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## **EFFECT OF INTEREST RATE CAPPING ON THE FINANCIAL PERFORMANCE OF SACCOS IN KENYA: A CASE OF SACCOS OPERATING FOSA IN KENYA**

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### **ABSTRACT**

*This study sought to establish the effect of interest rate capping on the financial performance SACCO's in Kenya. The study adopted a descriptive research design. The population of the study consisted of 164 SACCOs duly licensed to operate front office operations. The study used t-test and correlation analysis. The results showed a significant relationship between interest rate capping and financial performance of SACCOs in Kenya. If profitability is improved then there is significant improvement in terms of financial aspects in SACCOs. Credit term had positive and significant correlation with performance of SACCOs; if SACCOs improve the credit terms, the level of their financial performance improve. The study concluded that interest rate capping had an effect on financial performance of SACCOs in Kenya. The study recommended that Management should ensure the adoption of profitability strategies so as to influence financial performance for consistent achievement of organizational goals. The government and stakeholders should ensure that there is favourable external business environment for SACCOs in Kenya.*

**Key words:** Interest rate cappings; Financial performance; Return on assets

## 1.0 Introduction

A capped rate is a rate of interest that fluctuates but can not exceed a specified interest cap. Capping interest rates is a type of economic industry public control. Over the past few years, the number of nations using this type of control has declined primarily because most nations aim to have liberal financial policies, particularly for SACCOs. There are several factors that may make a government to choose to use interest rate caps, most of which are economic and political. One of them may be to assist a sector or industry where there is a market failure or a need for higher economic capacity (Pandey, 2012). Globally, interest rate caps are probably the longest. The earliest usury law proponents favoured zero interest rates. Aristotle claimed cash was sterile and no interest should be earned. Governments from ancient Egypt through contemporary times have for a multitude of purposes enforced interest rate ceilings. (Ahuja,2016).

Kenya, introduced an interest rate cap of 4% above the CBK Policy Rate for regulated financial institutions in September 2016. The measure was viewed as a populist move. However, in the short time since the law's enactment, signs suggest it is doing more harm than good to the overall economy, including the exclusion of higher risk borrowers like SACCOS, decreased levels of lending, and lower profits and stock values among banks. It seems the government is now looking to remove the caps given the effects on the economy and financial services sector. (Ngwatu, 2017). However, there have been some positive outcomes for the Kenyan financial inclusion industry such as more innovations, especially in digital lending, because the banks are restricted in lending, creating an opening for non-bank lenders. Some Kenyan banks have also started to buy MFIs in order to lend through them in smaller amounts. The caps have caused banks to diversify their product offerings more to insurance and leasing (Olga, 2013).

The financial performance of SACCOs therefore is the outcome of several operations carried out by the management, guided by the credit policies laid down. This is indicated by return on assets and earnings before interest and taxes, which are computed by comparing different items in financial position statement and the statement of comprehensive income (Nancy, 2017). Financial performance entails gauging the end result of a financial institution's operations and policies in financial terms. This has been done by calculating the firm's return on investment and return on assets (ROA). Nancy (2017) asserts that a loan either long term or short term is a major asset and revenue generator of a SACCO which affects performance of all types of SACCOs financially. The financial performance of financial institutions depends on return on assets (ROA) invested in the business. Therefore, when analyzing these SACCOs' financial performance the researcher is concerned with loans advanced, the non-performing loans and insurance premiums recovered in a given financial year, all these expressed to total assets and total value of loans respectively. Muth(1960) developed the notion of rational expectation that was first propagated by Pigou, Keynes and Hicks and then used this theory to describe the phenomena of the business. The theory is that the present scenario can determine a future

financial event. Market opinions, say the bonds and shares case, stay one of the true outcome's primary determinants(Olga, 2013).

Kenya's cooperative movement is the economy's fastest growing sub-sector and a significant boost to the living standards of employees (SASRA, 2017). SACCOS is already playing its critical part in mobilizing investment savings as envisaged in Kenya's Blue Print Vision 2030. The sub-sector consists of taking SACCOS without deposit and taking it. The deposit of SACCOS is authorized and controlled by SASRA, while the cooperative officer supervises the BOSAs. The 2010 Sacco Societies Regulations are risk-oriented, offering prudential norms needed to deposit with SACCO organisations to guarantee the SACCO sub-sector's economic stability. The key role of deposit taking SACCOs (FOSA) is the provision of lending services where members are advanced loans for a set period then payback with interest above the principal amount borrowed. SACCOs are expected to pay members interest on deposits on amount lying in their accounts as they are form of investment to members. FOSAs are the key institutions in SACCO sector affected by interest rate capping as their source of income is limited.

### 1.1 Research objective

To establish the effect of interest rate capping on financial performance of SACCOs in Kenya, A case of SACCOs operating FOSA in Kenya.

### 2.0 Methods

Descriptive research design was used in the study. The study involved the use of secondary data obtained from the following sources: SACCOs ' annual financial reports, the SASRA Annual Reports containing relevant information on SACCOs, and the Kenyan financial performance indicators. The study used multiple regression model which was:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon$$

Where: Y= Financial Performance of SACCOs

X<sub>1</sub>= Credit term

X<sub>2</sub>= Profitability

X<sub>3</sub>= Loan Portfolio

X<sub>4</sub>= Lending Interest Rate

α= Constant

β<sub>1</sub>,β<sub>2</sub>,β<sub>3</sub>,β<sub>4</sub> = Regression co-efficients

$\varepsilon$  = Error term

The dependent Variable was the financial performance of the SACCOs measured using Return on Assets(ROA) where as the independent variables were the Credit Term, Profitability, Loan portfolio and Lending Interest rate.

### 3.0 Results and discussion

**Table 1: Pair T-Test**

		Paired Differences					95% confidence interval of the Difference		Sig. (2-tailed)
		Mean	Standard Deviation	Std Error Mean	Lower	Upper	t	df	
Pair 1	Pre Credit – Post Credit	-.03299	.0048	.0012	-.0357	-.0301	-25.50	163	.000
Pair 2	Pre Profitability – Post Profitability	-.1420	.0266	.0071	-.1573	-.1266	-19.98	163	.000
Pair 3	Pre loan portfolio – Post loan portfolio	-.02116	.0052	.0014	-.0242	-.0181	-15.01	163	.000
Pair 4	Pre Lending interest rates –	-8662780.28	5668617.51	15150.75	119357.97	538981.97	-18.71	163	.000

Post  
lending  
interest  
rates

**Source: Researcher (2019)**

T-test results in Table 1 revealed that the mean difference between average credit term of the SACCOS operating FOSA was statistically significant ( $t(163) = -25.50, p < 0.000$ ). This implies that the difference in average credit term of the SACCOS after interest rate capping increased significantly. Therefore the interest rate capping had a significant effect on the credit term of the SACCOS operating FOSA. Further T-test findings show that the mean distinction between SACCOS operating FOSA's average profitability was statistically important ( $t(163) = -19.98, p < 0.000$ ). This means that interest rate capping regulation influenced the rise in SACCOS ' average profitability after interest rate capping. The interest rate capping therefore had a significant effect on the SACCOS working FOSA's average profitability. It also had a significant effect on the SACCOS credit portfolio ( $t(163) = -5.71, p < 0.000$ ). This implies that the rise in the SACCOS credit portfolio was due to interest capping regulation after the announcement date.

**Table 2: Correlation Analysis**

		Financial Performance	Credit Term	Profitability	Loan Portfolio	Lending Interest Rates
Financial Performance	Pearson Correlation	1				
	Sig. (2-tailed)					
	N	164				
Credit Term	Pearson Correlation	.536**	1			
	Sig. (2-tailed)	.000				
	N	164	164			
Profitability	Pearson Correlation	.499	-.141	1		
	Sig. (2-tailed)	.004	.143			
	N	164	164	164		
Loan Portfolio	Pearson Correlation	.589**	.546**	.059	1	
	Sig. (2-tailed)	.000	.000	.543		
	N	164	164	164	164	

		Pearson	.437**	.127	-.520**	.350**	1
		Correlation					
Lending	Interest	Sig. (2-tailed)	.000	.188	.000	.000	
Rates							
		N	164	164	164	164	164

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

#### Source: Research Findings (2019)

The study used the Pearson correlation to evaluate the correlation between the SACCOs ' financial results and the autonomous factors (Credit Term, Profitability, Loan Portfolio and Lending Interest Rates). The study found out a statistically significant correlation between the SACCOs loan term and financial results ( $r = .536$ ,  $p = .000$ ). The study also found that, as demonstrated by ( $r = .499$ ,  $p = .000$ ), there is a weak correlation between profitability and financial performance. As demonstrated by ( $r = .589$ ,  $p = .000$ ), Loan Portfolio has a significant relationship with profitability. The study also found out a weak relationship ( $r = .437$ ,  $p = .000$ ) between SACCO loan interest rates and financial performance.

#### 4.0 Discussion of findings

The study concluded that profitability, credit term, lending rate and loan portfolio form of interest rate capping contributed significantly to financial performance of SACCOs in Kenya. Finally, the study established that lending rate and loan portfolio had an effect on the financial performance of SACCOs in Kenya. A positive Pearson correlation coefficient obtained implied that if lending rate and loan portfolio is improved by a given margin, the level of financial performance would improve by the same margin.

#### 5.0 Recommendations

The management of SACCOs should consider the profitability, credit term, loan portfolio and lending interest rate as they correlate with the Return on Assets of SACCOs. The management of SACCOs should also enhance provision of profitability strategies to influence financial performance for consistent achievement of organizational goals. The government and stakeholders should ensure that there is a favourable business environment for SACCOs as they perform their business in Kenya.

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