Full Length Research Paper

Corporate governance and the financial performance of savings, credit and corporative societies

George Ndiwalana  Johnson Ssekakubo  Freddie Lwanga

1Department of Accounting Makerere University Business School  2Department of Management Science Makerere University Business School  3Department of Human Resource Management Makerere University Business School

Corresponding author email: kimayoka@gmail.com

Abstract

This study focused on examining the relationship between Corporate Governance and Financial Performance of Savings, Credit and Corporative Societies in Uganda. The motivation of this study was the fact that the Government of Uganda and other stakeholders had directed their effort towards enhancing good Corporate Governance in Savings, Credit and Corporative Societies. Despite this, Savings, Credit and Corporative Societies in Uganda showed declining financial performance. A cross sectional research design was used for the research study. The population included 69 Savings, Credit and Corporative Societies from which a sample of 59 Savings, Credit and Corporative Societies was obtained. A simple random sampling technique was used. Primary data was obtained from 51 Savings, Credit and Corporative Societies, providing a response rate of 86%. The data were collected using a self administered questionnaire with perceptions and beliefs sought to a five point Likert scale. The data obtained were analyzed using factor, correlation and regression analyses. From the analyses, it was established that, Corporate Governance has no significant effect on the financial performance of these Savings, Credit and Corporative Societies. In reference to the findings of the Study, the researcher concluded that there is no relationship between Corporate Governance and the Financial Performance.

Keywords: Corporate Governance, Financial Performance, SACCOS, Financial institutions

INTRODUCTION

There has been renewed interest in the corporate governance practices of modern corporations since 2001. This is particularly due to the high-profile collapses of a number of large corporations such as Enron Corporation and MCI Inc. (formerly WorldCom) in the United States of America; HIH and One. Tel in Australia; and Parmalat in Italy. In Uganda, the collapse of banks like Greenland bank, Uganda Corporative bank and International Credit bank was linked to poor corporate governance practices (Matama,2008). Based on these facts, it is important that Savings, Credit and Cooperative Societies(SACCOS) embrace corporate governance in order to survive in business.

Corporate governance is the system by which companies are directed and controlled (Cadbury Committee, 1992). It exists to resolve the conflict of interest between managers and shareholders which is purely a principal-agent problem arising out of separation of ownership and control (Bushman & Smith, 2003, Coase, 1937, Jensen & Meckling, 1976, Fama & Jensen, 1983, Williamson, 1985, Aghion & Bolton, 1992, Hart, 1995).

Available studies show that corporate governance has varying significance on the financial performance of an organization (Romano, Roberta, Bhagat, Sanjai & Brian, 2008; Chen & He, 2008; Chalhoub, 2009, Sueyoshi, Goto & Omi, 2010, Mehdi, 2007, Brown & Caylor 2009; Gürbüz’, Aybars & Kutlu, 2010, Kumar, 2005). Corporate governance significantly affects financial performance. This can be through; lower cost of capital (Black, Jang & Kim, 2006); lower cash operating expenses (Ashbaugh, Collins, & LaFond 2004); competitiveness (Kaheeru, 2001); corporate reputation (Edelman, 2010); and resource allocation (Maher & Andersson, 1999). From the
study conducted by Murphy & Poist, (1994); managerial competency is one of the rare, valuable, and difficult to imitate resources to enable firms to attain superior performance. It involves knowledge, skills, personal traits and abilities (Gatewood & Field, 1994, Kerr & Werther, 2008, MacDuffie, 1995, Batt 2002; Levine & Toyson, 1990; Ahmad & Schroeder, 2003), which are predictors of success in the job that in turn affect the firms' performance. Morishima (2006) provides a relationship between corporate governance, Managerial competency and financial performance where corporate governance influences Managerial competency through corporate management strategies that in turn influence improvement of the financial performance. Although rich empirical literature exists focusing on corporate governance and financial performance (Gatewood & Field, 1994, Kerr & Werther, 2008, MacDuffie, 1995, Batt 2002; Levine & Toyson, 1990; Ahmad & Schroeder, 2003), which are predictors of success in the job that in turn affect the firms' performance. Morishima (2006) provides a relationship between corporate governance, Managerial competency and financial performance where corporate governance influences Managerial competency through corporate management strategies that in turn influence improvement of the financial performance. Although rich empirical literature exists focusing on corporate governance and financial performance Morishima (2006), little has been done to examine corporate governance and financial performance of Savings, Credit and Corporative Societies.

According to the Fin Scope Uganda Study Report of 2007, 62% of Uganda's population had no access to financial services. The highest proportion of the un served population comes from the Eastern (Busoga inclusive) part of the country (Ministry of Finance, Planning and Economic Development -MOFPED, 2000). SACCOs were adopted by Government of Uganda as a means through which the rural Communities could access financial services. This is so because SACCOs present one of the most appropriate ways and in some places the only alternative, to serve the non served population (SNV report, 2010). In order to implement the above, the Government of Uganda initiated a new Rural Financial Services Strategy through which the Rural Finance Services program (RFSP) was “born” in order to build a strong and vibrant SACCO movement. (http://www.ucscu.co.ug). The focus of RFSP is building a SACCO movement that is financially self sustainable. Good corporate governance and managerial competency have been the focal point for building profitable and self sustaining SACCOs (http://www.rfspug.org). The purpose of this study was to establish the relationship between corporate governance and the financial performance of the SACCOs in Uganda.

**Corporate governance and financial performance**

Available research studies on Corporate Governance and Financial performance indicate that firms with better corporate governance tend to enjoy lower cost of capital (Black et al.2006), lower Cash Operating Expenses (COE) (Ashbaugh, Collins, & LaFond 2004). Lower COE improves the profitability of a firm. In Piprek (2007), the main constructs of financial performance are portfolio quality and profitability.

According to Miller (2011), firms that utilize governance tools more stringently to control agency costs will command greater contracting cost advantages, leading them to specialize in business with greater managerial discretion. Owing to the fact that Managers' pursue perquisite consumption instead of maximizing shareholder wealth when they are authorized to take discretionary actions, (Williamson, 1964, Jensen, 1986 and Stulz, 1990) argue that firms should reduce free cash flow under the discretionary control of managers so that they have fewer opportunities to undertake unprofitable investments. Myers & Smith (2010) find a stronger complementary relation between board independence and pay-for-performance among managers.


From the above, it is clear that the relationship between corporate governance and firm performance has received considerable attention with results showing significant relationship between the two.

However, (Dallas, 2011) notes that country-specific research on emerging markets has delivered mixed results, suggesting that empirical evidence on the relationship between corporate governance indicators and firm performance in emerging markets is inconclusive.

In addition, (Ponu, 2008) results from a study on Corporate Governance Structures and the Performance of Malaysian Public Listed Companies show that there is no significant relationship between corporate governance and company performance. Similar findings were obtained from Latona (2011), where it was found out that there is no difference in performance for companies having poor and excellent corporate governance. Hence no significant relationship was found between corporate governance and financial performance.

The above results indicate an inconclusive debate on the relationship between corporate governance and financial performance.

**Research design**

The researcher used a cross sectional research design. Data obtained from the respondents was collected at one point in time (Olsen and George, 2004).

**Study population**

The study population used for this research study included 69 SACCOs. These were the operating SACCOs in Uganda that received funds from Uganda Microfinance Finance Support Centre. The list from which
Table 1. Sample Characteristics

<table>
<thead>
<tr>
<th>Variable (N=51)</th>
<th>Description</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Designation</td>
<td>Accountant</td>
<td>3</td>
<td>5.9</td>
</tr>
<tr>
<td></td>
<td>Manager</td>
<td>32</td>
<td>62.7</td>
</tr>
<tr>
<td></td>
<td>Board member</td>
<td>16</td>
<td>31.4</td>
</tr>
<tr>
<td>Sex</td>
<td>Male</td>
<td>28</td>
<td>54.9</td>
</tr>
<tr>
<td></td>
<td>Female</td>
<td>23</td>
<td>45.1</td>
</tr>
<tr>
<td>Education level</td>
<td>Certificate</td>
<td>1</td>
<td>2.0</td>
</tr>
<tr>
<td></td>
<td>Diploma</td>
<td>34</td>
<td>66.7</td>
</tr>
<tr>
<td></td>
<td>Degree</td>
<td>15</td>
<td>29.4</td>
</tr>
<tr>
<td></td>
<td>Other</td>
<td>1</td>
<td>2.0</td>
</tr>
<tr>
<td>Years SACCO has been in operation</td>
<td>Over 5</td>
<td>1</td>
<td>2.0</td>
</tr>
<tr>
<td></td>
<td>2-5</td>
<td>33</td>
<td>64.7</td>
</tr>
<tr>
<td></td>
<td>Less than 2</td>
<td>17</td>
<td>33.3</td>
</tr>
<tr>
<td>Funds pool of the SACCO</td>
<td>More of shareholder capital</td>
<td>18</td>
<td>35.3</td>
</tr>
<tr>
<td></td>
<td>More of debt</td>
<td>33</td>
<td>64.7</td>
</tr>
<tr>
<td>Number of Board members</td>
<td>Less than 5</td>
<td>10</td>
<td>19.6</td>
</tr>
<tr>
<td></td>
<td>5-7</td>
<td>41</td>
<td>80.4</td>
</tr>
<tr>
<td>Number of employees</td>
<td>Less than 5</td>
<td>30</td>
<td>58.8</td>
</tr>
<tr>
<td></td>
<td>5-10</td>
<td>21</td>
<td>41.2</td>
</tr>
</tbody>
</table>

Source: Primary data

This population was obtained was got from Uganda Microfinance Support Centre - Iganga Zonal office (MSC-Iganga Zonal Office, monthly report, 31st March, 2011).

Sample design

Simple random sampling technique was used to determine the study sample. Krejcie and Morgan (1970) table of sampling was used to select 59 SACCOS from a population of 69 SACCOS. One respondent was selected purposively from each SACCO. The selected respondent had to be of the legal age of \( \geq 18 \) years, and knowledgeable about the operations of the SACCO. In most cases, a staff member was preferred.

Data collection and analysis

Data were collected using questionnaire. The collected data were sorted, coded, entered into SPSS software and analyzed. Descriptive statistics, correlation and regression analysis methods were used to analyze the data.

Findings

Background characteristics

The background information about SACCOS in Uganda and the respondents was obtained. The results are shown in table 1. In reference to table 1 above, most of the SACCOS have been in operation between two and five years (64.7%), 2% have operated for more than five years and the rest have operated for less than two years (33.3%). Most of the SACCOS operate using more of debt than equity (64.7%) as compared to 35.3% of those operating with more equity than debt. The results also show that 19.6% of the SACCOS have less than five board members and 80.4% have five to ten board members. As regards to the number of employees, 58.8% have less than five employees and 41.2% have five to ten employees.

Concerning the individual characteristics of the respondents, majority were male (54.9%) as compared to the female (45.1%). More of the respondents were Managers (62.7%), followed by Board members (31.4%) and accountants (5.9%). This implies that the researcher obtained data from the target respondents. Regarding their education level, 66.7% had diploma, 29.4% had degree and 4% had certificate and other qualifications.

Factor analysis

In trying to understand the outstanding factors in corporate governance and managerial competence, a factor analysis was done. Factor analysis also helped in compression of the data and presents an understanding
Table 2: Factor analysis for corporate governance

<table>
<thead>
<tr>
<th></th>
<th>Board performance</th>
<th>Transparency</th>
<th>Board composition</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Board commits resources to achieve the Mission of the SACCO.</td>
<td>.863</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The Board has regular meeting to review performance of the SACCO and guide on the way forward.</td>
<td>.844</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The Board is committed to the Strategic Vision and Mission of the SACCO.</td>
<td>.825</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The Board makes strategic decisions relating to best practices within the industry.</td>
<td>.821</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The Board appoints the SACCO Manager, monitors and checks to ensure that he acts in the best interest of the SACCO.</td>
<td>.821</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The Board regularly identifies the Strength of, opportunities available, the weaknesses and threats to the SACCO and maps a strategic direction to take.</td>
<td>.781</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The Board checks excesses that would promote personal interests of managers</td>
<td>.775</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The Board puts in place financial performance measures regarding the strategic objectives of the SACCO.</td>
<td>.753</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The Board cautiously supervises the work done by Management.</td>
<td>.746</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The Board identifies with and relates to networks that help the SACCO achieve superior financial performance</td>
<td>.743</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The Board ensures that there is continuity through succession planning.</td>
<td>.739</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The Board delegates to and rewards management for superior performance.</td>
<td>.734</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The Board ensures that Management puts in place all necessary controls to safeguard all SACCO resources.</td>
<td>.731</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The Board always operates in the best interest of shareholders.</td>
<td>.723</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The Board takes corrective action on adverse financial performance</td>
<td>.715</td>
<td></td>
<td></td>
</tr>
<tr>
<td>There is honesty in all information the SACCO management disseminates to stakeholders.</td>
<td>.849</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The information provided by the SACCO to its stakeholders is complete without omitting any material facts.</td>
<td>.794</td>
<td></td>
<td></td>
</tr>
<tr>
<td>All the information the SACCO management disseminates to its stakeholders is timely and relevant for decision making.</td>
<td>.727</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The SACCO management is open in all information it disseminates to stakeholders.</td>
<td>.726</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The responsibility for action is clearly indicated in the minutes arising from the proceedings of the SACCO meetings.</td>
<td>.724</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The SACCO management provides detailed information on its portfolio quality to its members in the shareholders meetings.</td>
<td>.715</td>
<td></td>
<td></td>
</tr>
<tr>
<td>All stakeholders obtain all necessary information from the SACCO to help them make informed decisions.</td>
<td>.714</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The board composition compares to the diversity makeup of the SACCO's employee base and maintains a diversity policy.</td>
<td>.898</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The Board of the SACCO provides the right mix of skills and knowledge to manage the SACCO.</td>
<td>.805</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Board members have expertise in Banking, Micro Finance, Accounting and Finance.</td>
<td>.718</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Eigen Values</td>
<td>14.657 8.165 5.795</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Variance (%)</td>
<td>28.186 15.702 11.144</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cumulative Variance (%)</td>
<td>28.186 43.888 55.032</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Primary data

The results of factor analysis for corporate governance were obtained and presented in table 2. Table 2 shows that corporate governance of the SACCOS in Uganda was explained by three factors. These included Board performance, Transparency and Board composition.

The important factors to address under board performance included: committing resources to achieve the Mission of the SACCO (.863), having regular meetings to review performance of the SACCOS and...
guide on the way forward (.844), being committed to the Strategic Vision and Mission of the SACCO (.825), making strategic decisions relating to best practices within the industry (.821), appointing and monitoring the actions of the SACCO Manager to ensure that s/he acts in the best interest of the SACCO (.821), regularly identifying the Strength of, opportunities available, the weaknesses and threats to the SACCO and map a strategic direction to take (.781), check excesses that would promote personal interests of managers (.775), putting in place financial performance measures regarding the strategic objectives of the SACCO (.753), cautiously supervising the work done by Management (.746), identifying with and relating to networks that help the SACCO achieve superior financial performance (.743), ensuring that there is continuity through succession planning (.739), delegating to and rewarding management for superior performance (.734), ensuring that Management puts in place all necessary controls to safeguard all SACCO resources (.731) and operating in the best interest of shareholders (.723).

Results on transparency show that the important elements to consider include:- honesty in all information the SACCO management disseminates to stakeholders (.849), completeness without omitting any material facts of the information provided by the SACCO to its stakeholders (.794), timeliness of all the information the SACCO management disseminates to its stakeholders to make it relevant for decision making (.727), openness in all information the SACCO management disseminates to the stakeholders (.726), clearly indicating the responsibility for action in the minutes arising from the proceedings of the SACCO meetings (.724), providing detailed information on the portfolio quality of the SACCO to its members in the shareholders meetings (.715) and the need for all stakeholders to obtain all necessary information from the SACCO to help them make informed decisions (.714). The important elements under Board composition included: - the board composition comparing to the diversity makeup of the SACCO’s employee base and maintaining a diversity policy (.898); the Board of the SACCO providing the right mix of skills and knowledge to manage the SACCO (.805) and Board members having expertise in Banking, Micro Finance, Accounting and Finance (.718)

Relationships between the variables

In order to understand the relationship between corporate governance, managerial competency and financial performance, correlation analysis was done.

Correlation analysis

Correlation analysis helped to establish the relationship between corporate governance, managerial competence and financial performance. The results that were obtained are presented in table 3.

Source: Primary data

Relationship between corporate governance and financial performance

Lastly the correlation analysis as summarized in table 3 shows a positive relationship between corporate governance and financial performance \( r = .546 \) \( p<.01 \). This indicates that better corporate governance is positively associated with better financial performance of SACCOS in Uganda. Likewise, poor corporate governance is associated with poor financial performance of these SACCOS. In other words, it means that an improvement in the board performance, transparency and board composition of these SACCOS is positively associated with an improvement in their profitability and portfolio quality.

Regression analysis

In order to establish the extent to which the variance in financial performance of SACCOS in Uganda is explained by corporate governance, regression analysis was done. The results that were obtained are presented in table 4.

Results in table 4 indicate that corporate governance only explain 37% \( (R^2 = .371) \) of the variance in the financial performance of the SACCOS in Uganda. This implies that 63% of the variance in financial performance is explained by other factors outside the model used.

Results in table 4 indicate that the effect of corporate governance on the financial performance of the SACCOS is insignificant \( (\beta = .057, p>.05) \). This implies that the
Table 4. Regression analysis

<table>
<thead>
<tr>
<th></th>
<th>Un standardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>T</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
</tr>
<tr>
<td>(Constant)</td>
<td>1.926</td>
<td>.256</td>
<td></td>
<td>7.500</td>
</tr>
<tr>
<td>Corporate Governance</td>
<td>.048</td>
<td>.200</td>
<td>.057</td>
<td>.238</td>
</tr>
</tbody>
</table>

Dependent Variable: Financial Performance

R Square: .371
Adjusted R Square: .345
F Statistic: 14.141
Sig. (F Statistic): .000

Source: Primary data

effect of corporate governance on the financial performance of these SACCO is insignificant.

These results further indicate that the regression model was also well specified (F = 14.141, P <.01). This implies that these outcomes from the model are reliable.

DISCUSSION OF FINDINGS

Relationship between corporate governance and financial performance

The finding from this study indicates an insignificant positive relationship between corporate governance and the financial performance of SACCOS in Uganda. As such, it does not significantly matter how good the Board performance, the transparency and board composition of these SACCOS are for them to improve their financial performance. The effort that the Government of Uganda and other stakeholders put in to enhance corporate governance among these SACCOS will not significantly improve their financial performance.

This finding is contrary to the studies by Miller (2011); Ashbaugh, Collins, & LaFond (2004), Jensen (1986) and Black et al., (2006) and various studies most of which are from the developed economies which found a significant positive effect of corporate governance on financial performance.

On the other hand, the same results are in agreement with similar findings which were obtained from Latona (2011) study where it was found out that there is no difference in performance for companies having poor and excellent quality of governance. Hence no significant relationship was found between corporate governance and financial performance. This is in agreement with results in Ponu (2008) which show that there is no significant relationship between corporate governance structures and company performance.

As such, the researcher agrees with the finding from Dallas (2011) which is to the effect that country-specific research on emerging markets concerning corporate governance and financial performance delivers mixed results. Thus suggesting that empirical evidence on the relationship between corporate governance indicators and firm performance in emerging markets is inconclusive.

CONCLUSION AND RECOMMENDATION

Corporate governance has no significant relationship with the financial performance of SACCOS in Uganda. As such, the effort to build strong corporate governance among these SACCOS must be in line with strengthening their managerial competency. Therefore the found constructs from this study of board performance, transparency and board composition should be strengthened in bid to support the strength of managerial competency among these SACCOS.

Further studies should be done to establish the factors that explain 63% of the variance in the financial performance of SACCOS in Uganda. This is because it is important that all the factors affecting the financial performance of these SACCOS are addressed together in order to improve their financial performance.

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