1-2 years          | 17        | 22.7    |
| 2-3 years          | 7         | 9.3     |
| 3-4 years          | 4         | 5.3     |
| more than 4 years  | 34        | 45.3    |
| Total              | 75        | 100.0   |

According to Table 3, the cluster of experience with the highest number of employees was more than four years that had 45.3 percent of the respondents. Forty percent of the respondents possessed less than 2 years of working experience in the Sacco while 14.6 percent of the respondents had between 2 to 4 years of working experience in the Sacco. Therefore, the working experience for the respondents was adequate for them to provide required information for the study. Gatuguta, Kimotho & Kiptoo (2014) agreed that over time it was established that most of cooperative staff had stayed in their Saccos for long time which was a facilitator towards their development in Kenya.

4.4 Descriptive analysis for control functions

This section gives the descriptive statistics for the questionnaire items for control functions. The statistics used are means and percentages presented in form of tables. Table 4 gave the outcome derived.
Table 4: Descriptive Analysis for Control Functions

| Statements (N=75)                                | Mean  | Std. Dev |
|-------------------------------------------------|-------|----------|
| There are policies governing the control systems | 4.53  | 0.86     |
| Reviews on the system is regularly done         | 4.31  | 0.65     |
| Physical monitoring on the system is regularly done | 4.31  | 0.65     |
| Information is processed efficiently            | 4.40  | 0.72     |
| Duties are well separated as per the roles      | 4.16  | 0.48     |

**Aggregate Mean & Std dev**

| 4.34 | 0.67 |

Table 4 shows the descriptive statistics for control functions summarized by five questions. All the five questionnaire items addressing control functions had means of more than four out of maximum of five. This indicated that majority of the respondents agreed to the assertions of existence of policies governing control systems, regular monitoring and review of control systems, processing of information was efficient and finally, separation of duties as per the roles. The overall mean was 4.34 out of 5; hence, the overall response was positive in support for proper control systems in the sampled Sacco. In agreement with Njoki (2015) confirmed that monitoring the internal control systems regularly was very important to find out the efficiency and effectiveness of the activities. The study noted that monitoring included regular management and supervisory activities, as well as human resources observe as they perform their activities.

4.5 Financial performance

The researcher also inquired on various level of performance level of Saccos had been faring. The results were documented in Table 5.

Table 5: Descriptive Statistics for Financial Performance

| Performance level | Frequency | Percent |
|-------------------|-----------|---------|
| High              | 34        | 45.3    |
| Moderate          | 25        | 33.3    |
| Low               | 10        | 13.3    |
| Very Low          | 6         | 8.0     |
| **Total**         | **75**    | **100.0**|

Table 5 shows that majority of the Saccos had at least moderate performance with only a few (21.3 percent) performing below average financially. This shows that performance of Saccos in Meru County was good and this trend correlated with the high levels of internal controls observed in Tables 4 on control functions. Kariuki (2017) got similar results whereby the researcher ascertained that there had been moderate performance financially out of practices of credit risk management in Saccos.

4.6 Hypothesis testing

The study measured hypothesis to examine the effect of control functions on the financial performance of Saccos in Meru County. The hypothesis indicated that control functions did not significantly affect financial performance of Saccos in Meru County. Table 6 indicated that R value of .456 which indicates a strong positive correlation. The R square value of 0.208 indicated
that control functions predicted 20.8% of the variability in the financial performance. The other 79.2% could be explained by other influences beyond control functions.

Table 4: Control function Model Summary

| Model | R       | R Square | Adjusted R Square | Std. Error of the Estimate |
|-------|---------|----------|-------------------|---------------------------|
|       | 0.456a  | 0.208    | 0.212             | 0.68720                   |

a. Predictors: (Constant), Control functions

4.7 ANOVA for linear relationship between control functions and financial performance.

The study analyzed analysis of variance to establish whether there was a linear relationship between control functions and financial performance. The p-value of the coefficient of control functions was 0.000, which was less than 5% (0.05). Therefore, the study rejected the null hypothesis hence concluding that at a significance level of 5%, control functions are significantly related to financial performance of Saccos in Meru County.

Table 5: ANOVA for Control Functions and Financial Performance.

| Model    | Sum of Squares | Df | Mean Square | F    | Sig.   |
|----------|----------------|----|-------------|------|--------|
| Regression | 18.998       | 4  | 4.750       | 10.057 | .000b  |
| Residual  | 29.752       | 70 | .472        |       |        |
| Total     | 48.750       | 74 |             |       |        |

a. Dependent Variable: Financial performance 
b. Predictors: (Constant), control functions

The results concur with those of Kiyieka and Muturi (2018) in a study on control activities and financial performance which revealed a significant relationship between the two variables.

4.8 Regression coefficients

The study analyzed for regression coefficients of control functions so as to

Table 6: Control Functions Securities Coefficients

| Model           | Unstandardized Coefficients | Standardized Coefficients | t     | Sig. |
|-----------------|-----------------------------|---------------------------|-------|------|
|                 | β                           | Std. Error                | Beta  |      |
| (Constant)      | -1.593                      | .704                      |       | .936 |
| Control Functions | .053                      | .057                      | .059  | 1.517| .004 |

a. Dependent Variable: Financial Performance

From Table 6, marginal increase in control functions as an internal control leads to 0.053 increase financial performance of Saccos in Meru County while holding other factors constant.
5.0 SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Summary of the findings

Objective one looked at control functions and majority agreed that reviews were done though at different intervals in different Saccos. This had a variation in terms of how often reviews were done in the respective Saccos. There was physical control as supported by majority of the respondents admitting that there were those in charge of physical controls and operations within the organization. Information on the other hand was processed effectively and efficiently though there were some cases of breakdown here and there due to poor maintenance of the systems or even power related. Duties were distinctively defined and employees were aware of their mandate which to some extent made their work easier as most of them were aware of what was expected of them.

5.2 Conclusion

There were policies on the control functions that helped in regulating and ensuring all the functions are controlled and that all what is happening is captured. The operations were regularly reviewed to ensure the systems and functions are up to date. On a normal working day there were people responsible for the physical operational control of functions within the organization to make sure nothing goes unnoticed leading to errors and malfunctioning of the system. Information was timely produced with the help of the standardized systems and updated systems operated by trained personnel. In some cases, there were information breakdowns where wrong data was picked or the system was not up to date or where there were power shortages. Duties were clearly defined where each and everyone knew their roles and what was expected of them. This therefore reduced confusion and improved efficiency and effectiveness in the operations and enhanced performance.

5.3 Recommendations and Contributions of the Study

The control functions should be readily available and continually updated by Sacco managers as they are the heart of the Saccos. If the functions are not working then it means the operations will eventually be paralyzed. This can be achieved by ensuring the guiding policies and guidelines are always available at the disposal of the user. Reviews should also be done regularly by Sacco regulators so as to ensure they are not outdated and to match the changing needs of the market and functional requirements. It is also recommended that physical control should always be done by operations heads in Saccos to avoid laxity from the operations. Information should be timely updated in the system by Information Technology (IT) department to avoid working with outdated information thus wrong results and it is very important to separate and define roles very clearly to eliminate cases of role conflicts during duty and function execution. When the functions are well controlled by Sacco boards, updated performance of the entire system is enhanced.
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