



FINANCIAL RISK MANAGEMENT STRATEGIES EMPLOYED BY LICENSED DEPOSIT TAKING SACCOS IN NAIROBI COUNTY

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ABSTRACT

With increased growth in deposit taking SACCOs in the past few years in terms of membership and deposits, they have been exposed to more financial risks. To survive the risks, they have to manage risks through various ways. Previous studies done on this area focus on management of risk using specific tools but none addresses the financial strategies employed by SACCOs in totality which is the gap that this study seeks to fill. This study examined financial risk management strategies employed by licensed deposit taking SACCOs in Nairobi County. The specific objectives were to find out whether deposit taking SACCOs employ active oversight board, financial risk management information systems, policies, procedures & limits, risk measurements and monitoring and comprehensive internal controls strategies in financial risk management. The study focused on all 44 deposit taking SACCOs. The population of interest was the risk managers or managing directors of the organizations. The research instrument used was questionnaires which were pre-tested to confirm clarity of the questions and their validity and reliability. Data was analyzed using quantitative techniques and then presented using distribution tables. The results revealed that most deposit taking SACCOs employ the strategies of active oversight board, policies, procedures and limits and comprehensive internal controls in financial risk management. The study concluded that SASRA needs to sensitize and educate members on proper financial risk management strategies to be employed by all deposit taking SACCOs and a more so a working management information system.

KEYWORDS; deposit taking SACCOs, financial risk management, strategies.

1.1 Background of the Study

Risk is about awareness of, and reaction to potential circumstances that could impede an entity's ability to achieve its goals and objectives. From this perspective, managers of an organization should formalize ways of identifying those circumstances and to develop steps to reduce or avoid the risks (Hill et al 2010). The chance of something happening will impact the achievement of objectives (Partnerships BC, 2005 and NIST, 2004). Risk management involves identifying, measuring, monitoring and controlling risks. The process is to ensure that the individual clearly understands risk management and fulfills the business strategy and objectives (SBP, 2003). In the early 1990s, Kenya experienced difficult economic times forcing commercial banks to demand higher minimum operating balances for individual accounts to sustain their businesses. This saw many middle and low income persons unable to operate bank accounts. SACCOs became popular among employed persons who had been unable to maintain or operate bank accounts and they responded by introducing a Front Office Service Activity (FOSA) which offered quasi banking services at competitive rates opening a new chapter in the SACCO business. (SASRA, 2010)

Financial Sector Deepening (FSD) Kenya recognizes the critical role of SACCOs in providing access to financial services to low income households in Kenya. FSD (2009), Indicated that SACCOs are one of the leading sources of rural finance and in many rural areas the local SACCO is the only provider of financial services. About 200 of the SACCOs are considered deposit-taking SACCOs, offering Front Office Savings Activities (FOSA). This implies that FOSA SACCOs operate more funds than those only operating Back Office Savings Account (BOSA). Based on the 2010 performance of the SACCO subsector, the deposit taking SACCOs accounted for over 75% of the deposits and total assets for the subsector as illustrated by the table 1.0 below.

Table 1.0: Comparison of the Deposits Taking SACCOs to the Non Deposit Taking Sacco Societies

Categories of Saccos	No. of Saccos	Members	Share Capital (Ksh.M)	Deposits (Ksh.M)	Loans (Ksh.M)	Total Assets (Ksh.M)
Deposit Taking Saccos (DTS)	215	1,546,966	5,414	123,137	123,493	171,344
Non Deposit Taking Saccos	3,065	351,690	1,255	34,403	34,433	44,799
TOTAL	3280	1898656	6,669	157,540	157,926	216,143
% of DTS to Total	7%	81%	81%	78%	78%	79%

Source: SASRA Report 2010.

The increased funds/deposits and larger amounts being loaned out to people/members some who don't qualify exposes them to more risk. The question; how do SACCOs shield themselves from the possible financial risks? Are there mechanisms or systems that enable them identify possible risks before they occur? These concerns need to be investigated. This is further illustrated by SACCO briefs (2011), which highlighted that, the SACCO Societies Regulatory Authority (SASRA) has been mandated to license and supervise SACCOs. The need for closer oversight is that accepting withdrawable deposits is particularly considered a high-risk activity as depositors risk losing their money.

Eurofinas, the European Federation of Finance House Associations, indicates that new consumer credit and outstanding consumer credit growth has increased steadily from 2001 to 2005 in Europe (shown in Figure 1.0). Therefore, financial institutions require strategies to minimize their risk. In Tanzania, the directorate of banking supervision (DBS) gave a list of risk management guidelines to be implemented by Banks and financial institutions which included; active board and senior management oversight, adequate policies, procedures and limits, adequate risk measurement and monitoring, management information systems and adequate internal controls. (DBS, 2010)

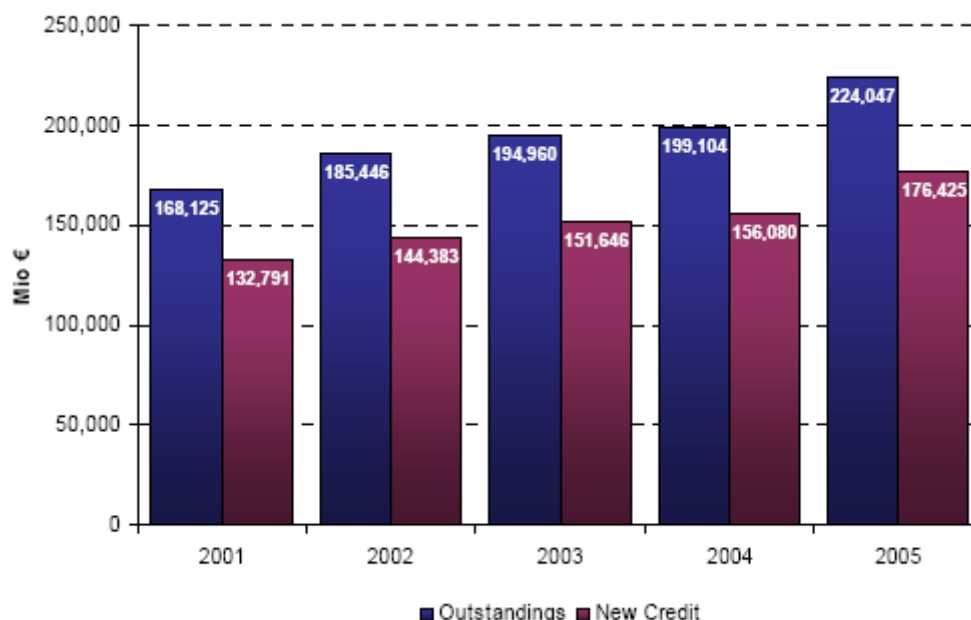


Figure 1.0 - Consumer credit on the rise (Eurofinas, 2005)

Nara (2012) in his paper Risk Management in Savings and Credit Cooperatives, found that Nepalese SACCOs lack systematic and quantitative methods to identify, monitor and control aggregate risk due to lack of comprehensive risk management system. There were instances of significant losses in some SACCOs because of insufficient attention on risk management which had been done through audit committee and internal audit system. He further observed that the Contribution of external audit on risk management is minimum and there are instances where some SACCOs had witnessed serious delinquency crisis due to poor risk management.

Murugu (2012) in his study, the effect of credit risk management practices on the performance of SACCOs in Kenya. A case of Nairobi based SACCOs, found that SACCOs have heavily relied on particular credit risk techniques which are not adequate to mitigate against loan losses in a dynamic and competitive lending environment. Secondly adequate credit risk monitoring and control mechanisms are lacking in majority of SACCOs which results in late detection and determination of non-performing and defaulted loans. Thirdly, governance structures that would ensure that the laid down credit risk policies are strictly adhered to is clearly lacking in majority of SACCOs

1.1.1 Oversight board

Boards of directors have ultimate responsibility for the level of risk taken by their institutions. Accordingly, they should approve the overall business strategies and significant policies of their institutions, including those related to managing and taking risks, and should also ensure that senior management is fully capable of managing the activities that their institutions conduct. While all boards of directors are responsible for understanding the nature of the risks significant to their institutions and for ensuring that management is taking the steps necessary to identify, measure, monitor, and control these risks, the level of technical knowledge required of directors may vary depending on the particular circumstances at the institution. Directors should have a clear understanding of the types of risks to which their institutions are exposed and should receive reports that identify the size and significance of the risks in terms that are meaningful to them. In addition, directors should take steps to develop an appropriate understanding of the risks their institutions face, possibly through briefings from auditors and experts external to the institution. Using this knowledge and information, directors should provide clear guidance regarding the level of exposures acceptable to their institutions and have the responsibility to ensure that senior management implements the procedures and controls necessary to comply with adopted policies.

1.1.2 Management information systems

The effectiveness of an institution's financial risk measurement process is highly dependent on the quality of management information systems. The information generated from such systems enables the board and all levels of management to fulfill their respective oversight roles, including determining the adequate level of capital that the

institution should be holding. Therefore, the quality, detail and timeliness of information are critical. In particular, information on the composition and quality of the various portfolios, including on a consolidated basis, should permit management to assess quickly and accurately the level of financial risk that the institution has incurred through its various activities and determine whether the institution's performance is meeting the financial risk strategy. It is also important that institutions have a management information system in place to ensure that exposures approaching risk limits are brought to the attention of senior management. All exposures should be included in a risk limit measurement system. The institution's information system should be able to aggregate credit exposures to individual borrowers and counterparties and report on exceptions to credit risk limits on a meaningful and timely basis. Institutions should have information systems in place that enable management to identify any concentrations of risk within the credit portfolio. The adequacy of scope of information should be reviewed on a periodic basis by business line managers, senior management and the board of directors to ensure that it is sufficient to the complexity of the business.

1.1.3 Policies, procedures and limits

An institution's directors and senior management should tailor their risk management policies and procedures to the types of risks that arise from the activities the institution conducts. Once the risks are properly identified, the institution's policies and its more fully articulated procedures provide detailed guidance for the day-to-day implementation of broad business strategies, and generally include limits designed to shield the institution from excessive and imprudent risks. Institutions should have policies and procedures that address their significant activities and risks. To ensure that, an institution's policies, procedures, and limits are adequate, they should at minimum address the following; (i) Provide for adequate identification, measurement, monitoring, and control of the risks posed by its significant activities, (ii) Be consistent with complexity and size of the business, the institution's stated goals and objectives, and the overall financial strength of the institution, (iii) Clearly delineate accountability and lines of authority across the institution's activities, (iv) Provide for the review of activities new to the institution to ensure that the infrastructures necessary to identify, monitor, and control risks associated with an activity are in place before the activity is initiated.

1.1.4 Risk measurements and monitoring

Effective risk monitoring requires institutions to identify and measure all material risk exposures. Consequently, risk monitoring activities must be supported by information systems that provide senior managers and directors with timely reports on the financial condition, operating performance, and risk exposure of the institution, as well as with regular and sufficiently detailed reports for line managers engaged in the day-to-day management of the institution's activities. In order to ensure effective measurement and monitoring of risk and management information systems, the following should be observed; the institution's risk monitoring practices and reports address all of its material risks, key assumptions, data sources, and procedures used in measuring and monitoring risk are appropriate and adequately documented and tested for reliability on an ongoing basis, reports and other forms of communication are consistent with the institution's activities, structured to monitor exposures and compliance with established limits, goals, or objectives and, as appropriate, compare actual versus expected performance, and reports to management or to the institution's directors are accurate and timely and contain sufficient information for decision-makers to identify any adverse trends and to evaluate adequately the level of risk faced by the institution.

1.1.5 Comprehensive internal controls

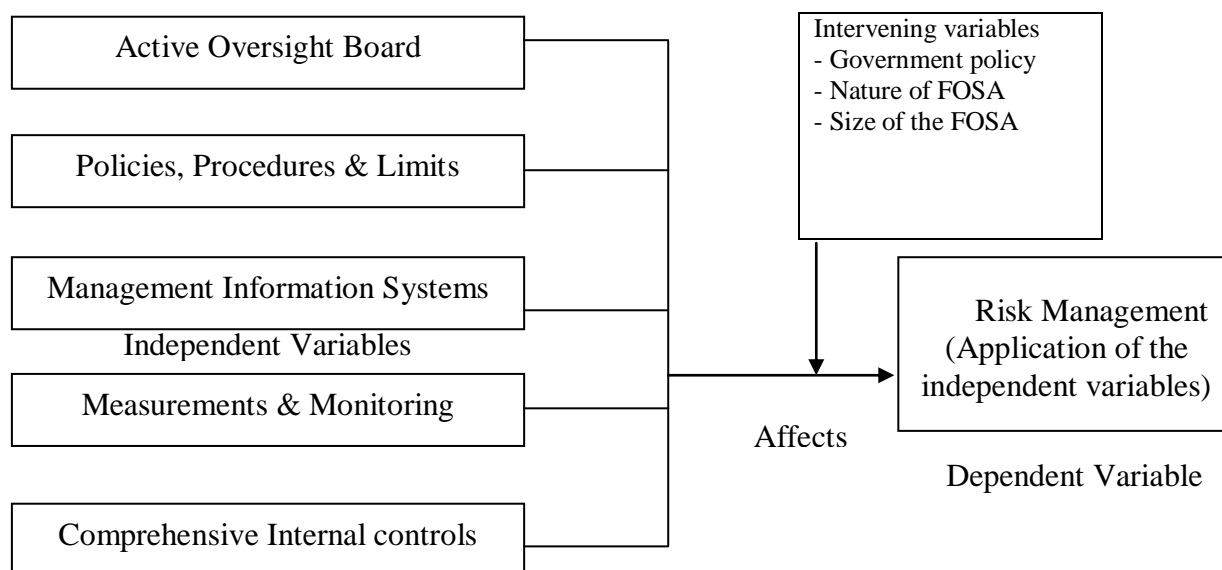
An institution's internal control structure is critical to its safe and sound functioning generally and to its risk management system, in particular. Establishing and maintaining an effective system of controls, including the enforcement of official lines of authority and the appropriate separation of duties such as trading, custodial, and back-office is one of management's more important responsibilities. Indeed, appropriately segregating duties is a fundamental and essential element of a sound risk management and internal control system. Failure to implement and maintain an adequate separation of duties can constitute an unsafe and unsound practice and possibly lead to serious losses or otherwise compromise the financial integrity of the institution. Serious lapses or deficiencies in internal controls, including inadequate segregation of duties, may warrant supervisory action. When properly structured, a system of internal controls promotes effective operations and reliable financial and regulatory reporting, safeguards assets, and helps to ensure compliance with relevant laws, regulations, and institutional policies. Internal controls should be tested by an independent internal auditor who reports directly either to the institution's board of directors or its audit committee. Given the importance of appropriate internal controls, the results of audits or reviews, whether conducted by an internal auditor or by other personnel, should be adequately documented, as should management's responses to them.

1.2 Statement of the Problem

The financial sector is the most volatile in the current financial crisis and for this reason, risk management is more important in the financial sector than in any other sectors (Carey, 2001). The ICAEW's policy document, *Entrepreneurship: The Key to Growing the SME Sector* (2011) stated: "SMEs place too little emphasis on risk management. The so called "lifestyle business" are not immune from common pitfalls and growing business are often highly vulnerable. Both require accessible and standardized tools that will identify risks and match them with appropriate techniques. Efforts have been undertaken by the Kenyan Ministry of Cooperative Development and Marketing (MoCDM) to reform the enabling environment for SACCOs. The SACCO Societies Act 2008, which passed into law requires deposit-taking SACCOs to meet strong regulatory standards and hence there is an urgent need for the 200 DTS to reform as they will be the first to be targeted by the regulation. (FSD, 2010). There is need therefore for more robust management information systems which will enable SACCOs to manage their operations more efficiently, manage growth, and generate reliable reports for both management and the forthcoming regulatory authority. Oldfield and Santomero (1997) pointed that adequate risk management systems require substantial firm-level commitment. Risk

exposures must be identified, measured and managed. This study was geared towards finding out whether DTS have such mechanisms to manage financial risks.

The specifically the study sought to establish whether DTS employ oversight board, management information systems, policies, procedures & limits, use risk measurements & monitoring and internal controls in financial risk management.



Source: Researcher 2012

RESEARCH DESIGN AND METHODOLOGY

Descriptive design was used in this study. According to Saunders et al (2009), it portrays an accurate profile of persons, events or situations. Descriptive research determines and reports the way things are. It attempts to describe such things as possible behavior, attitudes, values and characteristics (Mugenda and Mugenda, 2003). Thus, this approach was appropriate for this study, since the study intended to collect detailed information through descriptions and is useful for identifying variables.

Target population consists of all members of a real or hypothetical set of people events or objects from which a researcher wishes to generalize the results of their research (Babbie, 2004). Mugenda and Mugenda, (2008) observed that target population should be explicitly and unequivocally defined, otherwise statements about the target population after the analysis of data will not be trustworthy. The target population for the study was all DTS in Nairobi County. Data was collected from all DTS in Nairobi County. The data was collected from the risk managers/managers in the various DTS in the target population. The target population was sufficiently small and finite. The researcher conducted a census. Data was collected from every member of the population.

Data Collection Procedure

Primary data was collected using the questionnaire while the secondary data was collected from the records of SASRA. The researcher used the drop and pick method to administer the questionnaire. The questionnaire had closed ended questions. Questionnaires provide an efficient way of collecting responses from a large sample prior to quantitative analysis. (Saunders et al 2000)

Data Analysis and Interpretation

The data collected was analyzed using descriptive statistics. Descriptive statistics involves methods such as the distribution tables, mean, median, mode, standard deviation and variance. Data obtained was coded, organized and presented using frequency tables and percentages. The Scientific package for Social Sciences program was used to analyze the data.

RESULTS

Table 4.1: response rate

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid successful	38	86.4	86.4	86.4
unsuccessful	6	13.6	13.6	100.0
Total	44	100.0	100.0	

According to Mugenda and Mugenda (1999) a 50% response rate is adequate, 60% good and above 70% rated very good. This implies that basing on this assertion; the response rate of the study of 86.4% is very good.

Financial Risk Management**Table 4.2: chances of suffering financial risk**

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid agree	34	89.5	89.5	89.5
disagree	4	10.5	10.5	100.0
Total	38	100.0	100.0	

From the above table 89.5% of respondents agree that there are high chances of DTS suffering financial risks and 10.5% disagree.

Table 4.3: strategies used by FOSA SACCOs in financial risk management

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid agree	38	100.0	100.0	100.0

From the above table all the respondents agree that there are many strategies that can be used in financial risk management

Use of an active oversight board in financial risk management**Table 4.4: importance of oversight board**

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid agree	38	100.0	100.0	100.0

All the respondents agree that oversight boards are important in financial risk management.

Table 4.5: presence of oversight board

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid agree	22	57.9	57.9	57.9
disagree	14	36.8	36.8	94.7
n/a	2	5.3	5.3	100.0
Total	38	100.0	100.0	

From the table above, 57.9% of the respondents agree that DTS have oversight boards while 36.8% of the respondents say that they don't have oversight boards and 5.3% gave a N/A response.

Use of financial risk management information systems**Table 4.6: importance of financial risk management systems**

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid agree	35	92.1	92.1	92.1
disagree	2	5.3	5.3	97.4
n/a	1	2.6	2.6	100.0
Total	38	100.0	100.0	

Most of the respondents, 92.1% agree that financial management information system assist in financial risk management. 5.3% disagree while 2.6% did not know. This indicates that financial risk management information systems are very important in the risk management of FOSA SACCOs

4.7: presence of financial risk management system

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid agree	14	36.8	36.8	36.8
disagree	24	63.2	63.2	100.0
Total	38	100.0	100.0	

From the above table, 63.2% of the respondents don't use financial risk management systems while only 36.8% of the FOSAs use the financial risk management systems.

Use of policies, procedures and limits**Table 4.8: importance of policies, procedures and limits in financial risk management.**

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid agree	35	92.1	92.1	92.1
disagree	3	7.9	7.9	100.0
Total	38	100.0	100.0	

From the table above, 92.1% agree that policies, procedures and limits are important in financial risk management while 7.9% disagree.

Table 4.9: presence of policies, procedures and limits in financial risk management.

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid agree	35	92.1	92.1	92.1
disagree	3	7.9	7.9	100.0
Total	38	100.0	100.0	

From the table above, 92.1% of the FOSA SACCOS use policies, procedures and limits in financial risk management. 7.9% do not use them in financial risk management.

Use of risk measurements and monitoring strategies**Table 4.10: importance of risk measurements and monitoring**

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid agree	31	81.6	81.6	81.6
disagree	5	13.2	13.2	94.7
n/a	2	5.3	5.3	100.0
Total	38	100.0	100.0	

81.6% of the respondents agree that risk measurements and monitoring strategies are an important aspect of financial risk management. 13.2 % do not agree while 5.3% neither agree nor disagree.

4.11: presence of risk measurement and monitoring

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid agree	15	39.5	39.5	39.5
disagree	21	55.3	55.3	94.7
n/a	2	5.3	5.3	100.0
Total	38	100.0	100.0	

From the above table, 39.5% of DTS use risk measurements and monitoring strategies in financial risk management, 55.3% don't use risk measurements and monitoring strategies and 5.3% do not know.

Use of comprehensive internal controls**Table 4.12: importance of comprehensive internal controls**

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid agree	33	86.8	86.8	86.8
disagree	5	13.2	13.2	100.0
Total	38	100.0	100.0	

From the above table 86.8% of respondents agree that comprehensive internal controls are important in financial risk management. 13.2% disagree that comprehensive internal controls are important in risk management.

4.13: presence of comprehensive internal controls

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid agree	33	86.8	86.8	86.8
disagree	5	13.2	13.2	100.0
Total	38	100.0	100.0	

From the above table, 86.8% of respondents said that FOSA SACCOs use comprehensive internal controls in financial risk management. 13.2% said that they do not use comprehensive internal controls in financial risk management.

DISCUSSION

The study was seeking to find out whether DTS have an active oversight board to assist in financial risk management. From the findings, all respondents, 100% said that oversight boards are important in financial risk management. However, the findings revealed that 57.9% of the DTS use oversight boards while 36.8% said that they don't use oversight boards in financial risk management, 5.3% took a neutral position. These findings show that most DTS have an active oversight board to assist in financial risk management.

The researcher conducted the research to answer the question, "Do DTS use financial risk management information systems in financial risk management?" Most of the respondents, 92.1% agreed that financial management information system assist in financial risk management. 5.3% disagreed while 2.6% did not know. This indicates that financial risk management information systems are very important in the risk management of DTS.

From the findings on applicability, 63.2% of the respondents don't use financial risk management systems while only 36.8% of the DTS use the financial risk management systems in financial risk management. This indicates that this strategy is not widely used in most of the DTS in financial risk management. This may be attributed to the high cost of instituting the system in the organization.

The study was seeking to find out whether DTS use policies, procedures and limits in financial risk management. The respondents indicated an overwhelming support on the importance and use of this strategy. 92.1% of the respondents said that policies, procedures and limits are important in financial risk management and only 7.9% disagreed. Similarly, 92.1% of the DTS use policies, procedures and limits in financial risk management while 7.9% do not use them in financial risk management. This indicates that FOSA SACCOs use policies, procedures and limits in financial risk management.

The researcher wanted to establish whether DTS use risk measurements and monitoring strategies in financial risk management. From the findings, 81.6% of the respondents agreed that risk measurements and monitoring strategies are important for financial risk management and 13.2% do not agree while 5.3% neither agree nor disagree. On the applicability, 39.5% of DTS use risk measurements and monitoring strategies in financial risk management, 55.3% don't use risk measurements and monitoring strategies and 5.3% did not know. Although many respondents acknowledge that risk measurements and monitoring strategies are important few DTS are using it. This indicates few DTS use risk measurements and monitoring strategies in financial risk management.

The study focused on finding out whether DTS use comprehensive internal controls in financial risk management. The research findings indicate that 86.8% of respondents said that comprehensive internal controls are important in financial risk management while 13.2% disagreed. On the applicability, 86.8% of respondents said that DTS use comprehensive internal controls in financial risk management and 13.2% said that they do not use comprehensive internal controls in financial risk management. These findings indicate that most DTS use comprehensive internal controls in financial risk management.

CONCLUSION AND RECOMMENDATIONS

From the findings of this study, it can be concluded that DTS in Nairobi agree that active oversight board assist in financial risk management which helps to keep an eye on the financial occurrences of the organization and hence promoting proper management of financial risks.

Financial risk management information system helps to effectively and efficiently manage financial information and quick generation of information to manage risks in DTS. Though most DTS said that financial risk management systems are important most of the firms have not embraced it. The researcher hence concludes that this strategy should be explored and used by DTS.

From the findings of the research, most of the DTS make use of risk measurements and monitoring strategy in the management of financial risks and hence, it is one of the strategies used by DTS to manage financial risks.

Policies, procedures and limits define how the organization intends to carry out its tasks in management of financial risks. From the findings, it's one of the strategies widely used by DTS hence, use of policies, procedures and limits in a strategy used by DTS in the management of financial risks.

The research findings revealed that a comprehensive internal controls in financial risk management is a major strategies used by DTS.

RECOMMENDATIONS

The study recommends that to effectively manage financial risks, DTS need to have in place the strategies of effective oversight boards, financial risk management systems, proper policies, procedures & limits, comprehensive

Internal control and measurements and monitoring.

SASRA, the DTS regulating body should develop unified strategies and enforce their application across all DTS. This should be done in consultation with all relevant bodies. Sensitization should be done through education forum and updating of strategies conducted from time to time.

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