

Effect of Cash Management on Financial Performance of Deposit Taking SACCOs in Mount Kenya Region

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Abstract- This study sought to explore the effect of cash management on financial performance of deposit taking SACCOs in Mount Kenya Region. The target population was all the thirty licensed deposit taking SACCOs in Mount Kenya Region, the sampling technique employed was simple random sampling and the sample size was 92 respondents. This study adopted a descriptive survey in soliciting information on effects of liquidity management on financial performance of deposit taking SACCOs in Mount Kenya region. Primary quantitative data was collected by use of self-administered structured questionnaires. The researcher also used secondary data derived from the audited financial statement of the SACCOs and the regulator (SASRA). The data collected was analyzed, with respect to the study objectives, using both descriptive and inferential statistics. The researcher concluded that there is need to introduce cash management controls in the SACCOs, there is need to better strengthen the role of SASRA and increase its awareness, there is need to introduce credit management policy and finally increase the monitoring role of the government through its regulator in the sector since the sector plays a critical role on the achievement of vision 2030 and improved economic development of the members.

National Domestic Saving (Co-operative Bank of Kenya, 2010). Liquidity risk is a failure of SACCOs to honor approved loans due to inadequacy of loanable funds (Fiedler, Brown, & Moloney, 2002). Liquidity risk needs to be monitored as part of an integrated institution wide risk management process taking into account market and credit risk to ensure stability and improvement of loan portfolio in the balance sheet.

As Nyabwanga (2011) asserts, working capital management is a very important component of corporate finance because it directly affects the liquidity, profitability and growth of a business and is important to the financial health of businesses of all sizes as the amounts invested in working capital are often high in proportion to the total assets employed (as cited in Atrill, 2006). As Nyabwanga (2011) asserts, this management of short-term assets is as important as the management of long-term financial assets, since it directly contributes to the maximization of a business's profitability, liquidity and total performance. Consequently, businesses can minimize risk and improve the overall performance by understanding the role and drivers of working capital (as cited in Lamberson, 1995).

As Nyabwanga (2011) asserts, cash management is the process of planning and controlling cash flows into and out of the business, cash flows within the business, and cash balances held by a business at a point in time (as cited in Pandey, 2004). Efficient cash management involves the determination of the optimal cash to hold by considering the trade-off between the opportunity cost of holding too much cash and the trading cost of holding too little (as cited in Ross et al., 2008) and as stressed by Atrill (as cited in 2006), there is need for careful planning and monitoring of cash flows over time so as to determine the optimal cash to hold. As Nyabwanga (2011) asserts, setting up of a cash balance policy ensures prudent cash budgeting and investment of surplus cash (as cited in Kwame, 2007). This finding agree with the findings by (as cited in Kotut, 2003) who established that cash budgeting is useful in planning for shortage and surplus of cash and has an effect on the financial performance of the firms. The assertion by (Ross et al., 2008) that reducing the time cash is tied up in the operating cycle improves a business's profitability and market value furthers the significance of efficient cash management practices in improving business performance.

According to (Sambasivam, 2013), the deposit and loan portfolio in SACCOs amounts to about 34 percent of national savings and about 24 percent of outstanding domestic credit (as cited in CBK Report, 2008). It is undeniable fact that member's

I. INTRODUCTION

C1.1 Background of the study

Cooperative societies are an autonomous association of persons united voluntarily to meet their common economic and social needs through jointly owned and democratically controlled enterprises, which are organized and operated under the principles of cooperatives (ICA, 2005). They are embodied in the values of self-help, honesty, openness, self-responsibility, social-responsibility, democracy, quality, equity, solidarity, mutual caring, efficiency, transparency and accountability (Okello, 2006; ICA, 2005). Generally, cooperatives are community institutions voluntarily and autonomously established and managed by the communities, and also give services for the local communities.

As Clement (2012) asserts, SACCOs have the ability and opportunity to reach clients in areas that are unattractive to banks, such as rural or poor areas (as cited in Branch, 2005). This has made SACCOs more attractive to customers, thus deeply entrenching themselves in the financial sectors of many countries (as cited in Munyiri, 2006). In Kenya, SACCOs have mobilized over Kshs.200 billion in savings, accounting for over 30% to

loan demand is very high and incompatible compared with the availability of funds (Sambasivam, 2013). This follows that SACCOs face a risks arising from liquidity shortage and this has been a major cause of failure of many financial cooperatives (Sambasivam, 2013). SACCOs convert immediately available savings deposits into loans with longer maturities. (Nyabwaga et al., 2011) in their study on the effect of working capital management practices on financial performance contend that working capital management routines were low amongst small scale enterprises as majority had not adopted formal working capital management routines and also the study corroborates that there is a positive relationship between working capital management practices and financial performance.

Clement et al., (2012) in their study on financial practice as a determinant of growth of SACCOs wealth content that growth of SACCO wealth depended on financial stewardship, capital structure and funds allocation strategy. Both studies did not address the issue of cash management, loan repayment and investment on non-core activities which the current study tries to address. In Kenya, SACCOs do not have access to the lender of last resort, the Central Bank of Kenya. So in times of market difficulties and constrains they have nowhere to get the asset of cash. This makes them prone to the liquidity shortage, and no matter how small, can cause great damage to a savings institution (Monnie, 2009). It is against this background that a study should be carried out on effects of liquidity management and regulation on financial performance of deposit taking SACCOs in Mount Kenya Region.

The general objective of this study was to determine the effect of cash management on financial performance of deposit taking SACCOs in Mount Kenya Region.

The findings of this study will benefit, policy makers who include the management committees and the managers of the Sacco by providing information on the appropriate cash management techniques to adopt. Also the decision makers on policy in SACCO regulatory authority will benefit in ensuring SACCOs have sufficient cash management tools for their liquidity management.

This study adopted a descriptive survey design. As Hannah, (2013) asserts, research design is the arrangement of condition from collection and analysis of data in a manner that aims to combine relevance to the research purpose with economy in procedure (as cited in Upagade and Shende, 2012). In Kenya, there are one hundred thirty five (135) registered deposit taking SACCOs, (SASRA, 2014). The target population will be licensed deposit taking SACCOs in Mount Kenya Region (SASRA, 2014). The respondents will be the Chief Executive Office, finance manager, credit Manager and SACCO Treasurer from each Deposit taking SACCO. Hence the target population will be $(4 \times 30 = 120)$.

II. THEORETICAL FRAMEWORK

2.1 Introduction

This chapter reviews the existing literatures theories and models related to the variables used in the study, a review of past studies on the area of study.

2.2 Theoretical Framework

(Kotler & Gary, 2005) described theoretical framework as a collection of interrelated concepts such as in a theory to guide a research work as it determines the items for measurement and the statistical relationships being studied. A theory is a reasoned statement or group of statements, which are supported evidence meant to explain some phenomena.

2.2.1 Cash Management theory

The purpose of cash management is to determine and achieve the appropriate level and structure of cash, and marketable securities, consistent with the nature of the business's operations and objectives (Brigham, 1999). As Erkki (2004) asserts, Models on cash balance management have been proposed by (as cited in (Baumol, 1952), (Archer, 1966), (Beranek, 1963), (Miller & Orr, 1966), (Pigou, 1970), (Lockyer, 1973), & (Gibbs, 1976)) among others. (as cited in William Baumol,1952) was the first person to provide a formal model of cash management. As Erkki (2004) asserts, this model applied the economic order quantity (EOQ) to cash. Brokerage fees and clerical work form order costs while foregone interest and cash out costs form the costs of holding cash. Baumol's model is however probably the simplest, most striped down and sensible model for determining the optimal cash position (as cited in Ross, 1990). (as cited in Lockyer, 1973) on the other hand modified Baumol's model to incorporate overdraft facilities. According to Lockyer's approach the total annual cash policy cost attributable to the use of overdraft facilities is given by the sum of total annual cash transfer cost, total annual overdraft cost and the total annual holding cost. As Erkki (2004) asserts, Lockyer's model is critiqued for assuming overdraft facilities, which are not automatic especially for firms with poor credit rating. The model also assumes disbursements are even over the planning period.

As Erkki (2004) asserts, the cyclical nature of cash is recognized (as cited in Archer, 1966) who reasons that apart from providing a cash balance for transactional purposes, a cash balance should be provided for precautionary purposes, especially for seasonal activities that are unpredictable. In Archer's approach, costs related to overdraft facilities and capital costs of precautionary balances are compared to determine the optimum. Archer's approach is advantageous for it recognizes the cyclical nature of net cash flows of many firms. As Erkki (2004) asserts, enhances the reasoning (as cited in Archer, 1956). According to Gibbs, the determination of optimal cash balance involves a combination of investment and financial decisions. In Gibbs approach, cases where demand for money is of a cyclical nature a combination of short and long term borrowing should be used to avoid the use of long term funds to cover peaks arising from idle cash balance, during periods of low cash demand. Gibbs contends that, the determination of the amount of buffer money to hold is seen as an investment decision. Gibbs approach emphasizes holding costs, costs of short and costs of long-term borrowing and the costs of investment in marketable securities, (Erkki, 2004).

In order to do this a variety of activities need to be undertaken, because of the integrative nature of cash to the operation of the SACCO. Since most of the SACCO operations revolve around advancement of cash then it is imperative for a considerable minimum level of cash to be maintained. How a SACCO manages cash will definitely have implications on the

liquidity of the SACCO. The theory therefore is of essence on the bases of the policy the SACCOs may have in place with regard to cash retention so as to avoid illiquidity.

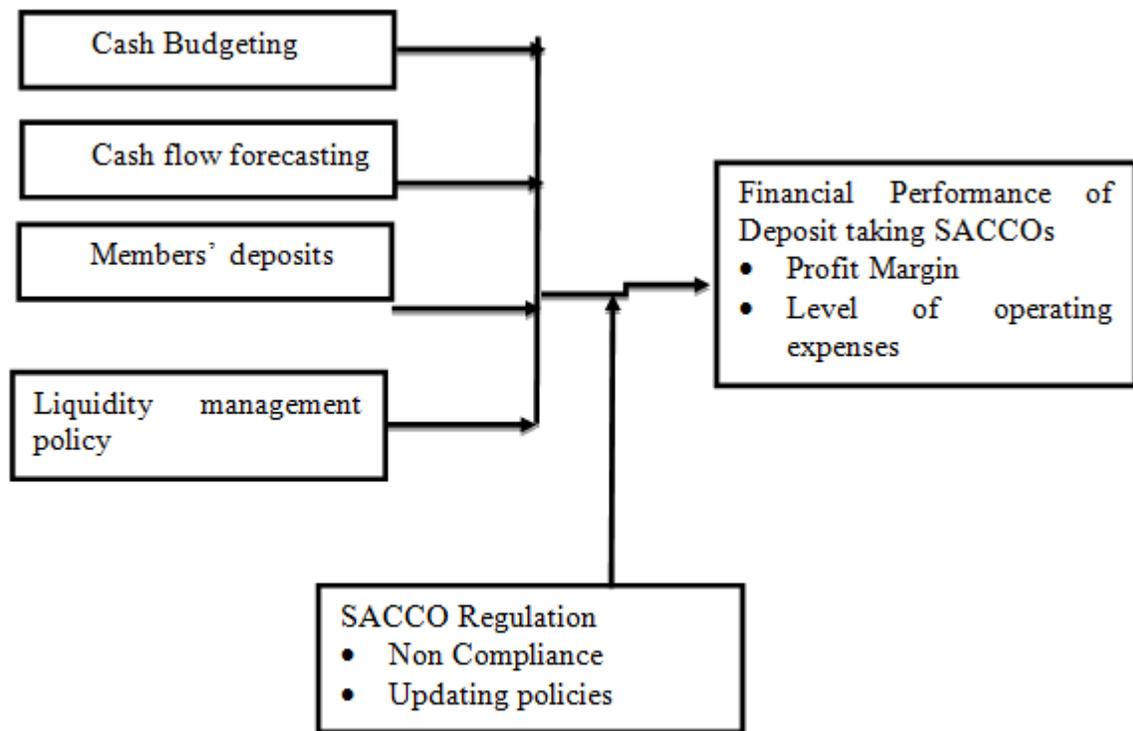
2.2.2 Free cash flow theory

As Huseyin (2011) asserts, managers have an incentive to hoard cash to increase the amount of assets under their control and to gain discretionary power over the firm investment decision, (as cited in Jensen, 1986). Having cash available to invest, the manager does not need to raise external funds and to provide capital markets detailed information about the firm's investment projects (Huseyin, 2011). Hence, managers could undertake investments that have a negative impact on shareholders wealth. Managers of firms with poor investment opportunities are expected to hold more cash to ensure the availability of funds to invest in growth projects, even if the NPV

of these projects is negative(Huseyin,2011). This would lead to destruction of shareholder value and, even if the firm has a large investment programme and a low market-to-book ratio. Thus, using the market-to-book ratio as a proxy, it is likely that the relation between investment opportunity set and cash holdings will be negative. This is critical in management of liquidity in the firm and ensuring there is a balance between meeting the current obligation to mitigate liquidity short fall and investing in the interest of shareholders wealth maximization (Huseyin, 2011).

2.3 Conceptual framework

As Sammy (2013) asserts, a conceptual framework refers to a group of concepts that are systematically organized in providing a focus, rationale and a tool for interpretation and integration of information (as cited in Balachander & Soy, 2003). This is usually achieved in pictorial illustrations.



Independent Variables

Moderating Variable

Dependent Variable

2.4 Empirical Review

As Nyabwanga (2011) asserts, cash management is the process of planning and controlling cash flows into and out of the business, cash flows within the business, and cash balances held by a business at a point in time (as cited in Pandey, 2004). As Nyabwanga (2011) asserts, efficient cash management involves the determination of the optimal cash to hold by considering the trade-off between the opportunity cost of holding too much cash and the trading cost of holding too little (as cited in Ross et al., 2008) and as stressed by (as cited in Atrill, 2006), there is need for careful planning and

monitoring of cash flows over time so as to determine the optimal cash to hold. A study by (Kwame, 2007) established that the setting up of a cash balance policy ensures prudent cash budgeting and investment of surplus cash. This finding agree with the findings by (Kotut, 2003) who established that cash budgeting is useful in planning for shortage and surplus of cash and has an effect on the financial performance of the firms. The assertion by (Ross et al., 2008) that reducing the time cash is tied up in the operating cycle improves a business's profitability and market value furthers the

significance of efficient cash management practices in improving business performance.

Erkki (2004) defined cash management as a part of treasury management, which is defined as a part of the main responsibilities of the central finance management team (as cited in Tiegen, 2001). Huseyin (2011) asserts, the specific task of a typical treasury function include cash management, risk management, hedging and insurance management, account receivable management, account payable management, bank relations and investor relations (as cited in Kytönen, 2004). (Huseyin, 2011) thinks that this definition is consistent with the (as cited in Srinivasan & Kim, 1986) classification of cash management areas as cash balance management, cash gathering, cash mobilization and concentration, cash disbursement, and banking system design. Cash balance management includes management of cash position, short-term borrowing, short term investing, cash forecasting. (Huseyin, 2011) opinion is that the classifications of Tiegen's cash management and Srinivasan and Kim's cash balance management are closely related concepts. (Huseyin, 2011) classifies cash management as operating transactions and financial transactions. The operating transactions include accounting ledgers, invoicing, terms of sales - cash collection, cash control and processing, cash forecasting. The financial transactions include optimization of cash, short-term investments, short term borrowing, interest rate risk management, exchange rate risk management, payment systems, information systems and banking investor relations (as cited in Kytönen, 2004).

As Jared (2013) asserts, the cooperative form is therefore regarded as having enormous potential for delivering pro-poor growth that is owned and controlled by poor people themselves. Nevertheless it is recognised that, lacking in capital and business management capacity, cooperatives have had a rather disappointing history in developing countries (as cited in Birchall, 2004). There is an argument then that it is the broader characteristics of cooperative organisation such as social ownership, people-centred objectives and their community base, rather than their precise organisational form should be advocated. According to (Mwaura, 2010) industry statistics in Kenya show that an estimated 60 SACCOs are way below the required minimum capital levels — and are expected to turn to the members for money needed to reach the threshold. Contributing money for the capital build-up will force members to take a portion of their monthly take-home or forego annual dividends in the next four years in support of the initiative. Nation staff SACCO has, for example, asked its members to increase their share capital to Sh 6,000 from the current Sh1, 000 in the next five months beginning August 2010.

As observed by (Steve, 2010) Maisha Bora SACCO had withheld part or whole dividends for the year 2009 and encouraged members to invest in beefing up the core capital in order to meet the SACCO liquidity demands. (Haileselesie, 2003) in his study about cooperatives in Saesi-Tsaeda-Imba, investigated that 78.7 percent of the members became member in cooperatives through mobilization and persuasion by the civil societies such as Farmers, Youth and Women's Associations. As a result, the members' were not aware of the duties and rights they have in the cooperative societies. According to Haileselesie's finding, for example, out of the total respondents

members' participation in the annual meeting was 12.2 per cent and 68.8 per cent of the total respondents had bought only one share. The result of the study revealed that the overall participation of members in co-operatives was weak (Haileselesie, 2003).

As Darek (2012) asserts, the problem of access to capital becomes even more challenging in emerging markets for a variety of reasons (as cited in Benedict and Venter, 2010; Cunningham and Rowley, 2010; Klonowski, 2005; Abor and Biekpe, 2006; Tagoet al., 2005). First, firms in emerging markets operate in an environment of imperfect legal infrastructure (as cited in Cunningham and Rowley, 2010; Klonowski, 2005). Capital providers must often agree to contractual terms that are suboptimal for them. Second, financial disclosure in emerging markets continues to be relatively poor (as cited in Sami and Zhou, 2008; Zhou, 2007; Klonowski, 2007). As Darek (2012) asserts, many countries report financial results under their own financial standards and regulations, which are different from those seen in international accounting standards; consequently, auditing firms must often recast the financial statements of firms operating in such markets. Third, asymmetry of information and moral hazards are more pronounced in emerging markets (as cited in Klonowski, 2007; Tagoet al., 2005). Access to information is a greater challenge to obtain, as sources of information on firms, the competitive posture of market players, and market size and growth rates are more difficult to find (as cited in Abor and Biekpe, 2006; Tagoet al., 2005). Fourth, firms operating within emerging markets have more problems related to corporate governance. The corporate governance concerns are more severe and more difficult to address than those experienced by firms in developed economies (as cited in Black et al., 2010; Klonowski and Golebiowska-Tataj, 2009; Parisiet al., 2009; Klonowski, 2007). Key issues may include the personal use of a firm's assets, unaccounted cash withdrawals, appointment of family members, and so on.

(Ondieki, 2011) in "The effects of external financing on the performance of SACCOs in Kisii District" observed that major challenges inherent in the cooperative movement in Kenya included: poor governance, limited transparency in management of cooperatives, weak capital base and infrastructure weakness including ICT. The same opinion is shared by (Karim, 2012) "African SACCO Regulatory framework" whereby it was observed that leadership or governance of a CFI determines to a large extent how the CFI responds to regulatory issues and how it operates within the regulatory framework. This requires that the BOD members file personal information return with the regulators.

According to (Odhiambo, 2013) in his study on the relationship between working capital management and financial performance of deposit taking savings and credit co-operative societies licensed by SACCO societies regulatory authority in Nairobi county. Interest rate on members' deposits as measure of financial performance was used as the dependent variable. The independent variable (working capital management) was measured by cash conversion cycle, current ratio, debt ratio and turnover growth. The findings indicated that efficient working capital management leads to better financial performance of a

SACCO, hence a positive relationship existed between efficient working capital management and financial performance variable. A study on the role of financial management practices in the performance of public service vehicle savings and credit co-operative societies in Kenya was done by (Kinyua, 2013). The objectives of this study were to, describe the profile of P.S.V SACCOs, investigate the role of financial management practices in the P.S.V SACCOs in Nyeri South district, identify areas of financial management that are influential to performance of P.S.V SACCOs, find out whether public transport SACCOs in Nyeri South District generate cash plans and budgets based on their specific priorities and to ensure that incoming financial resources facilitate the fulfillment of these priorities. The findings show that public service vehicle SACCOs have better financial management practices as showed by the six indicators of better financial management. Members' funds are protected against loan delinquency by setting funds and provision for statutory reserve provided for through cooperative Act. SACCOs have effective financial structure, high rate of return and high Loan Repayment. There are signs of growth indicated by positive change in the levels of profitability, turnover and capital. Better financial management practices have resulted to better performance of the SACCOs. The dividends payout for the members of the SACCOs is fairly high and is expanding, annually. The share capital level of the SACCOs has increased over the years of their existence. With expanding saving members are able to access credit facilities resulting to increased number of vehicles. The public service vehicle SACCOs have therefore continued to exist and grow over the years dominating the public transport sector.

2.5 Critique of the existing literature relevant to the study

Research article by (Kifle, 2011) on the management of savings and credit cooperatives from the perspective of outreach & sustainability: evidence from Southern Tigray of Ethiopia, the author did cite literature in relation to the area of study. There is enough buildup of information in relation to the research. The paper lacks theoretical framework on where the author builds up his research on. There is lack of sequential chronological order of literature as per specific objectives. The author describes clearly the area of study, provides the study population of ten SACCOs and states the usage of longitudinal research design with 2007 as the baseline. The researcher stated usage of both primary and secondary data and the way it was presented. The researcher failed to state the sampling technique, computation of the sample size and analysis of primary data. Usage of inferential statistics was not clearly stated and there is lack of econometric model to show the relationship between variables and establish the predictive nature of the information.

III. FINDINGS

4.1 Introduction

This section highlights the analysis of data based on objective, independent variable and Presentation of research findings and discussions of the results.

4.2 Response Rate

From the data collected, out of the 92 questionnaires administered, 68 were filled and returned, which represents 74% response rate. This response rate is considered satisfactory to make conclusions for the study.

4.3 Cash Management

The research objectives was to find the effect of cash management on financial performance of deposit taking SACCOs in Mount Kenya Region.

From the findings the researcher established that most SACCOs prepare cash budget regularly as indicated by mean of 4.51, this is strong but with level of dispersion of 0.532 shows that less controls are in place to ensure cash budgets are well prepared. Hence the need of the management to ensure stronger controls are in place in preparation of regular cash budget and this will be well represented by a smaller standard deviation.

From the finding the researcher also established that most SACCOs prepare cash flow forecast in order to inform critical decision in relation to financial performance as shown by a mean value of 4.01, this is well represented since the median is 4.00 which shows cash flow forecast is done and taken seriously in the SACCOs. Across the number of SACCOs, the process is not standard since the standard deviation of 0.743 is very high in comparison to preparation of regular cash budget. This reviewed that management is aware of the need of preparation of cash flow forecast and its implication on the financial performance of the SACCOs.

From the findings the researcher also established there was occurrence of both cash surpluses and shortages as indicated by mean of 2.93 and 2.78. The data showed that shortages were greater than surpluses. This raised an alarm in terms of cash management since it greatly affects day to day operation of the institution since cash is the key engine in the operation of the SACCOs. Also the standard deviation is on the higher side namely 0.719 and 0.878 hence the dispersion levels are high. This shows even though SACCOs undertake strict cash flow forecast, there are external variables that can affect cash management which poses a greater risk in the operations of the institutions. Hence the need to critically review in-depth on the factors both in the external environment and internal environment that can affect cash management in the institution and establish mitigating factors.

From the findings the researcher established that the monthly members' contribution was low as indicated by mean of 3.25, and strengthened by median of 3. This raises a great concern in the cash management of the SACCOs since members' contribution provides direct cash in the institution. The management need to find ways to encourage regular contribution of the members since it will affect the financial performance of the institution. Also the researcher established the level of dispersion was very high as reviewed by standard deviation of 1.238 hence it poses a high risk in the management of cash in deposit taking SACCOs. Hence the need of establishing good mechanism to encourage increase in membership contribution to boost financial performance of the SACCOs.

The researcher wished to establish the constraints SACCOs undergo during cash management. The researcher established that the main challenges as per the respondents were: lack of members integrity in relation to liquidity management; lack of

proper channels followed during liquidation process; methods and the techniques of depreciating assets; high level of loan demands and high loan default rate. Hence the advice of the researcher to the SACCO management to address the listed challenges on liquidity management soonest possible since it will result on improved financial performance of the institutions.

4.4 Hypothesis Testing

There is a Strong positive relationship between cash management and Financial Performance of Deposit taking SACCOs in Mount Kenya Region as indicated by correlation of 0.584. The p-Value of 0.000 is less than the acceptable significance level (α), hence the null hypothesis that there is no relationship between Cash Management and Financial Performance of Deposit taking SACCOS in Mount Kenya Region is rejected. This shows that the sampled data can be applied to the general population across deposit taking SACCOs at 95% confidence level.

4.5. Summary

Cash management is very critical as a liquidity management tool in deposit taking SACCOs the researcher studies the following parameters namely: preparation of regular cash budget, cash flow forecast, occurrence of cash shortages and surplus and monthly members' contribution. The researcher concluded that deposit taking SACCOs need to address the parameters critically to ensure that there is adequate cash management policy within the institution to ensure optimal financial performance of deposit taking SACCOs since they have a great role on the achievement of vision 2030 and the sector is a great contributor on the financial sector in the Kenyan economy. The management need to ensure there are adequate cash management controls to ensure all the time there is optimal cash where there are strategies to be in place during minimal cash and surplus cash since either of the side will contribute to liquidity risks to the organization.

IV. RECOMMENDATION

The following are the recommendation from this research study:

There is need for the regulator to introduce cash management controls that will be applied across all the deposit taking SACCOs. This will go way further towards increased cash management in the sector and contributes towards better financial performance in the sector.

There is need for the regulator to introduce cash ration to be deposited within the SACCO regulator. This will enable control of liquidity in the deposit taking SACCOs and also help on overnight borrowing to assist the SACCOS assess the regulator during cash shortage and release cash surpluses when there is excess funds.

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