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Does Competition from Commercial Banks affect the Financial Performance of Savings and Credit Co-operatives in the Banking Sector in Kenya?

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Abstract

Kenya has a long history of co-operative development that has been characterized by strong growth, thus making significant contribution to the economy. Co-operatives are recognized by the government to be a major contributor to national growth and development as they are found in almost all sectors of the economy. Commercial banks in Kenya have staged a stiff competition to the co-operatives through provision of unsecured personal loans. This study sought to establish the effects of the competition from commercial banks on the financial performance of Savings and Credit Co-operatives (SACCOs) in the banking sector in Kenya. This study adopted a descriptive survey design. The target population was co-operatives in the banking sector in Kenya. Stratified sampling and simple random sampling was used to obtain the sample items. A Likert scale questionnaire was used to gather primary information and a secondary data collection sheet was used in gathering secondary information regarding SACCOS' financial performance. Information was sorted, coded and input into the statistical package for social sciences (SPSS) version 21.0 for production of graphs, tables, descriptive statistics and inferential statistics. The results gave a correlation coefficient of 0.151 with an R-squared value of 0.419, while the ANOVA test gave a p-value of 0.000. The study concluded that there was a positive relationship between competition from commercial banks and the financial performance of SACCOs in the banking sector in Kenya. Further, the study concluded that competition from commercial banks was statistically significant in explaining the financial performance of SACCOs in the banking sector in Kenya. The study recommends that SACCOs should effectively manage competition from banks to improve their financial performance and to further stir up economic growth thus eradicating poverty.

Keywords: ***Economic, SACCOs, competition, financial performance***

Introduction

Kenya's co-operative movement has had strong growth in all sectors of the economy. Kenya's Savings and Credit Co-operatives (SACCO) sub-sector is the largest in Africa, accounting for over sixty two, sixty five and sixty three percent of the continent's savings, loan and assets respectively (Ayieko, 2017). It provides a framework for mobilization of human and capital resources and is critical in the

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country's social economic development. The combined assets for the entire co-operative movement in 2007 were worth approximately KSh. 230 billion and with a total turnover of KSh. 24.3 billion, of which SACCOs posted a combined turnover of KSh 14.4 billion (Ministry of Co-operative Development and Marketing, 2008). There are seven registered and active SACCOs in the banking sector in Kenya whose headquarters are in Nairobi, namely, Kencom SACCO Ltd, Co-operative Bank SACCO, Equity Bank SACCO, Family Bank SACCO, Nyumba SACCO, Kenya Bankers SACCO and Postbank SACCO (Ministry of Co-operative Development and Marketing, 2011). The largest among them in terms of membership and asset size being Kenya Bankers SACCO which draws its membership from across all banks while the other six SACCO draw members from the banks where their members are employed. OECD (2008) advanced that competition is key to the operation of markets, as it fosters productivity, innovation, and growth, which in turn create wealth and reduce poverty. Plowman (2013) defined competition as a special case of the struggle or contest for survival or conflicting interest. The study further advanced that governments must take responsibility for helping markets to function effectively for the poor, so that they enable choice, encourage innovation and provide goods and services to consumers at the lowest possible prices. The 2005 Report of the Commission for Africa (CfA) in Africa noted that the lack of competition raise costs significantly.

Statement of the Problem

The Ministry of Co-operative and marketing estimates that about 80% of the Kenyan population derives their income either directly or indirectly through cooperatatives initiatives. It is estimated that a significant 24.6million people (63%) participate either directly or indirectly in cooperatives enterprises (Republic of Kenya, 2008). The Kenya's SACCO sub-sector is the largest in Africa serving an estimated 50% of the total population either directly or indirectly. It has approximately 20 million members who directly or indirectly depends on the activities of SACCOs to earn a living and is a key source of employment for youths and women. The government has made a significant initiative to support co-operative movements through legislation with an aim fostering financial inclusion in its economic agenda (Ministy of Cooperative Development And Marketing, 2013). In Kenya, there were 6,727 registered SACCOs as at December 2010 (GOK, 2011). Despite government initiatives, a significant 3457 (51%) of the SACCOs were not operational. This high failure rate of SACCOs frustrates the achievent of increasing financial inclusion of Kenyans. It also implies those employed by the SACCOs that collapsed are negatively affected. Unlike the high 51% failure rate of SACCOs in Kenya, non of the SACCOs in the banking sector has failed (GOK 2011) . SACCOs in the banking sector in Kenya are unique in that, bank employees enjoy many employment perks including highly concessional and discounted internal employer loans. They also compete for the same savings with the commercial banks who happen to be the employers of the SACCO members. This study sought to establish the effect of competition from commercial banks on the financial performance of SACCOs in the banking sector in Kenya.

Literature Review

According to the resource-based theory, a firm may possess strategic resources, which enables it to conceive and implement strategies that improve its efficiency and effectiveness. This provides an organization with a golden opportunity to develop competitive advantages over its rivals which in turn can help the organization enjoy strong profits. Strategic resources are valuable, non-substitutable, unique and difficult to imitate attributes of a firm. They include organizational processes, assets, capabilities, information, knowledge and firm attributes which competitors cannot find alternative ways to gain the benefits that such a strategic resource provides (Barney, 1991). Co-operative finance have a supply of funding that is more stable and less responsive to monetary policy and market rates. It offers comparatively lower fees than commercial banks, that increase access of the poor to credit and reduces the cost of remittance transfers. Studies by Mumanyi (2014), Auka and Mwangi (2013) revealed that commercial banks in Kenya had relaxed their lending policy, thus attracting SACCO members to taking loans with them resulting to SACCOs losing members’ savings. Further, commercial banks were partnering with some SACCOs to act as security for SACCO members’ loans, thus threatening the survival of SACCOs. A study by Njagi (2012) observed that although SACCO membership and the demand for loans from SACCOs was reported to have increased, SACCO were facing the problem of low capital base causing SACCO members to seek financial services from other financial service providers. A study conducted by Ortmann and King (2007), indicated that financial institutions had been hesitant to provide credit to co-operatives due to the high risks associated with lending to them due to high transaction costs involved in granting small loans.

A study by Khole (2014) revealed that commercial banks were targeting small savers, who have all along been taking loans from SACCO, and offering them unsecured personal loans. This has in turn made SACCO members to switch their loyalty to commercial banks. However, the study further indicated that the financial performance of SACCOs was not grossly affected. The competition benefitted the members as the SACCOs were processing loans faster than before. Loan terms and conditions have significant influence on the loan volume granted by deposit taking SACCOs in Nyeri County in Kenya which made unsecured bank loans attractive to SACCO members (Wu’Adongo 2011). A study by Amara, Rotich & Onyango (2017) revealed that Mwalimu SACCO had not been grossly affected by the loans offered by the commercial banks and its members had benefited a lot as a result of the competition between commercial banks and SACCOs. In the past, SACCOs have enjoyed huge interest rate disparity between what they charge and what banks charged borrowers of between thirteen and eighteen percent. However, with the introduction of interest rate caps Kenya in September 2016, the gap has narrowed to about two percent. This in effect could pull a significant market share from SACCO clientele toward commercial banks as they offer unsecured loans (Ayieko, 2017).

Plowman (2013) found that reforms to competition policy had positive effects on productivity, growth and employment and highlighted the importance of protecting competition as it promotes development of new technologies, dynamism and prevents the creation of monopolies which are harmful to the economy and consumers. Wissenz, (2010) advanced that competition is fundamental as firms become more efficient, and therefore offer better and cheaper products and services to the community, and hence everyone benefits. Plowman, (2013) further asserted that positive competition increased motivation, innovation, and creativity necessary to improve processes and results. It also fosters a sense of respect, care, consideration, and empathy toward all team members, which leads to a team-oriented mindsets. In contrast, negative competition greatly jeopardises a team's ability to successfully grow and produce desirable results. It causes feelings of suspicion and lack of trust among members, which leads to the development of rivals, decreased productive energy, and potential violations of ethical standards.

Methodology

This study adopted a descriptive survey design to answer the research questions and quantitative analysis to evaluate the financial performance. The target population of this study was SACCO members who comprised of SACCO employees and bank employees in the banking sector in Kenya. Stratified sampling and simple random sampling techniques were used to obtain the respondents of the study. A sample of 384 respondents was taken which comprised of 29 SACCO employees and 355 bank employees who were SACCO members from all the seven SACCOs in the banking sector in Kenya. Primary information was gathered by use of a questionnaire coupled with informal interviews that were guided by the questionnaire. Secondary data on the financial performance was gathered from the annual reports of the SACCOs, which were obtained from the Ministry of Co-operative, Development and Marketing using a data collection sheet. The Pearson's correlation coefficient was used to gauge the strength of the relationship while a t-test was used to test the direction of the relationship between the independent variable and the dependent variable. A regression model was derived to project the value of the dependent variable for a given value of the independent variable. Further, an ANOVA test was used to test the significance of the influence of the independent variables on the dependent variable.

Findings

The study sought to examine whether competition from commercial banks influenced the financial performance of SACCOs in the banking sector in Kenya.

Financial Performance

The financial performance of SACCOs in the banking sector was measured using various indicators namely profit before tax, total assets, loans disbursed to members, member savings, dividends disbursed to the members and membership in the SACCOs. Results indicated that there was increased financial performance of SACCOs over the years of study as shown in table 1 below. The number of SACCO members increased from 3,829 in 2007 to 4,658 in 2012. This had a direct effect of increasing the amount of members' deposits, loans disbursed, profit before tax and the value of total assets in the midst of competition posed by commercial banks in Kenya.

Table 1 *Indicators of Financial Performance*

Indicator of Financial Performance	2007	2008	2009	2010	2011	2012
Number of members	3,829	3,816	3,685	3,905	4,229	4,658
Total Assets (KShs. In Millions	789.64	786.39	874.24	885.54	1,154.24	1,214.85
Profit before tax (KShs. In Millions)	450.90	518.23	621.34	702.68	768.02	672.41
Loans disbursed (KShs. In Millions)	639.67	622.25	589.60	627.98	841.08	893.28
Members' deposits (KShs. In Millions)	593.32	562.40	584.12	641.73	717.68	800.17
Total dividends paid (KShs. In Millions)	59.80	70.65	69.26	76.05	80.59	93.33

Descriptive Analysis for Competition and Financial Performance

Out of the 384 questionnaires issued, a total of total of 269 questionnaires were properly filled and returned by the respondents which represented a response rate of 70%. Analysis of the questionnaire responses indicated that 81% of the respondents disagreed that commercial banks are a great threat to survival of their SACCO, 65% disagreed that savings products of commercial banks are a great competitor to their SACCO products and 85% disagreed that loans from commercial banks are more favorable than loans from their SACCO. Furthermore results indicated that 73% of the respondents disagreed that land purchase using a bank loan was cheaper than using a SACCO loan, 83% disagreed that interest rate on loans of banks are better than those of the SACCO and 76% disagreed that commercial banks have better customer service than their SACCO. In addition, 66% of the respondents disagreed that commercial banks loan advertisements affect grow of SACCOs, 81% disagreed that SACCOs are more competitive than commercial banks in service delivery. The findings imply that there was low competition from commercial banks which explained the improved financial performance of SACCOs in the banking sector in Kenya. This also confirmed the resource based theory that SACCOs have strategic competencies which cannot be substituted and which enable them to thrive over their competitors, the commercial banks.

Inferential Analysis

Correlation analysis – competition and financial performance. Correlation analysis was conducted to determine the relationship between competition from commercial banks and the financial performance of SACCOs in the banking sector in Kenya. The results indicated that financial performance was positively correlated with competition with a correlation coefficient of 0.151 as shown in table 2 below. This reveals that any positive change in competition led to improved financial performance.

Table 2 *Pearson Correlation - Competition and Financial Performance*

Variable		Performance	Competition
Performance	Pearson Correlation	1	
	Sig. (2-tailed)		
Competition	Pearson Correlation	0.151	1
	Sig. (2-tailed)	0.013	

Regression analysis - competition and financial performance. Regression analysis was conducted to empirically determine whether competition was a significant determinant of financial performance. Regression results as shown in table 2 gave an R squared of 0.023 using the linear model, which meant that 2.3% of the variances in financial performance of SACCOs in the banking sector are explained by the variances in competition. However, with the combination of linear and non-linear components the R squared improved to 0.419 which meant that 41.9% of the variances in financial performance of SACCOs in the banking sector are explained by the variances in competition. This implied that the non-linear addition model is statistically significant with an F statistic of 181.41 and P value (0.000).

The quadratic model was supported by the scatter plot and line of best fit fitted in Table 3 below and the value of R-square of 0.419 as shown.

Table 3 *Model Summary - Competition and Financial Performance*

Model	R	R Square	Std. Error of the Estimate	R Square Change	F Change	df1	df2	Sig. F Change
1	.151a	0.023	0.52018	0.023	6.208	1	267	0.013
2	.647 b	0.419	0.40184	0.396	181.41	1	266	0.000
a Predictors: (Constant), competition								
b Predictors: (Constant), competition, competition squared								

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ANOVA - competition and financial performance. Results in Table 3 revealed that competition is statistically significant in explaining financial performance of SACCOs in the banking sector in Kenya. An F statistic of 95.906 indicated that the combined quadratic model was significant. This was supported by a probability value of (0.000). The reported probability of (0.000) is less than the conventional probability of (0.05).

Table 4 ANOVA – Competition and Financial Performance

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	1.68	1	1.68	6.208	.013b
	Residual	72.246	267	0.271		
	Total	73.925	268			
2	Regression	30.973	2	15.486	95.906	.000c
	Residual	42.952	266	0.161		
	Total	73.925	268			
a Dependent Variable: Performance						
b Predictors: (Constant), competition						
c Predictors: (Constant), competition, competition squared						

Regression model - competition and financial performance. The results of the regression model of competition and financial performance is a indicated in Table 4 below, which revealed that competition is statistically significant in explaining financial performance of SACCOs in banking sector in Kenya. This is supported by (b= -0.573, p value = 0.000). The negative beta explains that the SACCOs performance reaches a point where it stagnates and tends to go down whether competition is managed or not. This is summarized in the regression model below;

$$\boldsymbol{Y = 4.097 + 2.976X1 - 0.573X12}$$

Table 5 *Regression Coefficient - Competition and Financial Performance*

Model		B	Std. Error	T	Sig.
1	(Constant)	7.327	0.103	71.298	0.000
	Competition	0.113	0.045	2.492	0.013
2	(Constant)	4.097	0.253	16.22	0.000
	Competition	2.976	0.215	13.813	0.000
	Competition squared	-0.573	0.043	-13.469	0.000

Scatter plot. Results in the scatter plot revealed that there was a positive relationship between the competition and financial performance, which implied that, an increase in competition management influenced financial performance positively. However, as competition intensified beyond a certain level which the SACCOs cannot handle, their financial performance tended to decrease.

Conclusion

The study concluded that competition from commercial banks was low due to the unique and un-substitutable strategic competencies or resources which SACCOs possess. This low competition from commercial banks led to improved financial performance of SACCOs. The study further concluded that holding other factors constant, competition was found to have a positive and significant relationship with the financial performance of SACCOs in the banking sector in Kenya. This implied that managing competition in SACCOs was key in fostering the financial performance of SACCOs in banking sector in Kenya and also in stirring up economic growth and eradicating poverty.

Recommendations

The study recommends that the SACCOs should emphasize and enhance that the competition from commercial banks is managed well. They should also ensure that they engage the employees' views whenever making changes in the systems so that there would be smooth operations of the activities. The SACCO should also ensure that all employees are well trained about the policies governing the SACCOs to enlighten the employees on their knowledge about SACCO and their profitability.

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