



**INFLUENCE OF FIRM'S CAPITAL STRUCTURE ON THE RELATIONSHIP
BETWEEN FINANCIAL PRODUCTS DIVERSIFICATION AND PERFORMANCE OF
SACCO SOCIETIES IN KENYA: A CASE STUDY OF GUSII MWALIMU SACCO IN
KISII COUNTY**

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Abstract

The purpose of this study was to establish the influence of capital structure and diversification of financial products on the performance of Sacco Societies in Kenya particularly Gusii Mwalimu Sacco society. The findings include: refinancing loans which was one of the diversified financial products of the Sacco had the greatest correlation with performance of the Sacco (Pearson Correlation = 0.907) this was attributed to its high level of interest charge on this financial product when compared with other financial products. Performance of the Sacco depends on firm's capital structure, Sacco's financial products diversification; Performance of the Sacco (PS) = $2.002E-15 + 0.778 FPD + 0.222 FCS$. The capital structure had a significant contribution to performance ($\beta=0.214$, $p= 0.0000 <0.05$) while Financial Products diversification had the highest significant contribution ($\beta=0.786$, $p = 0.0000 <0.05$) and a strong association exists between financial products Diversification, Sacco capital Structure and Performance ($R = 0.984$) and the variation in Sacco's Performance can be accounted for upto 96.7% by the regressors: Sacco's capital structure as Kenya shillings over time and volume of Kenya shillings given out as loans on financial Products offered by the Sacco to its customers. The study recommends that Saccos should observe Capital structure requirements and financial products diversification to maximize their performance.

Keywords: Capital Structure, Financial Products Diversification

1. INTRODUCTION

Savings and credit cooperatives (SACCOs) are association of people who have come together with common goals geared at improving their livelihood economically. They are an important part of the financial sector in Kenya providing savings, credit and insurance services to a large portion of the population. Microfinance house, (2006). Today the most rapidly growing and profitable products in most business empires are in financial services, retail and management. Gusii Mwalimu Sacco society is among those providing financial services. The Sacco has a variety of financial products that meets the needs of its customers. Several Sacco societies are offering rival business products and they want to identify and distinguish their particular offering to their customers; the focus of these Sacco societies is not on brands *per se*, but on successful brands diversification that can satisfy their customers and even attract more from the market the Sacco's are operating. Gusii Mwalimu Sacco Society has positive diversification brands of its financial services. For a Sacco Society a successful brand is a name, symbol design or some combination which identifies the "product" as having a sustainable differential advantage to its customers (shareholders) and others. For Gusii Mwalimu Sacco the 'Differential Advantage' means that customers who are shareholders have a reason for preferring the financial brands of their Sacco to competitors brands for example salary advance by Gusii Mwalimu Sacco Society compared to other Commercial Banks. Gusii Mwalimu SACCO's is the "Brain" to Financial brand Products like 24 months' salary advance, 12 months advance, 6 months advance, emergency loans, refinancing loans, normal loans and currently the 84 months normal loan if the shareholders are senior savers.

2. Statement of the Problem

The key issues facing firms including Sacco's is how to allocate wealth among alternative assets; the situation is more complicated when the characteristics of their liabilities are included in the analysis. Therefore this study seeks to assess the influence of firm's capital structure on the relationship between financial product diversification and performance of Sacco Societies in Kenya with particular interest in Gusii Mwalimu Sacco society.

3. Objectives of the Study

The specific objectives of this study were to:

- i) Find out the influence of financial product's diversification on the performance of Gusii Mwalimu Sacco society
- ii) Establish the influence of firms capital structure on the Performance of Gusii Mwalimu

- iii) Establish the relationship between firm's capital structure, Financial product's diversification and performance of Gusii Mwalimu Sacco society

4. Research Methodology

The study adopted a descriptive case study design focused on Sacco societies in Kenya with particular interest in Gusii Mwalimu Sacco society's financial services to its customers. Target population was 418 respondents consisting of 26 Board of Directors, 86 Delegates and 306 employees of Gusii Mwalimu Sacco society. A structured questionnaires was used to collect data and the results and findings are discussed below.

RESULTS AND DISCUSSION OF FINDINGS

5. Financial Products offered by Gusii Mwalimu Sacco Society

The study established how satisfactory the financial products offered by the Sacco society are to its customers and shareholders in general. The responses were rated on a five point Likert scale where 5.0 very satisfactory, 4.0 satisfactory, 3.0 moderately satisfactory, 2.0 less satisfactory and 1.0 dissatisfied. The response rate obtained from the field was recorded as in table 1 below.

Table 1 Financial Products offered by the Sacco Society

Financial Products	5	4	3	2	1	$\sum f_i$	$\sum f_i w_i / \sum f_i$
Re-financing Loans	107	135	98	76	2	418	3.644
Normal Loans	82	143	186	5	2	418	3.713
Advance Loans	71	127	98	74	48	418	3.237
School Fees loans	64	91	215	28	20	418	3.361
Emergency Loans	103	138	92	73	12	418	3.591
FOSA 12 Months Loan	132	108	95	78	5	418	3.679
FOSA 24 Months Loan	109	214	90	3	2	418	4.017

The results in table 1 reveal that majority of the financial products offered by the Sacco to its members were rated to moderate satisfaction by the respondents where normal loans was rated at 3.713 weight strength, FOSA 12 month loan was rated at 3.679 weight strength, re-financing loans was at 3.644 weight strength. Therefore only FOSA 24 month loan was rated satisfactory at 4.07 weight strength and highly rated. The financial products offered by Sacco's depend on the total assets possessed by the Sacco. The total assets for the Sacco subsector stand at Ksh.216

billion in December 2010, and a growth of 11% from the Ksh.194 billion recorded in 2009. The growth in assets is funded mainly by member deposits and share capital at Ksh.164 billion comparing favourably with loans and advances which account for upto 73% (Ksh.158 billion) of the total assets. This reinforces the fact that Sacco's' core business is to lend to their members. The balance of the funds is retained earnings and loans of commercial banks, KUSCCO and other institutions. Therefore profitability of Sacco's depends on the variety of products which the Sacco offers to its customers in anticipation to make profit.

Cooperative societies as formal organizations enable their membership make efforts to achieve any common objectives on voluntary and democratic basis. According to (John, 2002), the first ever Co-operative movement was started by Robert Owen in the year 1844 and in recent years the SACCO sector has faced tough challenges globally as noted by (WOCCU, 2012) to include mission drifts, income generation, compliance, competition, insufficient capital among many others. The sectors financial stability will impact broadly on the nation's economic growth and employment creation. The total assets in the Kenya's SACCO sector increased to K.sh.248 billion from K.sh. 216 billion in 2010. Currently, the sector is the largest in Africa and accounts for 60, 64, and 63 per cent of the continent's savings, loan and assets respectively according to (SASRA, 2011). The use of financial products in SACCO saving increased from 9.2 to 10.6 in 2009 and 2013 while ratios for obtaining SACCO credit were 3.1 and 4.0 respectively, an indication of increased activity according to (CBK and FSD Kenya report, 2013). SACCOs need to safeguard gains made so far and build confidence since bankruptcy of a SACCO will be a manifestation of instability in the sector. The state of a country's economy affects SACCO memberships and loan intake as well. According to (Mpiira, et al., 2013) people will not join SACCO where there is no viable economic enterprise that would generate them income. Research from IMF by (Hesse and Cihák, 2007) however indicate that cooperative financial institutions tend to be more stable in times of crisis, as their investment patterns use the capital of members in ways that best serve their long term needs and interests. It is therefore thought that their comparative stability, under both average and extraordinary conditions, can help to mitigate crisis impact for members and clientele, especially in the short-term. However, since most SACCOs draw their membership from the formal sector, in times of economic downturn, the functioning of the SACCO can be undermined if member's incomes are destabilized by volatility in the economy and this may lead to reduction of members' savings and increased demand for

loans. Therefore a variety of diversified financial products is inevitable for Saccos to economically sustain their members.

6. Firms Capital Structure and Performance of Gusii Mwalimu Sacco society

A firms Capital Structure defined by (Horne, 1989) as the proportion or mix of securities used to finance a firm consist of Debt (borrowed) capital and equity (ownership) capital. An optimal capital structure is one that maximizes the firm value by minimizing the cost of capital that is the weighted average cost of capital is minimized and value of the firm is maximized. According to Modigliani, as firm's use of debt increases its cost of equity also raise and in an exactly specified manner. However, the cost of equity rises at a slower rate than it did in the absence of taxes. It is this characteristic that produces the increase in firm value as leverage increases, as shown in Modighiliani Miller Proposition I on capital structure. Therefore on this basis the study established the influence of the Sacco's capital structure on performance of Gusii Mwalimu Sacco Societies with a focus on the Core Capital and Institutional capital items. The respondents rate the capital structure items level of influence using a five point Likert scale on the performance of the Sacco (where 5.0 most influential, 4.0 more influential, 3.0 moderately influential, 2.0 less influential and 1.0 not influential). The response rate obtained from the field was presented in table 2 below.

Table 2: Firms Capital Structure and Performance of Gusii Mwalimu Sacco society

Capital Structure Items	5	4	3	2	1	$\sum f_i$	$\sum f_i w_i / \sum f_i$
Core Capital items	194	108	91	13	12	418	4.098
Institutional Capital items	213	195	6	3	1	418	4.473

Table 2 above reveal that institutional capital items are more influential on the performance of Gusii Mwalimu Sacco Society at 4.473 weight strength, while Core capital items are more influential to performance of the Sacco at 4.098 weight strength. The capital structure of a Sacco determines the asset base of the business entity on this basis Sacco's performance depends on their capital structure items. Based on SASRA report (2010), out of the 46 Sacco's, 22 Sacco's are teachers' based Sacco's which account for 34% of the Ksh.129 billion in total assets held by the Sacco's in Kenya. Gusii Mwalimu Sacco Society Limited has the highest asset base is supported by Core capital and institutional capital which form the capital structure of this Sacco.

For Gusii Mwalimu Sacco the ‘Differential Advantage ‘ means that customers who are shareholders have a reason for preferring their financial brands of their Sacco to competitors brands and this has greatly influenced its performance.

The core capital and Sacco Societies Act, 2008 defines Core Capital as fully paid up members’ shares, retained earnings, disclosed reserves all of which are not meant to be expended unless on liquidation of the Sacco society. Institutional capital refers to core capital less the members’ share capital. Institutional capital is the portion of the core capital that belongs to the SACCO society as an institution such that no one member can individually lay claim on it. This therefore led to introduction of Sacco Societies Regulatory Authority (SASRA) placing a heap of regulations to all SACCOs Including the Deposit Taking Sacco Societies to have a core capital of not less than 10 Million shillings, this compelled Sacco societies to launch a number of recruitment drives and share promotions to remain relevant in the financial service provision industry. Therefore new and existing shareholders were expected to provide money that was used to make new investments and meet regulatory requirements as per SASRA.

7. Regression Analysis

The regression results were generated using secondary data obtained from the Sacco for 25 days in a month for 10 months in a year resulting in 250 entries for financial products diversified and profit realised in form of interest income generated into the Sacco. The results were presented as below using correlation analysis.

Table 3 Correlations for financial Products Diversification and Performance (profitability) of Sacco

		Perfor mance of Sacco	FOSA loans	Normal Loans	Re- financing Loans	Emergenc y Loans	Advance Loans
Performance of Sacco	Pearson Correlation Sig. (2-tailed)	1					
FOSA loans	Pearson Correlation Sig. (2-tailed)	.831**	1				
		.000					

Normal Loans	Pearson Correlation	.768**	.871**	1			
	Sig. (2-tailed)	.000	.000				
Re-financing Loans	Pearson Correlation	.907**	.913**	.873**	1		
	Sig. (2-tailed)	.000	.000	.000			
Emergency Loans	Pearson Correlation	.768**	.814**	.873**	.803**	1	
	Sig. (2-tailed)	.000	.000	.000	.000		
Advance Loans	Pearson Correlation	.797**	.863**	.899**	.816**	.920**	1
	Sig. (2-tailed)	.000	.000	.000	.000	.000	

** . Correlation is significant at the 0.01 level (2-tailed).

Table 3 reveal that refinancing loans have the greatest relationship with performance of the Sacco (Pearson Correlation = 0.907) this is attributed to its level of interest charge which is highest when compared with other loans products. FOSA loans are second in relation to performance of the Sacco; the correlation is positive and strong at 0.831 and is significant. Therefore all the correlations coefficients are greater than 0.700 indicating a strong association of these diversified financial products in Gusii Mwalimu Sacco and performance of the Sacco in relation to its profitability for the period under study.

The study further analysed the relationship between Sacco's capital structure, financial product diversification and performance of the Sacco. The secondary data relating to the Volume of shareholders capital over time, volume of loans to diversified financial products over time and performance in terms of Sacco's profitability over time was used. The results obtained were presented as below.

Table 4: Coefficients for Capital Structure, Financial Product's Diversification and Performance

Model	Unstandardized Coefficients		Standardized Coefficients		T	Sig.
	B	Std. Error	Beta			
1 (Constant)	2.002E-15	.014			.000	1.000
Financial Product's Diversification(FPD)	.778	.027	.786		28.650	.000
Firm's Capital Structure (FCS)	.222	.031	.214		7.226	.000

a. Dependent Variable: Performance of the Sacco

Performance of the Sacco depends on firm's capital structure, Sacco's financial products diversification. Therefore;

$$\text{Performance of the Sacco (PS)} = 2.002E-15 + 0.778 \text{ FPD} + 0.222 \text{ FCS}.$$

The equation shows that capital structure has a significant contribution to performance (B=0.214, p= 0.0000 <0.05). Sacco's have typically attempted to diversify financial products to improve their performance as their customers are dynamic in needs for finances to finance various needs.

Table 5: Regression Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Sig.
1	.984 ^a	.967	.967	.07952	.000

a. Predictors: (Constant), Capital Structure, Financial Product's Diversification

b. Dependent Variable: Performance of the Sacco

Table 5 results show that a strong association exists between financial products Diversification, Sacco capital Structure and Performance (R = 0.984) and the variation in Sacco's Performance can be accounted for upto 96.7% by the regressors: Sacco's capital structure as Kenya shillings over time and volume of Kenya shillings given out as loans on financial Products offered by the Sacco to its customers.

8. Summary of the findings

The study established that 65.31% of the respondents were of the male gender while 34.69% are of the female gender. This result indicates that there is gender imbalance in the organization. The study established that majority of the respondents were aged between 40 to 49 years 55.98%; while those between 30 to 39 years were 25.6% the least number of respondents is observed in the age above 60 years who form 3.11%. The study further established that majority of the respondents in the study hold certificate level of education 46.41% of the total respondents. The Sacco belongs to the teachers of which the majority are in primary institutions which requires only certificate level of education as a minimum qualification to work. The respondents with degree level qualification formed 44.49% of the total respondents while those in secondary level of education formed 2.63% of the total respondents in this study. The study found that majority of the respondents have served for a period between 10 to 14 years and formed 46.89% of the total respondents in the Sacco ; 19.37% of the respondents served for 15 to 20 years, while 14.1% of the respondents served for a duration of over 20 years. Those who had served for a

period of between 1 to 4 years. The responses reveal that membership in the Sacco is a continuous process. Sacco's comprise over 50% of all cooperatives in Kenya and as financial institutions they play a critical role of financial intermediation in Kenya's financial landscape focusing mostly on personal development, small and micro enterprise sector of the economy. Therefore these members have been in the Sacco for some time.

The study established that communication of performance results to stakeholders as a business practice in the Sacco are carried out to a little extent, while capital investment evaluation techniques (3.538), evaluation of managerial performance (3.215) and identification of problems and improvement opportunities(3.548) are all rated to moderate extent as they are carried out in the Sacco society. The study further established that delegates meetings are the main educational method adopted by the Sacco to promote the financial products in the cooperative society and was rated by respondents at 3.761 weights. Seminars and brochures on the Sacco financial products were rated at 3.275 and 3.157 weights respectively which are all to moderate frequency in promoting the financial products.

The study established that majority of the financial products offered by the Sacco to its members were rated to moderate satisfaction by the respondents where normal loans was rated at 3.713 weight strength, FOSA 12 month loan was rated at 3.679 weight strength, re-financing loans was at 3.644 weight strength. Therefore only FOSA 24 month loan was rated satisfactory at 4.07 weight strength and highly rated. The financial products offered by Sacco's depend on the total assets possessed by the Sacco. The total assets for the Sacco subsector stand at Ksh.216 billion in December 2010, and a growth of 11% from the Ksh.194 billion recorded in 2009. The growth in assets is funded mainly by member deposits and share capital at Ksh.164 billion comparing favourably with loans and advances which account for upto 73% (Ksh.158 billion) of the total assets. This reinforces the fact that Sacco's' core business is to lend to their members. The balance of the funds is retained earnings and loans of commercial banks, KUSCCO and other institutions. Therefore profitability of Sacco's depends on the variety of products which the Sacco offers to its customers in anticipation to make profit.

The study found that that institutional capital items are more influential on the performance of Gusii Mwalimu Sacco Society at 4.473 weight strength, while Core capital items are more influential to performance of the Sacco at 4.098 weight strength. The capital structure of a Sacco determines the asset base of the business entity on this basis Sacco's performance depends on their capital structure items. Based on SASRA report (2010), out of the 46 Sacco's, 22 Sacco's

are teachers' based Sacco's which account for 34% of the Ksh.129 billion in total assets held by the Sacco's in Kenya. Gusii Mwalimu Sacco Society Limited has the highest asset base is supported by Core capital and institutional capital which form the capital structure of this Sacco. For Gusii Mwalimu Sacco the 'Differential Advantage ' means that customers who are shareholders have a reason for preferring their financial brands of their Sacco to competitors brands and this has greatly influenced its performance.

Regression analysis results on the relationship between Sacco's capital structure, financial product diversification and performance of the Sacco revealed that Performance of the Sacco (PS)= $2.002E-15 + 0.778 FPD + 0.222FCS$. The equation shows that capital structure has a significant contribution to performance ($B=0.214$, $p= 0.0000 <0.05$). Sacco's have typically attempted to diversify financial products to improve their performance as their customers are dynamic in needs for finances to finance various needs; and a strong association exists between financial products Diversification, Sacco capital Structure and Performance ($R = 0.984$) and the variation in Sacco's Performance can be accounted for upto 96.7% by the regressors Sacco's capital structure and financial Product's diversification offered by the Sacco to its customers.

9. Conclusion

Based on the findings on objective one on the influence of firms capital structure on the Performance of Gusii Mwalimu Sacco society. The study concludes that firm's capital structure statistically and significantly influences the performance of Gusii Mwalimu Sacco society.

Based on the findings on objective two out on the influence of financial product's diversification on the performance of Gusii Mwalimu Sacco society. The study concludes that financial products diversification offered by Gusii Mwalimu Sacco statistically and significantly influence the performance of the Sacco.

Based on the results of objective three on the relationship between firm's capital structure, financial product's diversification and performance of Gusii Mwalimu Sacco society. The study concludes that a strong association exists between financial products Diversification, Sacco capital Structure and Performance ($R = 0.984$) and the variation in Sacco's Performance is accounted for upto 96.7% by the Sacco's capital structure and financial Product's diversification offered by the Sacco to its customers who are majorly shareholders.

10. Recommendations

The influence of firms capital structure on the Performance of Gusii Mwalimu Sacco society results show a significantly influence on the performance of Gusii Mwalimu Sacco society. The study recommends that Saccos should monitor their capital structure to sustain and improve their performance.

On financial product's diversification and performance of Gusii Mwalimu Sacco society. The study recommends that financial products diversification offered by Gusii Mwalimu Sacco is inevitable and can be increased to increase profitability (performance) of the Sacco.

On the relationship between firm's capital structure, financial product's diversification and performance of Gusii Mwalimu Sacco society. The study recommends that when the variation in Sacco's Performance is accounted for upto 96.7% by the Sacco's capital structure and financial Product's diversification offered by the Sacco to its customers then the appropriate mix of Diversified financial products should be adopted to optimize the performance of the Sacco in relation to profit generation as interest income.

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