The Effects Of External Financing On The Growth Of Savings And Credit Co-
Operative Societies’ Wealth In Nairobi County, Kenya.

BY

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UNITED STATES INTERNATIONAL UNIVERSITY - AFRICA

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STUDENT’S DECLARATION

I, the undersigned, declare that this is my original work and has not been submitted to any other college, institution or university other than the United States International University in Nairobi for academic credit.

Signed: ________________________ Date: ______________________

Jessica Akinyi Onyango (Student ID NO.: 639951)

This project has been presented for examination with my approval as the appointed supervisor.

Signed: ________________________ Date: ______________________

Kepha Oyaro

Signed: ________________________ Date: ______________________

Dean, Chandaria School of Business
ABSTRACT

The main objective of this study was to establish the effects of external financing on the growth of Savings and Credit Co-operative Societies’ wealth in Nairobi County in Kenya. The specific objectives were: first to establish the negative and positive effects of external financing on growth of SACCOS’ wealth, second to establish the determinants of external financing that affect the growth of SACCOS’ wealth, and third to establish the association of external financing component of capital structure and the growth of SACCOS’ wealth.

The methodology entailed use of descriptive research design. The target population for this study was 43 licensed SACCOs as at December 2014 in Nairobi County as deposit taking by SASRA and were in operation since 2010. For the principle of this study, a sample was acquired from the population. Primary data was collected by use of questionnaires administered to 35 respondents that were sampled from the study. Out of this sample size 30 responded. Secondary data was also collected, by use of document review guide. Two research assistants were trained to assist in the data collection. Data was then analyzed by use of both descriptive and inferential statistics. Statistical Product and Service Solution (SPSS) and Ms Excel were used to analyze data.

The study found that growth of SACCOS’ wealth increased each year for the last five years in terms of borrowings, capital and assets adequacy, earnings and liquidity trajectories; that legal environment was conducive for SACCOs in Kenya but with certain areas that required improvement; and management practices were positive in the management of equity ratio. The study revealed that it was possible to finance non-withdrawable capital funded assets and to provide cushion to absorb losses and impairment of members’ savings. In case of the SACCOs that would face emergence of unexpected risks, the growth of SACCOS’ wealth in the County would ensure sustainability of the industry.

The major conclusion of the study was that SACCOs can easily access external finances and invest in profitable opportunities because when properly invested then external finances are a catalyst for growth; that the growth of SACCOS’ wealth significantly depended on management quality, earnings, liquidity, capital structure, and funds allocation; and that if
equity ratios were properly managed then liquidity gaps would be financed and hence stability of SACCOs would be enhanced.

The study recommends that SACCOs should adopt common measurements of best-practice in financial management; that SASRA should introduce cash management controls that will be applied across all the deposit taking SACCOs including the small ones; and that SACCOs should do proper analysis of investment options and only invest in profitable opportunities as this will ensure that SACCOs do not incur losses.
ACKNOWLEDGEMENT

I recognize the presence of God the Almighty in my life. For giving me the vigor and wisdom to have been able to prepare for the execution of this research project and finalizing this project. A special thanks my supervisor Mr. Kepha Oyaro for his guidance, advice and efficient timely response at each stage in the preparation and completion of this research project for examination. Thank you for your support and insight. My sincere appreciation goes to my dear family and friends for their understanding, abundant love, resource input, and encouragement throughout the research study.

May God bless you All.
DEDICATION

This research project is dedicated to my wonderful family, for their continuous support and sacrifice.
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<tr>
<td>ACCOSCA</td>
<td>African Confederation of Cooperative Savings and Credit Associations</td>
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<tr>
<td>CIC</td>
<td>Cooperative Insurance Company</td>
</tr>
<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
</tr>
<tr>
<td>KUSCCO</td>
<td>Kenya National Union of Savings and Credit Cooperatives</td>
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<td>SACCOS</td>
<td>Savings and Credit Cooperative Societies</td>
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<td>SAPs</td>
<td>Structural Adjustment Programs</td>
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<td>SASRA</td>
<td>Sacco Societies Regulatory Authority</td>
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<tr>
<td>SPSS</td>
<td>Statistical Product and Service Solution</td>
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<td>World Council of Credit Unions</td>
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CHAPTER ONE

1.0 INTRODUCTION

1.1 Background of the Study

External financing is defined as that finance coming from somewhere that is not within the company itself (Ondieki, et al., 2007). Another definition of external financing is that it is part of the total debt in a business that is owed to outsiders (Saleemi, 2009). For the purposes of this study we’ll define external financing as that part of total debt in a SACCO that is owed to private commercial banks, other cooperatives, national and international financial institutions (Ondieki, et al., 2007 & Saleemi, 2009). In Kenya, providers of external finance include: government of Kenya; donors; commercial banks; cooperative stakeholders such as Kenya national union of cooperatives (KUSCCO), cooperative insurance company (CIC), Africa confederation of cooperatives and credit associations (ACCOSCA), and World Council of Credit Unions (WOCCU); other SACCOS; and international financial institutions such as IMF and world bank (Pandey, 2000).

Wealth is the accretion of adequate institutional capital or retained earnings to guard against incurring losses, to finance non withdrawable capital funded assets and to protect members’ savings; thus wealth is intended to absorb operational losses of SACCOS (Ndiege, et al., 2013). If the wealth is inadequate then losses are absorbed by savings and share capital of the members; and this leads to impairment of members’ savings and as such SACCOS fail to achieve their objectives (Mwau, 2013).

For wealth to be created and to increase, efficient financial practice must be implemented; this involves SACCOS’ decisions to commit their funds to planned investment options. There is a need for SACCOS to make decisions to invest their funds more efficiently in anticipation of expected flow of benefits in the long run. These investment decisions generally include acquisition, expansion, modernization and replacement of long-term assets. Consequently, the value of SACCOS is deemed to increase where the investments are profitable and add to the wealth in the long run, this situation is obtained where the SACCO involves itself with investments that yield benefits greater than the opportunity cost of capital. Imperatively, SACCOS should ensure that the funds they have can adequately cover
all their operational costs, can enhance the institutional capital, dividends and rebates (Maina, 2007).

Cooperatives are organizations that are owned, controlled and benefit the users or members; they could be agricultural, non-agricultural, unions or savings and credit cooperatives (SACCOS). In Kenya the evolution of cooperatives can be divided into the pre-independence era; post-independence but pre-liberalization era; and era of liberalization, structural adjustment programs and privatization (Gardeklint, 2009).

In the pre-independence era which is generally the colonial period the first cooperative was established at Lumbwa in Rift Valley around 1908 but membership was only limited to white settlers, in 1944 colonial officers allowed Africans to form and join cooperatives, by 1952 Cooperative Societies Ordinance had been enacted and cooperatives continued to grow, there were about 160 registered cooperatives (Kenya Union of Savings and Credit Co-operatives, [KUSCCO], 2006).

In the post-independence era, there were about 1000 cooperatives which rapidly increased to 7000 in 1999; it is in this era that external financing of the SACCOS was high as the government of Kenya initiated donor assistance to the cooperatives, it also provided subsidized services to the cooperatives like government interest rate controlled credit and free extension service from the Ministry of Cooperative Development; and producer cooperatives were directly linked to government parastatals. Despite all these, the cooperatives were weak, most of them collapsed and government involvement beat the idea of cooperatives which are supposed to be user-controlled (Gardeklint, 2009; Wanyama, 2009).

In the era of liberalization, structural adjustment programs and privatization; the Kenyan government undertook the structural adjustment programs (SAPs) which were meant to stimulate economic growth through liberalization and structural reforms. Cooperatives which were fully dependant on government for funding thus faced a major crisis since they could not suddenly start operating on their own. The government’s role was then defined to be just facilitative in nature through the Sessional paper no. 6 of 1997; liberalization thus saw the
mergers and splits of cooperative societies into small uneconomic unit (Gardeklint, 2009; Wanyama, 2009).

The Cooperative Societies Amendment bill of 2004 sought to introduce a bit of government control on cooperatives, it was enacted to re-enforce government regulation of the cooperative movement through the office of the Commissioner for Co-operative Development. SACCO Societies Act of 2008 was legislated later to provide for the licensing, promotion, control and regulation of savings and credit co-operatives by the Sacco Societies Regulatory Authority (SASRA). Thus, this Act provides for the establishment of the Sacco Societies Regulatory Authority whose functions include licensing SACCOS to carry out deposit-taking business as well as regulating and supervising SACCOS (Wanyama, 2009).

SACCO members generally consist of workers under the same employer; members contribute to these societies thus are able to save and also acquire loans or credits from these societies. The financial sector in Kenya has been largely dominated by insurance companies, commercial banks, mortgages and pension funds which mostly do not lend to small households and start-ups. Thus the government of Kenya has continuously supported SACCOS since they remain the most important players in the provision of financial services and have deeper and extensive outreach than any other type of financial institution (Gardeklint, 2009).

SACCOS have relatively stable and low cost source of funding and low administrative costs because they are constituted of solid bases of small saving accounts, they are also started locally. In addition, they are able to advance loans at interest rates lower than those charged by other financial institutions and have the ability and opportunity to reach clients in areas that are unattractive to banks especially poor areas (Olando, et al., 2012). The major objective of SACCOS is to improve the welfare of their members through mobilization of disbursement of credit and facilitating savings; and they have been efficient in achieving this objective. In Kenya, for example, SACCOS have mobilized over 200 billion Kenya shillings in savings accounting for over 30% to National Domestic Savings (Government of Kenya, 2009).
The mobilization of savings should be supported by sufficient institutional capital which provides an enabling environment to absorb losses and impairment of members’ savings and also ensures permanency (Evans, 2001). Institutional capital, which consists of the core capital and less share capital, is mainly accumulated from appropriation of the surpluses, therefore, SACCOS should strive to maximize on the earnings to build the institutional capital (Ombado, 2010).

The permanence and growth of SACCOS even in unstable economic times is ensured by this institutional capital (Evans, 2001). As a matter of fact, it helps the SACCOS to grow and, remain economically and financially viable (Gijselinckx and Deverete, 2007). Such growth is enhanced by efficient financial practices which includes major decisions of need for external financing and proper investment that ensures growth in wealth. This should also revolve around the SACCOS’ financial discipline with an insightful influence on the success of all businesses conducted by the SACCOS (Mudibo, 2005). The financial practices should be proficient in working to increase SACCOS’ wealth, sustain the SACCOS’ value and satisfy the shareholders’ demands. As such, the financial practice team identifies the most appropriate methods and structure of financing the SACCOS’ assets and such a structure should be able to optimize surpluses (Evans, 2001).

1.2 Statement of the Problem

Theory has provided ambiguous predictions concerning the question of whether financial development exerts a positive, causative impact on long-run economic growth. It has been stated that financial systems may influence saving rates, investment decisions, technological innovation, and hence leading to long-run growth rates (Demirguc-Kunt and Levine, 2008). In addition, a comparatively less well-developed theoretical literature examines the dynamic interactions between finance and growth by developing models where the financial system influences growth, and growth changes the operation of the financial system. While theory provides a complex array of conflicting speculations, the empirical evidence is minimally confusing (Demirguc-Kunt and Levine, 2008).
The cooperatives sub-sector plays a significant role in the Kenyan financial sector; it contributes 45% of the country’s Gross Domestic Product. Earlier, inadequate funding has been identified in a number of studies as one of the main constraint hindering the growth of this sector. In recent years, however, a number of agencies (donor funded, government and private) have made lines of credit available to SACCOS for the purpose of on-lending to Sacco members, but despite this, studies show that many SACCOS are still unable to meet the demands of their clients for loans and withdrawal of savings (KUSCCO, 2009).

The major objective of SACCOS is member empowerment through savings mobilization, disbursement of credit and ensuring Saccos’ long term sustainability through prudent financial practice. Studies have also indicated that wealth generation is hampered by poor financial practices like mismanagement of external finances, high cost of funds and under-capitalization of cooperative enterprises. Overtime, SACCOS have been trying to address members’ demands by mobilizing funds and credit to members, however, they have not managed to grow their wealth sufficiently through the accumulation of enough institutional capital to finance non-liquid capital funded assets, guard against losses and impairment of members’ savings (Mudibo, 2005; Munyiri, 2006).

1.3 General Objective

To establish the effects of external financing on the growth of Savings and Credit Co-operative Societies’ wealth in Nairobi County in Kenya

1.4 Specific Objectives

1.4.1 To establish the positive and negative effects of external financing on SACCOS’ wealth.

1.4.2 To establish the determinants for external financing that affect SACCOS’ wealth.

1.4.3 To establish the external finance component of capital structure that affect SACCOS’ wealth.
1.5 Importance of the Study

1.5.1 SACCOS’ Management

This study is of importance to the management of SACCOS since it dwells into the long term sustainability of SACCOS through growth of wealth. SACCOS’ management will get the information necessary on the effects of external financing on growth of wealth and sound investment decisions and thus be able to make efficient management decisions on the same.

1.5.2 SACCOS Members

The findings of this study will be of importance to SACCO members because the effects of external financing on the growth of SACCO’ wealth will mean long term sustainability and this is of the most interest to the members of SACCOS.

1.5.3 SACCO Societies Regulatory Authority (SASRA)

The regulatory body of SACCOS will benefit from the findings of this study as it will be able to form workable policies and regulations especially on external financing of the SACCOS in Kenya. The regulatory body will have an insight on whether more or less stringent regulatory framework is needed for external financing of SACCOS.

1.5.4 Lenders to SACCOS

These include commercial banks, donors, government of Kenya, cooperative bodies like KUSCCO and CIC; and other SACCOS. This study is of importance to these lenders of external finances to SACCOS since they will understand the operations of these societies and how well external finances are utilized to aid to the growth of the wealth. Lenders will be able to make decisions on whether to have stringent measures on external financing to SACCOS.

1.5.5 Academicians and Researches

The findings of this study will be of importance to academicians and researches as they will get an insight into the effects of external financing to the growth of SACCOS’ wealth. It may also drive other researchers to study the extent to which internal financing has led to the
growth of SACCOS’ wealth. This will also contribute to the general body of knowledge and form a basis for further research.

1.6 Scope of the Study

This study on the effects of external financing on the growth SACCOS’ wealth; was done in Nairobi County in Kenya being the headquarters of several SACCOS in Kenya and having a wide coverage in terms of the population of SACCOS. The population consisted of all registered SACCOS as deposit taking Sacco business as at December 2014, according to SASRA registered SACCOS in Nairobi as at December 2014 and taking deposits were 43 in number; mainly because the study looked into their external financing levels in relation to growth for a period of the past five years up to December 2014.

One of the limitations experienced in this study was that responses were not obtained immediately on the questionnaires. Therefore, phone calls and emails were used to make follow ups hence the necessary responses were obtained from the respondents. Another limitation was the accessibility to secondary data and particularly financial statements of the SACCOS. These were considered internal documents not to be shared to the public. A letter was obtained from the University clearly stating that the information was strictly for use in the research which was purely academic. Financial statements were only available in the SACCO premises and no copies were allowed to be carried, however, the filling in of the document review guide by the research assistants was permitted.

1.7 Definition of Terms

1.7.1 External Financing

This is that part of total debt in a SACCO that is owed to private commercial banks, other cooperatives, national and international financial institutions (Ondieki, et al., 2007; Saleemi, 2009)

1.7.2 Wealth

This is the accumulation of enough institutional capital to finance non withdrawable capital funded assets, provide cushion to absorb losses and impairment of members’ savings (Ndiege, et al., 2013)
1.7.3 Institutional Capital
This consists of the retained earnings (core capital), and is mainly accumulated from appropriation of the surpluses, (Ombado, 2010)

1.7.4 SACCOS
These are savings and credit co-operative societies and are organizations that are owned, controlled and benefit users or members (Gardeklint, 2009).

1.7.5 Capital structure
This is the financial mix of how a company is financing its business and investments, that is, how a company utilizes debt and equity in its business (Berger and Patii, 2002).

1.8 Chapter Summary
External financing to SACCOs has been possible since the evolution of cooperatives to the era of liberalization, structural adjustment programs and privatization; it was not possible in the pre-liberalization era; thus creation of wealth as a result of acquiring external finances could be determined. The objective of this study was to establish the effects of external financing on the growth of SACCOS’ wealth. It was carried out on SACCOs in Nairobi County that were registered as deposit taking as at December 2014. The study would be of great benefit to SACCOS’ management, members, SASRA, lenders to SACCOs, academicians and researchers.

An elaborate literature review on this subject will be discussed in Chapter Two of this project. Chapter three will detail the research methodology; it will explain the research design, population and sampling design, data collection methods and the research procedures. This will then be followed by Chapter Four which will present the results and findings of the study. The last chapter will be Chapter Five which will contain discussion, conclusion and recommendations of the study.
CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Introduction

In this chapter, literature related to this study on the effects of external financing on the growth of SACCOS’ wealth, is going to be critically reviewed. It is divided into three parts in line with the specific objectives of the study, first the negative and positive effects of external financing on growth of SACCOS’ wealth, second the determinants of external financing that affect the growth of SACCOS’ wealth, and third the association of external financing component of capital structure and the growth of SACCOS’ wealth. Under each objective, there will be sub headings that will help in analyzing the literature relation, then, the conclusion will be a chapter summary.

2.2 Negative and Positive Effects of External Financing on SACCOS’ Wealth

2.2.1 Macro-level Analysis

At the macro-level analysis, studies have been carried out on the effects of finance on growth. Early works by Schumpeter (1911) concluded that financial sector development is predicted to have a positive impact on growth and per capita income. Later, another study by Goldsmith (1969) using a cross-country sample of thirty five countries, finds that financial development is consistent with periods of high economic growth (King and Levine, 1993). Building on the study by Goldsmith (1969), King and Levine (1993) find that high levels of financial development are associated with rapid economic growth, physical capital accumulation, and improvements in economic efficiency for a cross country sample of over eighty countries. In agreement, is a study by Levine and Zervos (1998) on stock markets, banks and economic growth, where, they argue that the development of financial markets and intermediaries has an important bearing on growth (Levine and Zervos, 1998).

There are other studies, on the other hand, that disagree with the above conclusion that financial development has significant impact on growth. Early studies by Robinson (1952) express disagreement stating that financial development is a natural consequence of
economic acceleration rather than a predictor of growth. Lucas (1998) also contends that the link between finance and growth is overemphasized (Ahmed and Hamid, 2011).

Thus looking at the early theories on financial structure, the above contrast studies support the original irrelevance theory. The financial structure irrelevance theory by Modigliani and Miller (1958) was the first to be adopted by experts on financial structure, before that; there was no generally accepted theory (Small-Stocks and Raviv, 2008). They assume that the firm has a certain set of expected cash flows; when the firm decides on a particular proportion of debt and equity to finance its assets all that it does is to divide up the cash flows among investors. Investors and firms are assumed to have equal access to financial markets hence there is homemade leverage. As a result of this, the leverage of the firm has no effect on the market value of the firm (Flannery and Hankins, 2007). The theory by Modigliani and Miller points out that the value of a firm is not influenced by how the financing is done, that is, it is independent of the sources of finance utilized by a firm (Small-Stocks and Raviv, 2008). The theory simply states that the source of financing is inconsequential if there are no transaction costs; no default risk; no taxation and in a perfect and efficient market (Pandey, 2010). This theory was however criticized because of the assumptions and when corporate tax was introduced into the equation, it was concluded that firms that acquire external finance like debt had higher values (Ahmed and Hisham, 2009).

The above studies are relevant to our current study on the effect of external financing on the growth of SACCOS’ wealth, however, they look at a broader aspect of cross country analysis whereas this study will narrow down to Kenya and specifically SACCOS. Thus we continue to examine the relevant related studies at micro level.

2.2.2 Micro-level Analysis

At the micro level, the emphasis is on how the lack of finance can slow down enterprise growth. The main perception underlying the growth and finance link at micro level is that greater financial development makes it easier to raise external finance. This, in turn, eases finance limitations, especially for small and medium firms because their ability to raise internal capital is limited. Thus, firms are able to invest in profitable growth opportunities; in this manner then greater financial access serves as a catalyst for growth (Ahmed & Hamid,
In a very influential study by Rajan and Zingales (1998) examining financial dependence and growth, they used data on 36 industries across 41 countries between 1980 to 1990 where the approach they used allowed them, one, to study a particular mechanism, external finance, through which finance operates rather than simply assessing links between finance and growth and two, exploit within-country differences concerning industries. They found that industries that are naturally heavy users of external finance benefit disproportionately more from greater financial development than industries are not naturally heavy users of external finance (Rajan & Zingales, 1998). This study by Rajan and Zingales (1998) though resonates well with our study on the effects of external financing on the growth of wealth of SACCOS is on a broader level of different industries thus our current study will narrow down to savings and credit co-operative societies.

In a study this time narrowing down to firm level data, Demirguc-Kunt and Maksimoviv (1998) examine whether financial development influences the degree to which firms are constrained from investing in profitable growth opportunities. They focus on the use of long-term debt and external equity in funding firm growth and estimate the external financing needs of each individual firm in the sample. Criticizing the assumptions by Rajan and Zingales (1998); Demirguc-Kunt and Maksimoviv (1998) argue that it is important to allow for differences in the amount of external financing needed by firms in the same industry in different countries. These differences may exist because firms in different countries employ different technologies, because profit rates may differ across countries, or because investment opportunities and demand may differ (Demirguc-Kunt and Levine, 2008). However, their findings are the same as those of Rajan and Zingales (1998) as they conclude that the proportion of firms that grow at rates beyond the rate at which each firm can grow with only retained earnings and short-term borrowing is positively associated with banking system size, meaning that firms that have high growth rates heavily use external financing (Demirguc-Kunt and Levine, 2008).

Considering specific studies conducted at country level, we look at a study by Andrew (2009) on the internal versus external financing of acquisition in British companies. They examined a premise that the source of financing of new investment has a bearing on its profitability. In contrast to the early studies by Rajan and Zingales (1998); and Demirguc-
kunt and Maksimoviv (1998), they found that, there is a negative impact on investments financed by external sources on profitability in the long-run, this effect is attributed to the high cost of borrowed funds and the increased costs and expenses of additional management needs that come about due to with external funds. The study recommended that organizations should utilize internal sources of financing like retained earnings to make investments especially those of long term nature (Andrew, 2009).

This study agrees with the pecking order theory, according to Miglo (2010) this theory forecasts that firms will choose less costly and risky financing for their investments and go on picking the highly costly and risky as the need arises. Usually, the more sensitive the security the higher the cost of equity; the pecking order theory does not take an optimal financial structure but instead state that firms show a distinct preference for using internal finance such as retained earnings over external finances. The resulting pecking order for financing of firms is therefore usually as follows: internally generated funds first followed by respectively low-risk debt financing (Ahmed and Hisham, 2009).

Another theory existing on the financial structure and growth of a firm is the trade-off theory. This theory explains a number of related theories used to evaluate the different costs and benefits of alternative leverage plans; it is assumed that interior solutions are obtained so that marginal costs and marginal benefits of each capital source obtained are balanced (Almeida and Philippon, 2007). The trade-off theory advances the idea of borrowing so that a firm can enjoy the tax advantage; when examining the effects of less restrictive assumptions as compared to those in the original irrelevance theory, like an introduction of corporate tax, a benefit for debt was created. The main benefit is the fact that interest payments are deducted in calculating taxable income thus allowing for tax shield for firms, this tax shield allows firms to pay lower taxes than they should when using debt capital instead of using only their own capital (Harrison, Love and McMillan, 2004). This theory may be imputed from actual world scenario whereby there are other factors to consider like when the interest rates are too high, but this depends on adding a structure which differs from firm to firm, thus this theory takes a simple approach by encouraging firms to gain from the tax shield created by debt financing (Ahmed and Hisham, 2009).
A number of studies have been conducted on co-operatives to examine the association of external financing and growth of wealth of SACCOS. One of these is a study by Fiorillo (2006) on the effects of wholesale lending to SACCOS in Uganda where he demonstrated that external financing would increase the capital of SACCOS and as such they would be able to increase their loan portfolios hence generate more income from interests earned on the loans; they would also be able to generate more income from membership and entrance fee since they could attract new members and retain the current members. The study showed that SACCOS can only be successful with the use of external funds if they did members sensitization, had good policies, did effective capacity building and if they had qualified and dedicated management and governance teams. The study concluded that external financing if applied effectively can help a strong SACCO become stronger but would not help a weak SACCO become strong (Fiorillo, 2006).

Another study is by Ondieki, Okiogal, Okwena and Onsase (2012) on the effects of external financing on the financial performance of SACCOS where they used descriptive survey design and descriptive statistics. The findings of their study revealed that financial performance of SACCOS was influenced by financing and investment policies and portfolio quality; they thus commended the use of external financing as highly shaping the growth of SACCOS’ wealth (Ondieki et al., 2012).

The study by Chipembere (2009) was concerned with unlocking funding opportunities for farmers through grass root SACCOS; and he observed that substantial outside funds changes the character of a SACCO as a member-owned and run institution especially when the SACCO receives grants. The tenet of self-help by mobilizing member savings for lending is undermined and this he found leads to laxity in the repayment discipline and eventual collapse of a SACCO. He thus, concluded that external financing is not the only cause of acceleration or deceleration in the savings rate; rather there are other factors like management and governance structures as well as capacity building and support given to the SACCO by external agencies other than the injection of external funds (Chipembere, 2009).

These studies at the micro level resonate well with our current study on the effects of external financing on the growth of wealth of SACCOS. However, most of these studies do not
exclusively examine the effect of external finance on the growth of wealth, which is gap this current study will fill.

2.3 Determinants for External Financing that Affect SACCOS’ Wealth.

2.3.1 Legal and Regulatory Environment Surrounding External Financing

In an early study conducted by Demirguc-Kunt and Maksimovic (1998) on law, finance and firm growth; they find that market imperfections such as underdeveloped financial and legal systems, limit a firm’s ability to raise long term external finance. This, in turn, inhibits the firm’s investment and growth potential (Demirguc-Kunt and Maksimovic, 1998). In agreement is the early study by Rajan and Zingales (1998) on finance development and growth, where they find that industries that depend more on external finance are likely to grow faster in countries that otherwise have better developed financial markets in terms of the legal environment. This is because of two reasons, first, financial development reduces the cost of raising external finance and secondly, it creates a disproportionately favorable environment for young firms that would otherwise find it more difficult to raise capital (Rajan and Zingales, 1998).

In agreement is a study by Beck, Demirguc-Kunt and Levine (2005) for a cross country sample of firms where they find that financial and legal constraints, as well as corruption, have an adverse influence on the growth of a firm. They, however, conclude that this relationship is dependent on the size of a firm as they find that the growth of small firms tends to be most severely affected by financing issues as compared to larger firms. Thus, the influence of financial and legal constraints on firm growth tends to be strongest for small firms (Beck et al., 2005).

In a study done by Ayyagari, Demirguc-Kunt and Maksimoviv, (2008), they investigated the importance of financing constraints relative to other business environment obstacles to the growth of a firm by sampling 4, 197 firms from eighty different developed and developing countries. They found that finance, policy instability, and crime are the only compelling constraints to firm growth. All other features of the business environment like corruption,
taxes and regulations, judicial efficiency, anti competitive practices among others have either insignificant or indirect influence on growth, which works through the compelling constraints channel (Ayyagari et al., 2008).

Another study was conducted by Nair and Kloepinger-Todd (2007) on reaching rural areas with financial services across four countries where they found that Sri Lanka and Kenya had the weakest regulatory environments in which neither discreet regulation nor financial supervision for SACCOS existed. Burkina Faso, on the other hand, was found to have special law for SACCOS, prudential regulation requirements, and arrangements for financial supervision, but had insufficient resources and capacity for effective supervision. In contrast, Brazil was found to have a well-developed regulation and effective supervision. This study recommended that SACCOS should provide financial services in rural areas in developing countries, but for them to be profitable; they should operate in environments with proper legal and regulatory framework (Nair and Kloepinger-Todd, 2007). In their study, Nair and Kloepinger-Todd (2007) showed that sustainability of SACCOS was related to financial and legal framework, however, their study did not explain how external financing exclusively affects the growth of SACCOS (Ondieki et al., 2012).

A study by World Bank (2007) on providing financial services in rural areas by looking at co-operatives found that failure was eminent where financial cooperative systems were unsustainable, were subject to political influence or were used by governments for their own purposes. They thus recommended in their study that for financial co-operatives to be sustainable; governments needed to provide an enabling environment. They also recommended that governments should not exercise excessive control that restricts growth and consolidation, and should not use SACCOS as channels to provide subsidized credits. They concluded that integration gave room for improved governance and the ability to provide a wide range of services (World Bank, 2007).

In agreement, was a study by Overseas Co-operative Development Council [OCDC] (2007) on co-operatives as pathway to economic, democratic and social development in the global economy, where they found that success factors for cooperatives were; legal framework, an economy that allowed all types of competitive businesses, member–centered services, membership being open to users, board of directors being elected by and from members only,
high equity–debt ratio, professional management, accountability of all employees to the co-operative, membership education, access to markets, willingness to use modern technology, and organization around a resource base and service adequate to sustain the co-operative as a viable business (OCDC, 2007). This study by OCDC (2007) touched very lightly on legal framework of external financing, thus failed to show in totality how these affect the growth of wealth of SACCOS, the independent variables were many that diluted a specific conclusion of legal framework of external financing and its effect on growth of wealth of SACCOS (Ondieki et al., 2012).

Looking at studies carried out in Kenya on co-operatives, there is a study by Gaita (2007) on factors that influence the growth of enterprises demonstrated that the lending institutions were not growing considerably due to poor lending practices. The study recommended that lending institutions should make products and services more available, stakeholders should be trained and favorable regulatory and legal framework is vital for growth of the institutions. This study by Gaita (2007) found that failures in SACCOS were related to lending; and that growth and sustainability was related to the financial and legal framework (Gaita, 2007). The study, however, did not examine how growth of wealth would be attained (Ondieki et al., 2012).

Another study conducted by Ochoki (2007) on factors influencing failure of front office services of SACCOS, found that there was inadequate laws to govern front offices of SACCOS, the front offices did not employ qualified staff, there was lack of planning and inadequate capital in SACCOS which affected growth. He recommended that SACCOS should ensure sound business practices and consider safety and liquidity (Ochoki, 2007).

The above studies are thus relevant to our current study as they examine the legal environment which firms operate in and how the legal and regulatory environment determine use of external finance that affect growth. They, however, examine broadly the legal and regulatory environment and effect on growth, our study will thus fill this gap by specifically looking at the legal and regulatory environment surrounding external financing on SACCOS in Kenya.
2.3.2 Management Practices Influencing External Financing

The notions of managerial best practices are summarized to the management styles that have always been better; complementarities which are practices that have become desirable because the environment has changed, innovation which also include dynamic diffusion (Reenen, 2012). Corporate governance has traditionally been associated with the principal-agent agency problem; a principal-agent relationship arises when a person who owns a firm is not the person who manages or controls it. Thus a proper corporate governance framework is part of best practices in management (Maher and Anderson, 2012). Thus, we analyze several studies on management practices that influence external financing which affect the growth of wealth of SACCOS.

Agrawal and Cooper (2007) conducted a study to examine whether certain corporate governance instruments were related to the possibility of a firm having increased earnings. They found that key governance characteristics such as outsourcing non-audit services from outside auditors, and having independent boards and audit committees, were unrelated to the possibility of a firm having increased earnings. In their study, they recommended that independent directors with financial expertise were worthwhile in providing oversight of a firm’s financial reporting practices (Agrawal and Cooper, 2007). Their study only related the growth of surpluses to proper corporate governance mechanisms without touching on financial structure (Olando, Mbewa and Jagongo, 2012).

Another study was by Det-Wet (2004) on a strategic approach in managing shareholders wealth of companies listed on the securities exchange in South Africa where he found that increase in sales without sustainable growth did not contribute significantly to the value of a firm. He found that there is a significant correlation between market value added and estimated value added, and that there was a weak correlation between market value added and the main drivers of estimated value added. In his study the recommendation was that managers needed to use the findings to optimize their approach to a firm’s value management (Det-Wet, 2004).

In agreement was a study by Kaloi (2004) on the factors contributing to liquidity problems on savings credit co-operatives where he found that in SACCOS where there were delays in
remittance, loan default rates were high, there were low monthly earnings and low rate of
investment in illiquid assets experienced losses due to these factors hence there was no
growth of wealth. The study recommended that the Ministry of Co-operative Development
and Marketing should introduce sensible remittance policies (Kaloi, 2004). The study,
however, only superficially dealt with issues that affected liquidity and financial structure of
SACCOS but did not show the management practice contribution to their growth (Olando et
al., 2012).

An important management practice is to foster innovation by accessing finances thus
promoting growth (Ahmed and Hamid, 2011). In their study, Ayyagari, Demirguc-Kunt and
Maksimovic (2007) of a sample of 10,000 firms from thirty four developing countries show
that firms with greater access to external finance are also more innovative and dynamic. They
measure innovation by the firm’s ability to introduce new products and processes, and
dynamism by activities such as opening new plants, getting from within activities that were
previously outsourced, and establishing foreign joint ventures and new licensing agreements
(Ayyagari et al., 2007).

2.4 External Finance Component of Capital Structure that Affect SACCOS’ Wealth

2.4.1 Borrowed Funds versus Institutional Capital

Capital structure is the financial mix how a company is financing its business and
investments, that is, how a company utilizes debt and equity in its business (Berger and Patii,
2002). Borrowed funds by SACCOS are those funds acquired from outside the organization,
they could be money borrowed from banks, non-banking institutions, other SACCOS,
government among others (Saleemi, 2009). Institutional capital on the other hand are the
internal sources of finances, it includes common stock (ordinary share capital) and retained
earnings (Ombado, 2010).

In a study conducted by Eriotis, Vasiliou and Ventoura-Neokosimidi (2007) on how firm
characteristics affect capital structure, they investigated the relationship between debt-to-
equity ratio and the firm’s profitability. In their study, the firm characteristics were analyzed
as determinants of capital structure according to different explanatory theories, then the
hypothesis tested was that debt ratio at time t depends on the size of the firm at time t, the
growth of the firm at time t, its quick ratio at time t and its interest coverage ratio at time t.
The findings of the study justified the hypothesis that there is a negative relation between the
debt ratio of the firms and their growth, their quick ratio and their interest coverage ratio.
They found that size appears to maintain a positive relation and according to their dummy
variable there is a differentiation in the capital structure among firms with a debt ratio greater
than fifty percent and those with a debt ratio lower than fifty percent. Taking into
consideration the level of a firm’s investment and the degree of market power, the study
found that there is a strong negative impact of the debt-to-equity ratio on a firm’s
profitability. This means that highly profitable firms tend to use their internal finances for
their investment activities as compared to not so profitable firms that highly rely on debt
financing (Eriotis et al., 2007).

In another study conducted by Al-Kayed, Zain and Duasa (2014) where they examined the
relationship between capital structure and performance of Islamic banks, they stated that
these banks can either use high capital ratios which increase their soundness and safety while
lowering the required return by investors, or depend on deposits and bonds which are
considered cheaper sources of funds due to their tax rebate. The study thus established that
the performance of Islamic banks measured by profitability responds positively to an increase
in equity measured by capital ratio [Al-Kayed et al., 2014].

Hutchison and Cox (2006) conducted a study where they examined the relationship between
capital structure and return on equity for banks in America in the relatively less regulated
period from 1983 to 1989 as well as in the more highly regulated period between 1996 and
2002. They did a regression of return on equity on two periods of lagged values of return on
equity and capital with time and bank specific dummy variables. Their study found that for
banks in the USA, there is a positive relationship between financial leverage and return on
equity, meaning that firm’s values would rise if there is use of borrowed funds (Hutchison
and Cox, 2006). This study however has been criticized for not having a control for reverse
causality from performance to capital structure (Al-Kayed et al., 2014).
In another study by Wurgler (2000) on financial markets and the allocation of capital estimated the country specific elasticity of investment to value added sequentially to describe the country differences in the extent to which investment increases in growing industries and decreases in declining industries. By using the industry-level gross fixed capital formation as the dependent variable because the focus is on the aggregate impact of financial system development, the study concluded that the elasticity tends to be larger in countries with larger credit markets, more informative stock prices, less state ownership of firms and greater minority investors (Wurgler, 2000). This study uses realized industry-country level value added growth as a proxy for industry growth opportunities, and shows that this proxy can be justified as it is significantly positively correlated with more traditional industry measures of growth opportunities like price to earnings ratio and sales growth. Certainly, in a country with a perfectly developed financial market, realized growth is aligned with demand and productivity shocks thus this reflects growth opportunities. In addition, if latent industry growth opportunities are positively auto-correlated, it is possible to use current realized growth to approximate future growth opportunities. However, it is less clear whether potential-to-realized growth connection is true in countries where opportunities anticipated in the past are not reflected in current growth due to financial or labour market frictions (Bena and Ondko, 2009).

Another study was by Pratomo and Ismail (2006) which explicitly examined the capital structure effect on Islamic banks’ performance. They examined the agency cost hypothesis for Islamic banks in Malaysia under which high leveraged Islamic banks tend to reduce agency costs. They found that increasing leverage imposes financial discipline on management because they will be less able to make wasteful expenditures but will make better investment decisions as well as exercising pressure on managers to generate cash flows. Consequently, higher leverage or lower equity capital ratio is associated with higher profit efficiency, if all things are held constant (Pratomo and Ismail, 2006).

A study by Chowdhury, A. and Chowdhury, S.P. (2010) sought to examine the impact of financial structure on the wealth of a firm using comparative, correlation and regression analysis. They found that maximizing the wealth of a firm requires a perfect combination of debt and equity, whereas cost of capital has a negative correlation in this decision and the
cost of capital should minimum possible. They also found that by changing the financial structure composition, a firm can increase its wealth in which the finance manager can utilize the debt in order to form optimal financial structure to maximize the wealth of shareholders (Chowdhury and Chowdhury, 2010).

A study by Obwori, Munene and Kaburi (2012) about the effect of funding on the growth of small scale enterprises demonstrated that the amount gotten from external funds does not effectively support the growth of firms. One of the limitations to firms was that small scale enterprises had limited access to borrowings because of lack of collaterals, bank accounts and the high interest rates for the loans. The recommendations from the study were that there should be provision of basic institutional structures for capacity building, the firms should build linkages with financial institutions in order to attract funding, and there is need for a financial strategy implementation plan for firms (Obwori et al., 2012).

In agreement was the study by Trong (2012) on the link between funding structure and the performance of microfinance institutions, he found that the performance of these institutions vary depending on the consistency of the characteristics of the microfinance institutions. The study also found out that profitable and regulated microfinance institutions which take up more commercial funds tend to have higher sustainability, efficiency and outreach to new members; that a large scale of operations helps microfinance institutions achieve higher profitability; that there is no trade-off between the level of attraction of new members by the microfinance institutions and their efficiency; that larger loan amounts attract higher loan costs; and that the recent global financial crisis had a minor impact on the performance of microfinance institutions since they had a low level of self-sufficiency which is associated with a low degree of financial integration (Trong, 2012).

Another study was by Mwau (2013) on the effect of financing diversification on the performance of SACCOS in Kenya. He found that there is a significant positive effect on the performance of SACCOS brought about by financing diversification (Mwau, 2013).

Also, there was another study conducted by Mumanyi (2014) that sought to identify the challenges and opportunities facing SACCOS in Kenya and narrowing his study to Mombasa
County. This study found out that one of these challenges was lack of finance, and that despite this; opportunities were available to SACCOS as they had a positive impact on economic development including capital accumulation. One of the recommendations of the study to policy makers and government was to formulate policies and strategies that will support the growth of SACCOS and this would be a significant alternative solution for financing micro and small businesses; the study thus brought up concerns over the SACCOS financing and indicated that such would influence the growth of SACCOS (Mumanyi, 2014).

The above studies are relevant to our current study because they relate the effect of capital structure by looking at external financing on the growth of wealth of firms. They however do not clearly show the effect of borrowed funds versus institutional capital on the growth of wealth of SACCOS in Kenya which is a gap this study seeks to fill.

2.5 Chapter Summary

This chapter has been divided into three parts according to the specific objectives of the study. The first part is to establish the negative and positive effects of external financing on the growth of SACCOS’s wealth. Literature related to this objective has been critically reviewed by looking at them from the macro level analysis and at micro level analysis. The second part is to establish the determinants of external financing that affect the growth of SACCOS’ wealth. Under this, literature has been reviewed on the sub topics; legal and regulatory framework surrounding external financing of SACCOS; and management practices in SACCOS. The third and final part is to establish the external financing component of capital structure and the growth of SACCOS’ wealth. Literature that speaks about this objective have been analyzed and critically reviewed under the sub-topic of borrowed funds versus institutional capital. The need to carry out this research on the effects of external financing on the growth of wealth of SACCOS has been clearly articulated.

The research methodology that was used in this study will be discussed in the subsequent chapter. It will explain the methods and procedures which were used to carry out the study. It will also contain a description of the research design, sampling design, data collection methods, research procedures, and data analysis methods that were used in the study.
CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 Introduction

This chapter analyzes the research methodology that was used in this study on the effects of external financing on the growth of SACCOS’ wealth. The first part looks at the research design; the second part gives a description of population and sampling design; third part is the data collection methods; fourth part looks at the research procedures; fifth part gives an explanation of the data analysis methods; and then the last part is the chapter summary.

3.2 Research Design

This study adopted descriptive research design - which describes the characteristics of existing phenomenon – in soliciting information on the effects of external financing on the growth of SACCOS’ wealth in Nairobi County. Descriptive research design was used since it provided insight into the research problem by describing the variables of interest, in this case, external finances and growth in wealth. It was used for defining, estimating, predicting and examining the associative relationship of these variables; this helped as it provided useful and accurate information to answer the questions based on what, when, where, how and who (Saunders, Lewis and Thornhill, 2012).

A justification as to why descriptive research design was used for this study is that, the objectives of descriptive research include: to determine the frequency of occurrence of a phenomenon, to discover whether a relationship exists between two variables and to describe the state of a variable. This is what this research was all about; it determined the rate of growth of wealth of SACCOS and the level of external financing, it discovered the relationship between external financing and the growth of wealth of SACCOS and it described the growth of wealth of SACCOS as well as their level of external financing.
3.3 Population and Sampling Design

3.3.1 Population

The target population for this study consisted of all SACCOS in Nairobi County licensed as at December, 2014 by the Sacco Societies Regulatory Authority (SASRA) under the regulation 8 (1) of the Sacco Societies (Deposit-taking Sacco business) regulations, 2010. A total population of 43 SACCOS was studied; as listed in the appendix section. There was homogeneity in the population because they had similar characteristics based on this study – all were located in Nairobi and licensed by SASRA.

3.3.2 Sampling Design

3.3.2.1 Sampling Frame

The sampling frame consisted of all licensed SACCOS by SASRA in Nairobi County as at December, 2014; and those that had been in operation for the past five years before the year 2014. That is, those SACCOS that had been in operation between 2010 and 2014; their year of licensing was not critical; however, they were all licensed as at 31st December, 2014. This sampling frame was chosen for this study because information for the five years about the variables of external finances and growth of wealth was required, in order to carry out the analysis of the effects of external financing on the growth of wealth of SACCOS. In this study, the sampling frame was the same as the target population according to the licensed SACCOS by SASRA in Nairobi County as at December, 2014.

3.3.2.2 Sampling Technique

The sampling technique that was used for this study was probability sampling, under this type of sampling, each element in the sampling frame has an equal chance of being picked to be in the sample. It was mostly associated with survey based research where the researcher made inferences from the sample about the population in order to meet the research objectives. This ensured fair representation and generalization of the findings to the general population as it was not biased. Systematic sampling was then applied; where in accordance to the sample size desired, the population was divided by the sample size then the first
number was picked randomly, then subsequent numbers were selected using the sampling fraction to determine the frequency of selection (Saunders, et al., 2012).

3.3.2.3 Sample Size

Having used the sampling technique described above, the sample size was 35 SACCOS as listed in the appendix section. According to Mugenda and Mugenda (2003) a sample of 10% of the population would yield good results. On the other hand, for descriptive research design it is recommended for the sample to have at least 30 elements (Kombo and Tromp, 2006). This study had a total of 43 licensed SACCOS as the population and a sample of 35 SACCOS was studied through descriptive statistics. Through the application of probability sampling then systematic sampling, the first number picked was number 1 and the subsequent numbers picked were arrived at by adding one, thus, 1, 2, 3, 4 and so on up to 35.

3.4 Data Collection Methods

Primary and secondary data were collected. Secondary data was collected from SACCOS’ financial statements and other financial records using document review guide; while primary data was collected using a structured questionnaire which consisted of both closed and open-ended questions. The questionnaire was divided into four parts; section A had general information questions about the SACCO, section B had questions based on the first objective which was the negative and positive effects of external financing on growth of SACCOS’ wealth, section C was based on the second objective which was the determinants for external financing that affect the growth of SACCOS’ wealth and section D had questions based on the third objective which was the association of external financing component of capital structure and the growth of SACCOS’ wealth. The questionnaires were administered to the Finance Managers of the SACCOS in the sample.

3.5 Research Procedures

The data collection tools were pretested and the errors detected were corrected; this ensured that questions were clear and easy to understand. Piloting was carried out on a similar group – SACCOS in Nairobi registered after December 2014 but had been in operation for the past
five years. A total four data collection tools were pretested. Later, amendments were done on the data collection tools and the actual research was carried out.

The study employed the services of two research assistants (university students) thus data was collected efficiently and effectively; they were first adequately trained to understand the data collection tools then were sent to the field. The SACCOS were informed of the intention to collect data for this study in the month of December, 2015; and arrangements were made and data collected in the month of January and February, 2016. The research assistants assisted the respondents to fill in the questionnaires and they also filled in the documents review guide. These were followed up by call backs which increased the response rate and ensured quality control.

3.6 Data Analysis Methods

The data collected was first checked for errors of omission and commission. The data was then edited, classified and coded, measured, tabulated, cleaned, analyzed and interpreted accordingly. Data analysis techniques applied were both descriptive statistics and inferential statistics; descriptive statistics, that is, the mean, variance and standard deviation was carried out for the variables external finance and growth of SACCOS’ wealth under univariate analysis and each of these variables described. Correlation analysis was then done to establish if there was a significant relationship between the dependant variable, growth of wealth and the independent variable, external financing. The data was presented using figures and tables. The Statistical Product and Service Solution (SPSS) and Ms Excel were used to analyze the data; these packages were used to enter data, edit, in calculations of the descriptive statistics, and for presentation.

3.7 Chapter Summary

This chapter looked at the research methodology used in this study on the effects of external financing on the growth of SACCOS’ wealth. It started with a brief introduction, and then a brief description of the research design. Population and sampling design was then properly detailed by describing the population, the sampling frame, sampling technique and the
sample size. The data collection methods were then described, followed by an explanation of the research procedures to be applied in the study, then finally a description of the data analysis methods. The total population under study was 43 SACCOs. Out of this, a sample of 35 was selected using the registered SACCOs list from SASARA as at December 2014. Data was then collected through questionnaires and document review guide. It was then edited, coded, transcribed, and finally cleaned. SPSS and Ms Excel were used for analysis. The next chapter will present the results and findings of the research in detail.
CHAPTER FOUR

4.0 RESULTS AND FINDINGS

4.1 Introduction

This chapter presents the results and findings of the research study. The results have been presented in tables, figures and content delivery to highlight the major findings. They are also presented sequentially according to the specific objectives of the study. Findings from responses on the specific objectives on namely: the negative and positive effects of external financing on SACCOS’ wealth; determinants for external financing that affect growth of SACCOS; and the association of external financing component of capital structure and SACCOS’ wealth: have been addressed in the questionnaires and presented here. The chapter closes with a summary of the chapter. Mean scores and standard deviations analyses have been used to analyze the data collected.

4.1.1 Response Rate

The questionnaires that were distributed to the respondents totaled 35. 30 questionnaires were filled and collected while 5 were not filled; the total response rate was 86%. According to Mugenda and Mugenda (2003) fifty percent response rate is deemed to fair, while a response rate of sixty percent is good and a response rate of over seventy percent is excellent. Therefore, the response rate of 86 percent achieved during data collection was adequate for this study; however, 2 questionnaires had errors and thus were not used for analysis.

Table 4.1: Response Rate

<table>
<thead>
<tr>
<th>Number of Questionnaires</th>
<th>Number</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Filled Questionnaires</td>
<td>30</td>
<td>86%</td>
</tr>
<tr>
<td>Unfilled Questionnaires</td>
<td>5</td>
<td>14%</td>
</tr>
<tr>
<td>Total</td>
<td>35</td>
<td>100%</td>
</tr>
</tbody>
</table>
4.2 Demographic Information

4.2.1 Designation of Respondents in the SACCO

Respondents who filled the questionnaires held different positions in the SACCOs. From the findings, accountants were 35.7%; 28.6% were finance managers, 21.4% were administration heads; and clerical and credit officers were each 7.1% as shown in Figure 4.1.

![Designation of Respondents in the SACCO](image)

**Figure 4.1: Designation of Respondents in the SACCO**

4.2.2 Number of years worked in the SACCO

From the research findings, 21.4% of the respondents have worked in the SACCOs for a period of between zero to three years; 42.9% have been in the SACCOs for a period of 4 to 7 years; 7.1% of the respondents have been in operation for a period of between 8 and 11 years; 10.7% of the respondents have been working in the SACCOs for a period of between 12 and 15 years, whereas 17.9% of the population have been in operation for a period of 16 years and above as shown in Figure 4.2. The study shows that majority of the respondents had worked for more than 5 years in the SACCOs and therefore were in a position to respond efficiently to the study questions and appreciate the reason for this study.
4.2.3 Number of years the SACCO has been in operation

The respondents were asked about the number of years their SACCO had been in operation, 14.3% of the respondents pointed out that their respective SACCOs have been in operation for less than 10 years; another 14.3% have been in operation for a period of between 11 and 20 years; 28.6% have been in operation for a period of between 21 to 30 years and the rest of the population (42.9%) have been in operation for 41 years and above.
4.2.4 Current membership size of the SACCO
From the findings, 21.4% of the SACCOs had a membership size of between 2001 and 3000, 14.3% had a membership size of between 3001 and 4000, whereas 64.3% had a membership size of 4001 and above as shown in Figure 4.4.

Figure 4.4: Number of Years of Operation for SACCOs

4.2.5 Sector of the SACCO in the Kenyan Economy
There are different sectors in the Kenyan economy, SACCOs were asked of the sectors in which they operate in and several different sectors were mentioned like airline, energy, finance, agriculture, telecommunication, health and there were those that served the general public

4.2.6 Year the SACCO was licensed by SASRA
From the findings, 25% of the SACCOs were licensed in 2009, 42.9% were licensed in the year 2010, while 7.1% and 17.9% were licensed in the year 2011 and 2012 respectively as shown in Figure 4.5.

Figure 4.5: Year licensed by SASRA
4.3 Negative and Positive Effects of External Financing on SACCOs’ Wealth

4.3.1 Acquiring Finances from External Parties
Respondents of the study were asked to indicate whether they acquired finances from external sources and all the SACCOs under study stated that they acquired some form of external finances; 100% agreed that they acquired external finances while 0% did not acquire external finances. When asked about the type of finances that they acquired from external parties, 71.4% of the respondents stated that their SACCOs acquired long term loans, 7.1% borrowed short term loans and 21.4% of the population acquired grants; this shows that most SACCOs are getting external finances from different sources.

Figure 4.6: Type of External Finances Acquired

4.3.2 Reason for Seeking External Financing
Respondents were asked to provide answers on each item that was measured by a five point Likert scale ranging from 1 (most influential) to 5 (least influential). The data has been presented in percentage, mean, standard deviation and ranked as shown in Table 4.2.
Table 4.2: Reason for Seeking External Financing

<table>
<thead>
<tr>
<th>Reason for Seeking External Financing</th>
<th>Most Influential</th>
<th>Very Influential</th>
<th>Influential</th>
<th>Moderately Influential</th>
<th>Less Influential</th>
<th>Mean</th>
<th>Std Deviation</th>
<th>Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>To increase capital</td>
<td>11</td>
<td>8</td>
<td>5</td>
<td>4</td>
<td></td>
<td>2.1667</td>
<td>1.55106</td>
<td>5</td>
</tr>
<tr>
<td>To increase membership size</td>
<td>6</td>
<td>10</td>
<td>11</td>
<td>1</td>
<td></td>
<td>2.2917</td>
<td>0.90790</td>
<td>4</td>
</tr>
<tr>
<td>To cover operating expenses</td>
<td>4</td>
<td>10</td>
<td>7</td>
<td>7</td>
<td></td>
<td>3.3182</td>
<td>0.42716</td>
<td>1</td>
</tr>
<tr>
<td>To boost SACCO income through investments</td>
<td>5</td>
<td>10</td>
<td>6</td>
<td>7</td>
<td></td>
<td>2.4583</td>
<td>0.44129</td>
<td>2</td>
</tr>
<tr>
<td>The cost of external funds (interest rates and tax impact)</td>
<td>6</td>
<td>8</td>
<td>8</td>
<td>6</td>
<td></td>
<td>2.2500</td>
<td>0.94409</td>
<td>3</td>
</tr>
<tr>
<td>For issuance of loans to members</td>
<td>15</td>
<td>6</td>
<td>5</td>
<td>2</td>
<td></td>
<td>2.3750</td>
<td>0.95743</td>
<td></td>
</tr>
</tbody>
</table>

From the table, mean and standard deviation were used to test respondent ideas where standard deviation is the square root of the variance. It measures the spread of a set of observations. The larger the standard deviation is, the more spread out the observations are while mean is the arithmetic mean across the observations. Respondent’s views were rated, upon determining factors according to their level of influence. The statement on covering operating expenses was found to be the most significant with a mean of 3.3 and a standard deviation of 0.42716. Other influential factors were boost SACCO income through investments with a mean of 2.4583 and a standard deviation of 0.44129 and for issuance of loans to members with a mean of 2.3750 and a standard deviation of 0.95743. The least...
influential factor was the statement on increase capital which was supported with a mean of 2.1667 and a standard deviation of 1.55106.

### 4.3.3 Contribution of External Finances to SACCOs Incurring Losses

Respondents of the study were asked whether acquiring finances from external sources has contributed to the SACCO incurring losses, 89.3% disagreed with the statement, whereas the other 10.7% agreed with the statement.

Table 4.3: Contribution of External Finances to SACCOs Incurring Losses

<table>
<thead>
<tr>
<th></th>
<th>Strongly Agree</th>
<th>Agree</th>
<th>Undecided</th>
<th>Disagree</th>
<th>Strongly Disagree</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>3.6%</td>
<td>7.1%</td>
<td>0%</td>
<td>50.0%</td>
<td>39.3%</td>
</tr>
</tbody>
</table>

When asked whether the SACCO utilized the external finances in any profitable investments, 28.6% stated that such finances were not injected in any profitable investments in their SACCOs while 71.4% admitted that the institutions have utilized the finances for profitable investment; such investments mostly included income generating buildings and motor vehicles.

### 4.3.4 Level of borrowing of the SACCO for the last 5 years

From the findings, 75% of the institutions conducted in the study have borrowed in excess of Ksh. 10million, 17.8% had borrowed in a region of between 5 and 9 million Kenya shillings and a small percentage of 7.1 had a borrowed within a range of 1 to 4 million Kenya shillings; this showed that majority of SACCOs had large borrowings of above 10 million Kenya shillings. This data has been presented in Figure 4.7.

![Figure 4.7: Level of Borrowing of the SACCOs](image-url)
4.4 Determinants for External Financing that Affect SACCOS’ Wealth

4.4.1 Legal and Regulatory Environment

4.4.1.1 Licensing Process of SACCOs by SASRA

On rating of the current licensing process of SACCOs by SASRA, 50% of the respondents were satisfied with the legal and regulatory environment, and another 42.9% gave an average approval rating; respondents argued that the regulatory framework has brought professionalism, has improved business dimension, and that SARSA has adequate mechanisms and processes that are clear and attainable for SACCOS within their capacity. However, 7.1% of respondents gave a poor rating of the licensing process by SASRA; among the recommendations that members proposed were; improvement and revamping of the system and reducing a lot of bureaucracy in the processes.

Table 4.4: Licensing Process by SASRA

<table>
<thead>
<tr>
<th>Rate the Licensing Process</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Poor</td>
<td>2</td>
<td>7.1%</td>
</tr>
<tr>
<td>Good</td>
<td>12</td>
<td>42.9%</td>
</tr>
<tr>
<td>Satisfactory</td>
<td>14</td>
<td>50.0%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>28</strong></td>
<td><strong>100.0%</strong></td>
</tr>
</tbody>
</table>

4.4.1.2 Supervision of Operations of SACCOs by SASRA

On rating the supervision of the operations of SACCOs by SASRA officials, 82.1% of the respondents were satisfied with the rate of supervision, while the other 17.9% had a below average rating. They however mentioned the areas of improvements as: ICT including automation, innovation and IT leveraging; lack of structures and resources for supervision; minimum credit of deposits; strengthen legislation to cushion customers from losses; supervision in governance and supervision should be extended to small SACCOs. They were also asked whether the current laws (the SACCO Societies Act of 2008) governing the SACCOs are adequate and a combined percentage of 92.9 agreed with the statement while the other small percent of 7.1 rejected the statement.
Table 4.5: Supervision of Operations of SACCOs by SASRA

<table>
<thead>
<tr>
<th>Supervision by SASRA</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Below Average</td>
<td>5</td>
<td>17.9%</td>
</tr>
<tr>
<td>Good</td>
<td>8</td>
<td>28.6%</td>
</tr>
<tr>
<td>Satisfactory</td>
<td>15</td>
<td>53.6%</td>
</tr>
<tr>
<td>Total</td>
<td>28</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

4.4.1.3 Ease of Access to External Finances by SACCOs in Kenya

On the ease of SACCOs to access external finances in Kenya 60.7% agreed that it is easy for SACCOs to access external finances in Kenya, while the other 39.3% disagreed to the statement as shown in Table 4.6.

Table 4.6: Ease of Access to External Finances by SACCOs in Kenya

<table>
<thead>
<tr>
<th>It is Easy to access External Finances in Kenya</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strongly Agree</td>
<td>2</td>
<td>7.1%</td>
</tr>
<tr>
<td>Agree</td>
<td>15</td>
<td>53.6%</td>
</tr>
<tr>
<td>Disagree</td>
<td>11</td>
<td>39.3%</td>
</tr>
<tr>
<td>Total</td>
<td>28</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

4.4.2 Management Practices

4.4.2.1 Rating Investment Policy of SACCOs and Parties Involved in their Formulation

On the rating the investment policy of SACCOs, 71.4% agreed that their respective policies were good and satisfactory while the other 22.5% had the opinion that their policies were slightly below average. Respondents were also asked about the involvement of different parties in the formulation of such policies and the data presented in Table 4.7.
Table 4.7: Parties Involved in Formulation of Investment Policy in SACCOs

<table>
<thead>
<tr>
<th>Parties Involved</th>
<th>Highly Involved</th>
<th>Satisfactorily Involved</th>
<th>Involved</th>
<th>Moderately Involved</th>
<th>Poorly Involved</th>
<th>Mean</th>
<th>Std Deviation</th>
<th>Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Board of Directors</td>
<td>24</td>
<td>4</td>
<td></td>
<td></td>
<td></td>
<td>4.1429</td>
<td>0.35635</td>
<td>1</td>
</tr>
<tr>
<td>Chief Executive Officers</td>
<td>24</td>
<td>4</td>
<td></td>
<td></td>
<td></td>
<td>4.1429</td>
<td>0.35635</td>
<td>1</td>
</tr>
<tr>
<td>Managers</td>
<td>22</td>
<td>6</td>
<td></td>
<td></td>
<td></td>
<td>3.2143</td>
<td>0.41786</td>
<td>2</td>
</tr>
<tr>
<td>Members of Staff</td>
<td>11</td>
<td>9</td>
<td></td>
<td></td>
<td></td>
<td>2.8929</td>
<td>0.83174</td>
<td>4</td>
</tr>
<tr>
<td>Members of the SACCO</td>
<td>17</td>
<td>4</td>
<td>4</td>
<td>4</td>
<td>3</td>
<td>2.9286</td>
<td>1.41234</td>
<td>3</td>
</tr>
</tbody>
</table>

Respondents of the study pointed out that Board of Directors and Chief Executive Officers were highly involved with a mean of 4.14 and a standard deviation of 0.35635. Other valuable parties were managers with a mean of 3.2, Members of the SACCO with a mean of 2.9 and members of the staff with a mean of 2.89 and thus they were respectively ranked.

4.4.2.2 Review of SACCOS’ Investment Policy

When asked the frequency at which the SACCOS’ investment policy is reviewed, 28.6% of the respondents admitted that their SACCOS’ investment policy is reviewed on a quarterly basis, 14.3% were of the opinion that they are reviewed on a semi-annual basis, with a bigger population of 57% giving their opinion that their SACCOS’ investment policy is reviewed on annual basis as presented in Table 4.8.

Table 4.8: Review of SACCOS’ Investment Policy

<table>
<thead>
<tr>
<th>Investment Policy is Reviewed</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quarterly</td>
<td>8</td>
<td>28.6%</td>
</tr>
<tr>
<td>Semi Annually</td>
<td>4</td>
<td>14.3%</td>
</tr>
<tr>
<td>Annually</td>
<td>16</td>
<td>57.1%</td>
</tr>
<tr>
<td>Total</td>
<td>28</td>
<td>100.0%</td>
</tr>
</tbody>
</table>
4.4.2.3 Efficiency of Technological System used by SACCOs

Respondents of the study were asked whether the technological system currently in use by their respective SACCO is an excellent system in all aspects, 85.7% agreed with the statement, 7.1% were undecided while another 7.1% disagreed with statement indicating that in a majority of the SACCOs under study the technological system used was excellent in several aspects.

Table 4.9: Efficiency of Technological System used by SACCOs

<table>
<thead>
<tr>
<th>Technological System in use is Excellent</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strongly Agree</td>
<td>3</td>
<td>10.7%</td>
</tr>
<tr>
<td>Agree</td>
<td>21</td>
<td>75.0%</td>
</tr>
<tr>
<td>Undecided</td>
<td>2</td>
<td>7.1%</td>
</tr>
<tr>
<td>Disagree</td>
<td>2</td>
<td>7.1%</td>
</tr>
<tr>
<td>Total</td>
<td>28</td>
<td>92.9%</td>
</tr>
</tbody>
</table>

4.4.2.4 Rating System used to Assess Soundness of SACCOs

Respondents were asked to rate the extent at which the SACCO used a list of rating system to assess its soundness, this data was then presented in frequency, mean, standard deviation and ranked as shown in Table 4.10.

Table 4.10: Rating System used to Assess Soundness of SACCOs

<table>
<thead>
<tr>
<th>Rating System</th>
<th>Always</th>
<th>Most Times</th>
<th>Moderately</th>
<th>Sometimes</th>
<th>Never</th>
<th>Mean</th>
<th>Std Deviation</th>
<th>Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Adequacy</td>
<td>17</td>
<td>11</td>
<td></td>
<td></td>
<td></td>
<td>3.3929</td>
<td>0.48721</td>
<td>3</td>
</tr>
<tr>
<td>Asset Quality</td>
<td>19</td>
<td>9</td>
<td></td>
<td></td>
<td></td>
<td>3.3214</td>
<td>0.47559</td>
<td>4</td>
</tr>
<tr>
<td>Management Quality</td>
<td>19</td>
<td>9</td>
<td></td>
<td></td>
<td></td>
<td>3.3214</td>
<td>0.47559</td>
<td>4</td>
</tr>
<tr>
<td>Earnings</td>
<td>13</td>
<td>15</td>
<td></td>
<td></td>
<td></td>
<td>3.5357</td>
<td>0.50787</td>
<td>2</td>
</tr>
<tr>
<td>Liquidity</td>
<td>11</td>
<td>17</td>
<td></td>
<td></td>
<td></td>
<td>3.6071</td>
<td>0.49735</td>
<td>1</td>
</tr>
</tbody>
</table>

From the table above Liquidity was given the highest rating with a mean of 3.60 and a standard deviation of 0.49735, followed by Earnings with a mean of 3.53 and a standard
deviation of 0.50787, and then followed by Capital Adequacy with a mean of 3.39 and a standard deviation of 0.48721. Asset Quality and Management Quality were supported with equal approval rating with a mean of 3.32 and a standard deviation of 0.47559.

4.5 External Finance Component of Capital Structure that Affect SACCOS’ Wealth

4.5.1 Amount of Core Capital maintained by SACCOS and Financing of Investments
When asked the amount of core capital that the SACCO maintains at any given point in time 92.9% pointed out an amount in excess of 10 million Kenya shillings and the other 7.1% quoted a range of 5 to 9 million Kenya shillings. Most of the SACCOS investments were funded using external finances (64%) while for others (36%) their investments were mostly funded by internal finances.

![Figure 4.8: Amount of Core Capital Maintained by SACCOS](image)

4.5.2 Separation of Capital from the Members’ Deposits and Contribution of External Finances to Growth of SACCOS
Respondents were asked whether they have managed to separate members’ contribution from capital and 78.6% admitted that their respective SACCOS have managed to separate capital from the members’ deposits while 21.4% were of the opinion that their SACCOS haven’t separated capital from the members’ deposits. In addition, 7.1% of respondents disagreed that external finances have contributed to the growth of their SACCOS while 17.9% were undecided on whether external finances have contributed to the growth of SACCOS, and the
other 75% strongly agreed that external finances have contributed to the growth of their SACCOs.

![Separation of Members’ Deposits from Capital](image)

**Figure 4.9: Separation of Members’ Deposits from Capital**

### 4.6 Correlation Analysis of External Financing and Growth of SACCOs’ Wealth

The study found that there was a significant relationship between growth of wealth for SACCOs and external financing that also confirmed the description given above of the variables. Under the Pearson correlation, the independent variable external financing was statistically significant to growth of SACCOs’ wealth. For external financing $r$ was 0.677 showing that there is a strong positive linear relationship between external financing and growth of SACCOs’ wealth as shown in Table 4.11.

**Table 4.11 Correlation of External Financing and Growth of SACCOs’ Wealth**

<table>
<thead>
<tr>
<th></th>
<th>Growth of Wealth</th>
<th>External Financing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Growth of Wealth</td>
<td>Pearson Correlation</td>
<td>Sig. (2 tailed)</td>
</tr>
<tr>
<td></td>
<td>N</td>
<td>28</td>
</tr>
<tr>
<td>External Financing</td>
<td>Pearson Correlation</td>
<td>Sig. (2 tailed)</td>
</tr>
<tr>
<td></td>
<td>N</td>
<td>28</td>
</tr>
</tbody>
</table>
4.7 Chapter Summary

This chapter has presented the results and findings of the study. Findings have been presented in frequency tables and figures. The presentation is aligned to the specific objectives of the study and covers the negative and positive effects of external financing on SACCOS’ wealth; determinants for external financing that affect growth of SACCOs; and the association of external financing component of capital structure and SACCOS’ wealth. These were addressed in the questionnaires and have been presented and explained here indicating that external finances have greatly influenced the growth of SACCOS’ wealth. The next chapter presents in detail the discussions of findings, conclusions and recommendations based on the results and findings.
CHAPTER FIVE

5.0. DISCUSSION, CONCLUSIONS, AND RECOMMENDATIONS

5.1 Introduction

The study sought to establish the negative and positive effects of external financing, the determinants of external financing, the external financing component of capital structure and how these affect the growth of SACCOS’ wealth. This chapter presents the summary, discussions of research findings, conclusion of the findings, and recommendations of the study.

5.2 Summary

The general objective of this study was to investigate the effects of external financing on the growth of Savings and Credit Co-operative Societies’ wealth in Nairobi County in Kenya. To attain this the study established the negative and positive effects of external financing on SACCOS’ wealth, it also established the determinants of external financing that affected SACCOS’ wealth, and also determined the external finance component of capital structure that affected SACCOS’ wealth. This study used a descriptive research design to build a profile of external financing and growth of SACCOS’ wealth in Kenya. It used probability sampling then systematic sampling to study 35 SACCOs out of the 43 SACCOs licensed by SASRA as at December 2014 and being in operation for the past five years up to December 2014. The data was collected using questionnaires and document review guide; and a detailed research procedure was used to ensure credibility and accuracy of data obtained. Once data was collected, it was edited, coded, transcribed, and cleaned then it was analyzed using SPSS and Ms Excel.

The first specific objective was to establish the negative and positive effects of external financing on SACCOS’ wealth. The study found that most of the SACCOs acquired external finances and that the reason for seeking external finances for most of them was to cover operating expenses followed by boosting SACCO income through investments. Most of the SACCOs borrowed 10 Million Kenya Shillings and above; and a majority disagreed that external finances contributed to SACCOs incurring losses.
The second specific objective was to establish the determinants of external financing that affect SACCOS’ wealth. This was divided into two parts, the first was the legal and regulatory environment and the second part was on management practices. On the legal and regulatory environment; most SACCOs rated the licensing process and supervision of their operations by SASRA as satisfactory. Most SACCOs also agreed that in Kenya it was easy for SACCOs to access external financing. On the management practices; the SACCOs stated that the parties that were highly involved in the formulation of investment policy were board of directors, chief executive officers, managers, members of SACCOs and members of staff in that order; and most of them rated these investment policies as good and satisfactory. The SACCOs stated that their investment policies were reviewed annually and they also agreed that the technological system they used was excellent in several aspects. The study found that the growth of SACCOS’ wealth increased each year for the last five years - borrowings, capital and assets adequacy, earnings and liquidity trajectories.

The third and last specific objective was to establish the external financing component of capital structure that affects growth of wealth of SACCOs. The study found that most SACCOs maintained a core capital of ten million Kenya Shillings and above at any given time; and most SACCOs stated that most of their investments were funded by external finances. The study also found that a number of the SACCOs had managed to separate members’ deposits from capital; and that most SACCOs also strongly agreed that external finances had contributed to the growth of their SACCOs.

5.3 Discussions

In this section, the results and findings of the study will be interpreted with respect to the specific objectives including to establish; the negative and positive effects of external financing on SACCOS’ wealth; determinants for external financing that affect growth of SACCOs; and the association of external financing component of capital structure and SACCOS’ wealth in Nairobi County.
5.3.1 Negative and Positive Effects of External Financing on SACCOs’ Wealth

The study shows that most of the SACCOs acquire some form of external financing like the short term loans, long term loans and grants. The major reason for seeking external finances as the study established is to cover operating expenses followed by boosting SACCO income through investments. This finding agrees with those of Ahmed and Hamid (2011) who stated that with ease of access to external finances, organizations are able to invest in profitable opportunities and in this manner, then, greater financial access serves as a catalyst for growth.

Most of the SACCOs under study disagreed that eternal financing contributes to them incurring losses and that they utilized the finances in profitable investments with the borrowings for most of the SACCOs being more than ten million Kenya shillings. This is in line with the conclusion by Fiorillo (2006) that the effective application of external financing would boost a strong SACCO in becoming even stronger and would weaken further a weaker one.

Each year the SACCOs experienced growth of retained earnings from the period under study, which revealed a good performance of SACCOs in Nairobi County over the study period. From the words of Ndige et al. (2013), when there is growth of SACCOs’ wealth it is possible to finance non withdrawable capital funded assets, provide cushion to absorb losses and impairment of members’ savings. (Mwau, 2013) supports this by showing that where the wealth is insufficient, losses are absorbed by members’ savings and share capital, which leads to their impairment of the members’ savings; which would hinder the achievement of the said objectives.

The study also revealed that for most SACCOs their most influential reason for seeking external financing was to cover operating expenses as the first and followed by to boost SACCO income through investments; showing that external finances improved the financial performances of the SACCOs. These findings are in line with the conclusions by Ondieki et al., 2012 whose study revealed that financial performance of SACCOS was influenced by financing and investment policies and portfolio quality; they thus commended the use of external financing as highly shaping the growth of SACCOs’ wealth.
Greater financial development makes it easier to raise external finance; this is the main perception underlying the growth and finance link at micro level. This, in turn, simplifies finance limitations, especially for small and medium firms because their ability to raise internal capital is limited. Thus, firms are able to invest in profitable growth opportunities; in this manner then greater financial access serves as a catalyst for growth (Ahmed & Hamid, 2011).

5.3.2 Determinants of External Financing that Affect SACCOS’ Wealth
Most of the SACCOs agreed that it was easy for them acquire external finances in Kenya, showing that the legal and regulatory environment was conducive for the SACCOs to thrive. This is in agreement with Rajan and Zingales (1998) who stated that countries that have a better developed legal environment have increased financial development and growth: financial development reduces the cost of raising external finance and creates a disproportionately favorable environment for young firms that would otherwise find it more difficult to raise capital.

For most of the SACCOs the investment policies were satisfactory, reviewed regularly and board of directors and chief executive officers were mostly involved in the formulation of the policies. These good management practices boost the working environment in SACCOs thus increase performance of these institutions; and policy constraints are a major fall back to growth. In agreement are Ayyagari et al. (2008) who found that finance, policy instability, and crime are the only compelling constraints to firm growth; all other features of the business environment like corruption, taxes and regulations, judicial efficiency, anti-competitive practices among others have either insignificant or indirect influence on growth, which works through the compelling constraints channel.

For a majority of the SACCOs under study, the technology they apply in their organizations were satisfactory in all aspects, financial development fosters innovation especially in technology which eases management for most organizations. This is in line with a study by Ayyagari et al. (2007) which publicized that firms with greater access to external finance are also more innovative and dynamic.
The growth of SACCO wealth was not consistent but fluctuating over time. At first the increase was high, which was a very encouraging situation, then reduced overtime. This could have been attributed by bureaucratic processes in SARSA, inadequate technology, and unfavorable legal and regulatory environment. It was not easy to link the decline to financing issues of the SACCOs but to a certain point it may be related to the credit crunch which is out of the scope of the study. A study by Mumanyi (2014) raised concerns over the SACCOs financing and showed that such would influence the SACCOs growth; but also revealed that despite the challenges, opportunities were available for SACCOs and their impact to the economic development, including capital accumulation. The study by Mumanyi (2014) recommends policy makers and governments to come-up with policies and strategies that will support the growth of SACCOs.

Management practices as revealed in the study was an important aspect on the growth of SACCOs as most respondents stated that members of staff and members of SACCOs were involved in the formulation of investment policies in a number of SACCOs. This was as concluded by Chipembere, 2009 that external financing is not the only cause of acceleration or deceleration in the savings rate; rather there are other factors like management and governance structures as well as capacity building and support given to the SACCO by external agencies other than the injection of external funds.

5.3.3 External Finance Component of Capital Structure that Affect SACCOS’ Wealth

Investments from SACCOs under study were mostly funded by eternal finances and significant level of core capital (an average of ten million Kenya shillings) was always maintained. These SACCOS’ wealth increased at a small percentage over the period under study with a few fluctuations for reasons out of their scope. This is in agreement to the study by Al-Kayed et al. (2014) who established that performance of Islamic banks measured by profitability responds positively to an increase in equity measured by capital ratio. In addition, it also resonates well to a study by Hutchison and Cox (2006) whose study showed that there is a positive relationship between financial leverage and return on equity, meaning that firm’s values would rise if there is use of borrowed funds.

From these arguments, then it can be said that there was an assurance of SACCOs continuity in Nairobi County because the SACCOs had sufficient funds to absorb losses and impairment
of members’ savings (separation of capital from the members’ deposits), in case of the SACCOs facing emergence of unexpected risks and technology advancement (Branch 2006; Xuezhi & Ndiege, 2013). These SACCOs have adequate retained earnings to finance non withdrawable capital funded assets (Trong, 2012), which negated the study by Obwori, et al. (2012) that found that amount earned does not effectively support the growth of firm. The study by Mwau (2013) found out that diversification in financing had a significant positive effect on SACCO performance; which acts as an anchor in the present study by relating the experience of growth of SACCOS’ wealth to performance. This makes the present study comfortably declare that there was considerable growth of SACCO wealth in the County to ensure sustainability of the industry.

The findings on the external financing component of capital structure showed that most of the SACCOs use cost of capital when determining sources of funds and careful evaluations are made when determining sources of funds. Therefore, SACCOs alike are always striving to maintain their liquidity at safe levels. This move is informed by the need to fund increases in assets and meet obligations as they come due, without incurring unacceptable losses. Liquidity can be understood in terms of flows (as opposed to stocks).

The significant relationship between the external financing component of capital structure and growth of SACCOS’ wealth could be attributed to appropriate mix of internal and external funds in financing the firm’s assets. This implies that proper capital structure mix can lead to growth of SACCOS’ wealth. This involves the prudent funds allocation strategy which boosts the volume of returns with minimum risk. On overall, funds allocation strategy and growth of SACCOS’ wealth showed strong positive significant relationship. Prudent investment strategies therefore enhance growth of SACCOS’ wealth.

5.4 Conclusion

5.4.1 Negative and Positive Effects of External Financing on SACCOs’ Wealth

The study concludes that the major reason for seeking external finances for most SACCOs is to cover operating expenses followed by to boost SACCO income through investments; thus SACCOs can easily access external finances and invest in profitable opportunities because
when properly invested then external finances are a catalyst for growth. The external finances were also not a contributor to SACCOs incurring losses according to the study.

5.4.2 Determinants of External Financing that Affect SACCOS’ Wealth

The study found that legal and regulatory environment for SACCOs in Kenya was conducive and that accessibility to external finances was easy, however, there was need for improvement by the regulatory body SASRA. The study concludes that the legal and regulatory environment of SACCOs in Kenya was good enough for the SACCOs to operate in with some ease. The study also concludes that though there are areas that require improvement by SASRA, their supervision of the SACCOs was good in terms of controlling the borrowing rates of SACCOs and the separation of capital from members’ deposits. In addition, the management practices for most SACCOs were inclusive of members of SACCOs and members of staff; as well as use of technological system which was also a contributor to the growth of wealth.

5.4.3 External Finance Component of Capital Structure that Affect SACCOS’ Wealth

The study concludes that a certain amount of core capital is maintained by SACCOs and that most investments are funded by external finances, which is plausible because this shows that there is reasonable equity ratio maintained. According to the study, most SACCOs have managed to separate capital from members’ savings which is a positive move so that capital is not overstated at any given time especially when seeking eternal financing. In addition, there is a strong positive contribution of external financing to the growth of SACCOS’ wealth.

5.5 Recommendations

5.5.1 Recommendations of the Study

5.5.1.1 Recommendations on Negative and Positive Effects of External Financing

The study recommends that the use of institutional capital as a mode of financing SACCOS’ activities would ensure their sustainability in the competitive co-operative sector; but not use
of external finances in covering such expenses because, in the long run, this may make the SACCOs incur losses as such expenses should be covered by internal income. Thus the study recommends that SACCOs should adopt common measurements of best-practice in financial management.

5.5.1.2 Recommendations on Determinants of External Financing

The study recommends that the regulator (SASRA) should introduce cash management controls that will be applied across all the deposit taking SACCOs including the small ones. This will go way further towards increased cash management in the sector and contribute towards better financial performance in the sector. There is also need for the regulator to introduce cash ration to be deposited within the SACCO regulator as this will enable control of liquidity in the deposit taking SACCOs and also help on overnight borrowing to assist the SACCOs assess the regulator when there is cash shortage and release cash surpluses when there is excess funds.

The study also recommends that since the growth of SACCOS’ wealth significantly depends on management quality, earnings, liquidity, capital structure, and funds allocation; SACCOs should apply proper capital mix in their financing and aim at minimizing the use of debt capital in their financing so as to be able to pay the related costs. In addition, they should review their by-laws and working policies to ensure that the optimum external financing is encouraged. Although external financing has a very close and linear association with growth of SACCOS’ wealth, the borrowing should be designed to ensure that there is maximum growth of wealth obtained from such credit. Clear lending procedures and policies will ensure smooth growth of SACCOS’ wealth.

5.5.1.3 Recommendation on External Finance Component of Capital Structure

The study recommends that SACCOs should do proper analysis of investment options and only invest in profitable opportunities as this will ensure that SACCOs do not incur losses. In addition, SACCOs should maintain a proper capital structure and also invest on certain
opportunities using internal funds as this will cushion them from costs associated with external finances. Since the core investments of SACCOs is loans to members and liquid investments show a strong positive relationship with growth of SACCOS’ wealth; which can be attributed to the fact that liquid investments can be converted into cash easily to meet short-term obligations; SACCOs should properly manage their equity ratios in order to finance liquidity gaps hence enhance stability of SACCOs.

5.5.2 Suggestion for Further Research

This study shows that administrative workers from different SACCOs have different levels of management for external financing that influence growth. In future, research could investigate if the types of legal and regulatory framework enacted in the country have an influence on SASRA engagement on the SACCOs, that is, currently they are limited to only supervise up to the level provided in law. This might be useful for regulatory bodies such as SASRA that have the highest influence on the engagement of administrative workers in SACCOs. In this manner SACCOs will know in which areas to concentrate their efforts.

Secondly, this present study found that internal and external financing affected growth of SACCOS’ wealth, where they contribute by seventy two percent but other factors, that is, the remaining twenty eight percent were not revealed. So another study should be conducted to fill this gap by assessing these factors, other than external financing which would affect the growth of SACCOS’ wealth.
REFERENCES


Personal RePEc Archive (MPRA), No. 6012. Medan, Indonesia: Universitas Sumatera Utara.


YOU ARE INVITED TO A RESEARCH SURVEY ON THE EFFECTS OF EXTERNAL FINANCING ON THE GROWTH OF SACCOS’ WEALTH IN KENYA

Dear (insert name),

You are invited to participate in a research study titled “The Effects of External Financing on the Growth of SACCOS’ Wealth in Nairobi County”. This study is being conducted by Jessica Akinyi from United States International University - Africa and her research assistants. The purpose of this study is purely for academic purposes.

As the finance manager in your SACCO, you know best the negative and positive effects of external financing on the growth of wealth, the determinants of external financing that affect the growth of wealth, as well as the association of the external financing component of capital structure and the growth of wealth in your SACCO. Please take a few minutes to share your knowledge with us, the questionnaire should take only 20 minutes to complete.

What’s in it for you? If you wish, the findings and recommendations of this research can be shared with you for general knowledge and application in your SACCO. There are no risks involved in participating in this study and all information will be treated with utmost confidentiality.

The questionnaire will be presented to you in your office on 7th December, 2015 and collected between 12th January and 26th February, 2016 by the research assistants. At the same time, the research assistants will also fill in the document review guide with information from your financial statements for the periods 2010 to 2014.

Should you have any questions or comments please feel free to contact me on (insert telephone number or insert email address). Your participation is highly appreciated.

Yours faithfully,
Jessica Akinyi
APPENDIX II: QUESTIONNAIRE

PART A: GENERAL INFORMATION

1. Name of SACCO: ..........................................................

2. Current designation in the SACCO: ....................................................

3. Number of years that you have worked in the SACCO
   - 0 – 3 □
   - 4 – 7 □
   - 8 – 11 □
   - 12 – 15 □
   - 16 and above □

4. Number of years the SACCO has been in operation:
   - 0 – 10 □
   - 11 – 20 □
   - 21 – 30 □
   - 31 – 40 □
   - 41 and above □

5. What is the current membership size of the SACCO
   - 0 – 1,000 □
   - 1,001 – 2,000 □
   - 2,001 – 3,000 □
   - 3,001 – 4,000 □
   - 4,001 and above □

6. This SACCO is in which sector of the Kenyan economy......................

7. Year the SACCO was licensed by SASRA: .....................................

PART B: EFFECTS OF EXTERNAL FINANCING ON SACCOS’ WEALTH

8. Does the SACCO acquire finances from external parties?
   - Yes □
   - No □

   If no please proceed to part C

9. If yes, what type of finances?
   - Long term loans □
   - Short term loans □
   - Grants □
   - Others □ please specify: .........................................................
10. Why did the SACCO seek external financing? Please rate the following determining factors according to their level of influence.

<table>
<thead>
<tr>
<th>Factor</th>
<th>Most Influential</th>
<th>Very Influential</th>
<th>Influential</th>
<th>Moderately Influential</th>
<th>Less Influential</th>
</tr>
</thead>
<tbody>
<tr>
<td>To increase capital</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>To increase membership size</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>To cover operating expenses</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>To boost SACCO income through investments</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The cost of external funds (interest rates and tax impact)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>For issuance of loans to members</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

11. Acquiring finances from external sources has contributed to the SACCO incurring losses.

<table>
<thead>
<tr>
<th>Strongly Agree</th>
<th>Agree</th>
<th>Undecided</th>
<th>Disagree</th>
<th>Strongly Disagree</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

12. Has the SACCO utilized the external finances in any profitable investments?

Yes ☐    No ☐
If yes, please specify…………………………………………………………………………………………
…………………………………………………………………………………………………………………………

13. What is the level of borrowing of the SACCO for the last 5 years

- Less than Ksh. 1million ☐
- Ksh. 1million – 4million ☐
- Ksh. 5million – 9million ☐
- Ksh. 10million and above ☐
PART C: DETERMINANTS OF EXTERNAL FINANCING OF SACCOS

i. LEGAL AND REGULATORY ENVIRONMENT

14 Rate the current licensing process of SACCOS by SASRA.

| Poor □ | Below Average □ | Good □ | Satisfactory □ | Excellent □ |

15 Please explain your answer: ........................................................................................................

.................................................................................................................................

16 Rate the supervision of the operations of the SACCO by SASRA officials

| Poor □ | Below Average □ | Good □ | Satisfactory □ | Excellent □ |

17 Please mention the area(s) in your view that should be improved ...................

.................................................................................................................................

18 The current laws (the SACCO Societies Act of 2008) governing the SACCOS are adequate

| Strongly Agree | Agree | Undecided | Disagree | Strongly Disagree |

19 It is easy for SACCOs to access external finances in Kenya

| Strongly Agree | Agree | Undecided | Disagree | Strongly Disagree |

ii. MANAGEMENT PRACTICES

20 Rate the investment policy of your SACCO

| Poor | Below Average | Good | Satisfactory | Excellent |


21 To what extent are the following parties involved in formulating the investment policy?

<table>
<thead>
<tr>
<th>Parties Involved</th>
<th>Highly Involved</th>
<th>Satisfactorily Involved</th>
<th>Involved</th>
<th>Moderately Involved</th>
<th>Poorly Involved</th>
</tr>
</thead>
<tbody>
<tr>
<td>Board of Directors</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chief Executive Officers</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Managers</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Members of Staff</td>
<td></td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Members of the SACCO</td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Others, please specify</td>
<td></td>
<td></td>
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<td></td>
<td></td>
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</tr>
</tbody>
</table>

22 How regularly is the SACCOS’ investment policy reviewed?

- Quarterly □
- Semi annually □
- Annually □
- Others □ please specify: ...........................................

23 The technological system currently in use by your SACCO is an excellent system in all aspects

<table>
<thead>
<tr>
<th>Strongly Agree</th>
<th>Agree</th>
<th>Undecided</th>
<th>Disagree</th>
<th>Strongly Disagree</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

24 To what extent does the SACCO use the following rating system to assess its soundness?

<table>
<thead>
<tr>
<th>Rating System</th>
<th>Always</th>
<th>Most Times</th>
<th>Moderately</th>
<th>Sometimes</th>
<th>Never</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Adequacy</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Asset Quality</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Management Quality</td>
<td></td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Earnings</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Liquidity</td>
<td></td>
<td></td>
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<td></td>
</tr>
</tbody>
</table>
PART D: CAPITAL STRUCTURE: THE EXTERNAL FINANCES COMPONENT

25. What amount of core capital does the SACCO maintain at any given point in time?
   - Less than Ksh. 1million
   - Ksh. 1million – 4million
   - Ksh. 5million – 9million
   - Ksh. 10million and above

26. The SACCO’s investments are funded by:

<table>
<thead>
<tr>
<th></th>
<th>Always</th>
<th>Most Times</th>
<th>Moderately</th>
<th>Sometimes</th>
<th>Never</th>
</tr>
</thead>
<tbody>
<tr>
<td>External Finances</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Internal Finances</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

27. Has the SACCO managed to separate capital from the members’ deposits?
   - Yes
   - No

28. External finances have contributed to the growth of the SACCO:

<table>
<thead>
<tr>
<th></th>
<th>Strongly Agree</th>
<th>Agree</th>
<th>Undecided</th>
<th>Disagree</th>
<th>Strongly Disagree</th>
</tr>
</thead>
</table>
APPENDIX III: DOCUMENT REVIEW GUIDE

NAME OF SACCO

AMOUNTS IN KENYA SILLINGS

<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital (equity)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Retained Earnings</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Members Deposits</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loans disbursed to members</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Long term Liabilities</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Short term Liabilities</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fixed Assets</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Assets</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income from assets</td>
<td></td>
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<td></td>
</tr>
</tbody>
</table>
## APPENDIX VI: POPULATION

<table>
<thead>
<tr>
<th>NAME OF SOCIETY</th>
<th>POSTAL ADDRESS</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. AFYA SACC O SOCIETY LTD</td>
<td>P.O BOX 11607-00400, NAIROBI</td>
</tr>
<tr>
<td>2. AIRPORT SACC O SOCIETY LTD</td>
<td>P.O BOX 19001-00501, NAIROBI</td>
</tr>
<tr>
<td>3. ARDHl SACC O SOCIETY LTD</td>
<td>P.O BOX 28782-00200, NAIROBI</td>
</tr>
<tr>
<td>4. ASILI SACC O SOCIETY LTD</td>
<td>P.O BOX 49064-00100, NAIROBI</td>
</tr>
<tr>
<td>5. CHAI SACC O SOCIETY LTD</td>
<td>P.O BOX 278-00200, NAIROBI</td>
</tr>
<tr>
<td>6. CHUNA SACC O SOCIETY LTD</td>
<td>P.O BOX 30197-00100, NAIROBI</td>
</tr>
<tr>
<td>7. COMOCO SACC O SOCIETY LTD</td>
<td>P.O BOX 30135-00100, NAIROBI</td>
</tr>
<tr>
<td>8. ELIMU SACC O SOCIETY LTD</td>
<td>P.O BOX 10073-000100, NAIROBI</td>
</tr>
<tr>
<td>9. FUNDILIMA SACC O SOCIETY LTD</td>
<td>P.O BOX 62000-00200, NAIROBI</td>
</tr>
<tr>
<td>10. HARAMBEE SACC O SOCIETY LTD</td>
<td>P.O BOX 47815-00100, NAIROBI</td>
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<tr>
<td>11. HAZINA SACC O SOCIETY LTD</td>
<td>P.O BOX 59877-00200, NAIROBI</td>
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<tr>
<td>12. JAMII SACC O SOCIETY LTD</td>
<td>P.O BOX 57929-00200, NAIROBI</td>
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<tr>
<td>13. KENPIPE SACC O SOCIETY LTD</td>
<td>P.O BOX 314-00507, NAIROBI</td>
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<td>14. KENVERSITY SACC O SOCIETY LTD</td>
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<td>15. KENYA BANKERS SACC O SOCIETY LTD</td>
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<td>16. KENYA POLICE SACC O SOCIETY LTD</td>
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<td>17. KINGDOM SACC O SOCIETY LTD</td>
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<tr>
<td>18. MAGEREZA SACC O SOCIETY LTD</td>
<td>P.O BOX 53131-00200, NAIROBI</td>
</tr>
<tr>
<td>19. MAISHA BORA SACC O SOCIETY LTD</td>
<td>P.O BOX 30062-00100, NAIROBI</td>
</tr>
<tr>
<td>20. MILIKI SACC O SOCIETY LTD</td>
<td>P.O BOX 43582-00100, NAIROBI</td>
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<tr>
<td>21. MWALIMU NATIONAL SACC O SOCIETY LTD</td>
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<tr>
<td>22. MWITO SACC O SOCIETY LTD</td>
<td>P.O BOX 56763-00200, NAIROBI</td>
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<tr>
<td>23. NACICO SACC O SOCIETY LTD</td>
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<tr>
<td>24. NAFAKA SACC O SOCIETY LTD</td>
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<td>25. NAKU SACC O SOCIETY LTD</td>
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<td>26. NASSEFU SACC O SOCIETY LTD</td>
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<td>27. NATION SACC O SOCIETY LTD</td>
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<td>28. NEST SACC O SOCIETY LTD</td>
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<tr>
<td>29. SAFARICOM SACC O SOCIETY LTD</td>
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<tr>
<td>30. SHERIA SACC O SOCIETY LTD</td>
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<td>31. STIMA SACC O SOCIETY LTD</td>
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<td>32. TELEPOST SACC O SOCIETY LTD</td>
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<tr>
<td>33. TRANSCOM SACC O SOCIETY LTD</td>
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<td>34. UFNISI SACC O SOCIETY LTD</td>
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</tr>
<tr>
<td>35. UFUNDI SACC O SOCIETY LTD</td>
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<tr>
<td>36. ORTHODOX DEVELOPMENT SACC O SOCIETY</td>
<td>P.O BOX 43582-00100, NAIROBI</td>
</tr>
<tr>
<td>37. UKRISTO NA UFANISI WA ANGLICANA SACC</td>
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</tr>
<tr>
<td>38. UKULIMA SACC O SOCIETY LTD</td>
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<tr>
<td>39. UNITED NATION SACC O SOCIETY LTD</td>
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<tr>
<td>40. WANA-ANGA SACC O SOCIETY LTD</td>
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<tr>
<td>41. WANCHI SACC O SOCIETY LTD</td>
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<tr>
<td>42. WANANDGE SACC O SOCIETY LTD</td>
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</tr>
<tr>
<td>43. WAUMINI SACC O SOCIETY LTD</td>
<td>P.O BOX 66121-00800, NAIROBI</td>
</tr>
</tbody>
</table>

Source: SASRA