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**ABSTRACT**

*The study critically analysed the effect of interest rate on financial performance of SACCOs. The paper was organized in different sections. In the first section the background of the study was discussed highlighting the conceptual review of the research variables. Then, the problem identification was discussed together with the significant and the scope of the study. In the second section, the study outlined the empirical review of the existing literature on the study variables, the critique of the literature reviewed and the eminent research gaps that warranted further study. In the next section, the study gave a brief of the methodology adopted. The study relied on document and literature reviews hence desktop research. Finally, the last section outlined the findings of the study, conclusions arising from the review of the empirical literature and recommendation for further study. The research also adopted a conceptual framework that guided the research on the study area.*

**Keywords:** Interest Rate, Financial Performance, SACCOS

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## INTRODUCTION

According to Crowley (2007), interest rate is regarded as the price paid by the borrower for the use of money borrowed from the financial institution or fee paid on borrowed asset. In other terms interest can be referred to as "rent of money". In a capitalistic society interest rates are very fundamental and are normally expressed as a percentage rate over the period of one year (Sayedi, 2013). As a price of money, interest rate reflects market information regarding expected change in the purchasing power of money or future inflation. Interest rates are derived from macroeconomic factors which are the study of the behaviour of the economy as a whole such as total output, employment levels, income and the interrelationship among diverse economic sectors (Karl, Ray, and Shannon, 2009).

Financial performance refers to as a measure of how well a firm uses assets in generating revenue. According to Almazari (2011), the common indicators of financial performance are Return on Investment (ROI), Return on Assets (ROA), value added and profitability margin. Different forms of assessment should be used in measuring financial performance. Some of these assessments include operation efficiency and level of service delivery. SACCO subsector financial performance is based on the financial data and information extracted from their audited financial statements and reports. It is a requirement in Kenya that SACCOs should register their audited accounts with the commissioner of Cooperative Development before presentation to members at the annual general meeting (SASRA, 2012).

Savings and Credit Cooperatives (SACCOs) form part of financial institutions in Kenya. Cooperative society can be defined as independent association of persons who are united voluntarily to meet their common cultural, economic needs and aspirations. The main aim of these societies is to pool scarce resources and eliminate the middlemen so as to achieve a common

goal (Republic of Kenya, 2008). The society provides short-term loans and encourages the habit of saving among members. Members of these organizations benefit from favorable terms catered to their needs as compared.

### Problem Statement

In Kenya, SACCOs play an important role in economic development since 63% of the Kenyan population is benefiting from the SACCOs activities either directly or indirectly (Republic of Kenya, 2013). SACCOs face competition from banks which provide loans and savings to members of the public at a cheaper price and with less collateral requirements. Kenya Union of Savings and Credit Cooperatives, KUSCCO (2009) study revealed that SACCOs in Kenya face a number of threats in leading business to its members. This has been attributed to high cost of borrowing from banks to finance SACCOs activities and difficulties in access of credit from banks. According to Auka and Mwangi (2013), SACCOs continue to face stiff competition as some of their members are seeking financial services from commercial banks due to relaxed lending policy and favourably low interest rates. Okundi (2011) also observed that SACCOs suffer challenges of their members preferring loans from commercial banks because the amount of loans rewarded to them by commercial banks is not pegged on savings as in the case of SACCOs. Since there was an empirical evidence that interest rate has a significant effect on financial performance (Ndegwa, Waweru and Huka, 2016; Kariuki and Ngahu, 2016; Ngumi, 2014; Khan and Sattar, 2014; Onyekachi and Okoye, 2013), a critical analysis of effect of interest rate on financial performance of SACCOs in Kenya was inevitable. This would help in developing a favourable interest rate for better performance of SACCOs that had been rocked with a number of challenges.

### Objective of the Study

The objective of the study was to critically analyze the effect of interest rate on financial performance of SACCOs in Kenya.

The significance of the study was that SACCO's management would benefit from the study empirical review since they would utilize the data to implement relevant interest rate policies to attract more members hence improves their financial performance. Sacco's customers would also benefit from the implementation of study findings due to improved access to financial services caused by favourable interest rate.

To investors, they would be able to determine the most appropriate time to make investments in SACCOs based on prevailing interest rates.

This study would be of significant to the government and macroeconomic policy makers since they would understand the relationship between the effects of interest rates on financial performances of SACCOs. Finally, the academia and researchers would benefit from the study gaps by conducting further studies to fill the gaps.

The study was limited to review of theoretical literature on interest rate and financial performance of SACCOs in Kenya. Desktop review of literature was undertaken by researcher based on reviews of previous theoretical and empirical literature. The findings and conclusion from the study were based on the previous findings.

## **LITERATURE REVIEW**

The section presented key empirical studies relating to interest rate and financial performance of SACCOs in Kenya. It also analysed the arising methodological weaknesses of the study and finally presented the inherent knowledge gaps.

### **Empirical Review**

#### **Interest Rate and Financial Performance**

Studies have been conducted in regard to interest rate and financial performance. A study by Onyekachi and Okoye (2013) sought to determine the influence of lending rate on the financial performance of

Nigerian Deposit Money Banks between 2000 and 2010. The study utilized time series analysis and found out that bank lending rate positively and significantly influenced the financial performance of Nigerian deposit money banks.

Khan and Sattar (2014) studied the impact of interest rate changes on the profitability of commercial banks operating in Pakistan during 2008-2012. The study used Pearson Correlation method to find out the relationship between interest rate and profitability. The study found out that increase in interest rate results to decrease in profitability of commercial banks. Ngumi (2014) studied the effect of lending interest rates on financial performance of deposit taking micro finance institutions in Kenya using ordinary least square method. It was found that interest rate plays an important role in improving financial performance of SACCOs.

Otuori (2013) did a study on the determinant factors of exchange rates and their effects on the performance of commercial banks in Kenya. The study found a highly correlation between import and export interest rates, inflation and exchange rates. This imply that manipulation of interest rates exert influence on inflation, exchange rates and currency values. Higher interest rates results to higher returns by lenders.

Holtgrave and Crosby (2003) conducted a study on the effect of banking behavior in Africa using linear regression analysis. The study revealed that interest rates charged by banks has a significant effect on lending behavior thus when interest rates are low, more people will be encouraged to borrow money from the banks. This study analyzed the banking behavior in Africa and interest rate emanates from the study findings as one of the factors affecting lending behavior.

Kariuki and Ngahu (2016) examined the effect of interest rates on loan performance of Microfinance Institutions in Naivasha Sub-County, Kenya. The study

used survey research design and found out that there was a strong relationship between interest rate and loan performance (loan repayment). The study revealed that customers default in short-term loan payment due to high interest rate attached to them as compared to long-term loan payment.

Ndegwa, Waweru and Huka (2016) carried out a study on the influence of interest rate on financial performance of Micro Financial Institutions (MFIS) in Imenti North Sub-county. The study adopted descriptive survey research design using correlation and regression analysis. The study revealed that interest rate changes affect the performance of the institutions. It was recommended that in order to increase the uptake of loans by the MFIS, they should charge interest rates within the range being charged by the commercial banks.

#### **Critique of Empirical Review and Research Gaps**

Khan and Sattar (2014) study was conducted in Pakistan thus generalization in Kenya may prove difficult. Profitability was used as a dependent variable leaving out other aspects of financial performance like ROE and ROA. Onyekachi and Okoye (2013) studied the influence of lending rate on the financial performance of Nigerian Deposit Money Banks between 2000 and 2010. A study in Kenya is of essence to compare these research findings. Also a study in SACCOs in other countries and in Kenya can be of importance so as to establish the effect of leading rates on financial performance.

Ngumi (2014) study coverage was in deposit taking SACCOs in Kenya thus the findings cannot be generalized to no-deposit taking SACCOs which provides a gap to be filled for generalization of the study findings in all the SACCOs in Kenya. Also the method used for the study was ordinary least square method thus it will be interesting to use a different approach for comparison of the study findings.

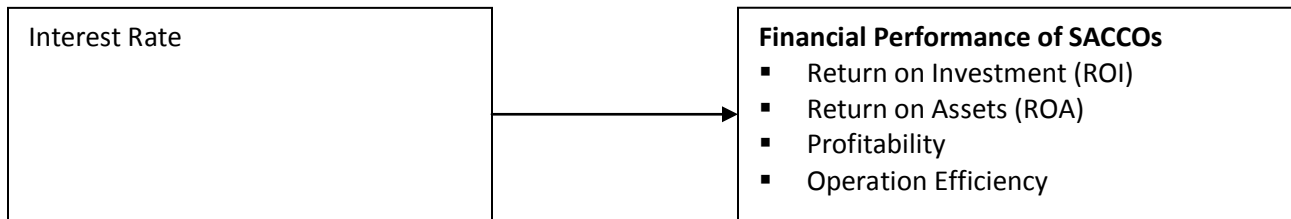
Otuori (2013) study generally analyzed exchange rates and effect on financial performance of banks

and limiting its findings to commercial banks which may not be applicable to SACCOs in Kenya. The study also failed short for examining interest rate and financial performance indicators like ROE, ROA and profitability but examined financial performance in general. Holtgrave and Crosby (2003) study did not attach a lot of premium to interest rate and its effect on financial performance of SACCOs thus providing an eminent gap in the study area scope and study constructs.

Kariuki and Ngahu (2016) study scope was limited to microfinance institution with limited generalization to SACCOs. Also the study used loan performance as dependent variable thus the study findings cannot be generalized to other findings that used financial performance indicators of ROE and ROI. The area scope was also limited to Naivasha Sub-county thus cannot be generalized to study findings conducted in the entire republic of Kenya. Ndegwa, Waweru and Huka (2016) study was limited in scope to Imenti North Sub-county thus cannot be generalized to MFIS in Kenya. The study area of coverage was on MFIS and not in SACCOs thus conflicting results may be generated when the same study is conducted in SACCOs.

In general analysis of the above literature revealed that interest rate has a significant effect on financial performance. Revealed literature revealed different dimension of financial performance which was majorly profitability hence there was inadequacy in covering other elements of financial performance like ROA and ROE thus generating an eminent knowledge gap for future researchers. Also analyzed literature mainly concentrated in banks and micro finance institution with little if any emphasis placed on SACCOs thus there must be a deliberate act to study extensively effect of interest rate on Sacco's financial performance in Kenya. The empirical literature that analyzed SACCOs dealt majorly on Deposit Taking SACCOs in Kenya with little emphasis on non-deposit

taking SACCOs thus eminent gaps that need to be addressed.



**Independent Variable**

**Dependent Variable**

**Figure 1: Conceptualization on the relationship between Interest Rate and Financial Performance of SACCOs**

Source: Researcher Conceptualization (2021)

## METHODOLOGY

The researcher undertook document reviews. Conclusion and recommendation were based on the empirical reviewed of previous literature. The empirical studies were critically analyzed to generate glaring gaps in the study that formed the basis of researcher voice in the study.

## CONCLUSION AND RECOMMENDATIONS

Arising from the study empirical review and critique of the literature, it was noted that studies conducted on effect of interest rate on financial performance of SACCOs have eminent gaps which necessitate a future study. The gaps ranges from study scope, study areas, methodological issues like research design and data collection instruments. Most studies reviewed have been conducted in sectors such as microfinance and banks especially commercial banks both locally and internationally. Little if any to the researcher knowledge is known concerning SACCOs thus a need to focus on SACCOs. Regarding research design, most researchers have utilized descriptive survey research design hence a departure should be made by employing more intensive research design like

longitudinal, cross-sectional and correlational research design so as to make a comparison on the research findings. As far as method of data analysis is concern, a number of studies were based on regression and correlation, ordinary and least square, a mixed of method of data analysis is therefore necessary for a more elaborate research findings.

Arising from the study conclusions, it was recommended that;

- A study should be conducted on the effect of interest rate on financial performance of SACCOs in Kenya due to limited empirical evidence in the area. Particularly, the study should focus on research variables depicted in conceptual framework.
- The study to be conducted should employ mixed research design
- The scope of the study should be enhanced to cover wide areas
- Mixed method of data analysis should be employed so as to have an in-depth analysis of data obtained from the field.

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