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ABSTRACT

The study focused on the influence of Liquidity being a factor of financial distress on financial performance among Savings and Credit Co-operative Societies in Kakamega County. Sacco shareholders were posting a great challenge on financial performance due to their rigid stand towards revenue generation as a result this has led to mismanagement and poor investment decisions among SACCOs hence contributing to organization failure. The objective of the study was to investigate how liquidity influences the financial performance of SACCOs in Kakamega County. This study adopted a descriptive Survey research design. The target population was the employed managers of SACCOs in Kakamega County; Kenya. The study applied Krejcie Morgan approach for determination of the sample. Primary data was collected by use of self-administered structured questionnaires. The data collected was analyzed using descriptive statistics and inferential statistics. The findings were that liquidity was found to have a positive influence on Return on Equity. The study recommended that managers should be keen on the liquidity policies in their SACCOs. Members should invest ideas in the understanding of Liquidity to boost financial performance of SACCOs. The study recommended for further studies on similar variables in other different financial institutions but different analytical methods to be applied.

Key words: *Liquidity, Financial Distress Factors, Financial Performance*

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INTRODUCTION

Financial performance refers to a firm's general financial health over a certain time frame (Amalendu, Somnath & Gautam, 2011). In relation to Savings and Credit Cooperatives their financial performance are unique in their operations and any decisions regarding financial performance must be done in a unique way (Momanyi, 2014). According to Kariuki (2014) assessing the financial performance of a business allows decision makers to evaluate the results of business planning as well as activities in financial terms and as a result the entities overall financial health is increased over a certain time frame. The purpose of measuring financial performance is to give the organization high returns on the capital employed in the business (Ngui, 2010). According to Gruian (2010) financial performance is the composition of several factors including liquidity, capital structure and asset quality.Financially distressed firms are firms that are experiencing financial difficulties in maintaining their normal operations and in most severe conditions they are exposed to bankruptcy proceedings (Baharin & Sentosa, 2013). It is a condition when a company cannot meet (or has difficulties paying off) its financial obligations to its creditors. It occurs when operating cash flows are not sufficient to satisfy current obligations and the firm is forced to take corrective actions (Ray & Mahavidyalaya, 2011).

Recent history indicates that there have been several corporate failures throughout out the world. During these last years, the annual flow of failures of companies did not stop growing and this trend became more marked during the periods of world economic crisis of 2007-2008 (Sami, 2013). The world witnessed collapse of reputed institutions such as General Motors (2009), Swissair (2001), The CIT Group (2009), Conseco (2002), Pacific Gas & Electric Ltd (2001), Delta Air lines (2005), Parmalat (2003), Enron (2001) and WorldCom (2002) which were icons of corporate financial stability prior to filing for bankruptcy. Corporate financial distress has mainly been attributed to poor governance, severe competition, adverse economic factors and the capital structure and more so failure to honour the obligations due to illiquidity factors (Outecheva, 2007). Managerial incompetence is the most common reason for a company's distress and possible failure but the ultimate cause of failure is often simply running out of cash and other liquid funds (Aasen, 2011).There are two types of financial distress costs; direct bankruptcy costs and indirect bankruptcy costs. Direct bankruptcy costs include primarily legal and administrative costs while indirect bankruptcy costs reflect the difficulty of managing a company when it faces bankruptcy. Indirect costs are hidden and not as obvious as direct costs. Indirect costs are lost opportunities which the company misses as a result of a deteriorating solvency position. These costs are unobservable and difficult to estimate (Aasen, 2011).

According to Vuran (2009), the development and use of models of financial distress prediction can be very important in two different ways. First, as an early warning signal such models are very useful to managers, authorities to take corrective action. Second, such models can be useful in aiding decision making of firms by making prudent decisions on the utilization of their available cash and other resources. It must be noted that if early warning signals can be identified with the failing firms as a result of financial distress, it can deter managers from making poor investment decisions as well as helping them in implementing required actions that will help to offset possible future losses (Limam, 2011). Predicting failure as early as possible with sound accuracy enables firms to take action to reduce the costs of bankruptcy, avoid failure to all stakeholders and contribute towards the business and financial environment stability (Gharaibeh *et al.,* 2013).

Organizations financial performance is determined by liquidity and in this case liquidity describes the degree to which an asset or security can be quickly bought or sold in the market without changing the asset's price. It is therefore evident that inadequate

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liquidity or excess liquidity may be harmful to the smooth operations of the firm (Janglani & Sandhar, 2013). This affirms that the liquidity position of an organization is important and needs to be regulated. There are great repercussions of increased liquidity for financial institutions which leads to reduction of the organization ability to raise external finance (Uzhegova, 2010).It is certain that capital structure determines performance of a firm. C*apital structure* is how an organization finances its entire activities and growth through use of different sources of funds. While explaining capital structure it is important to note that debt comes in the form of bond issues or long-term notes payable, while equity is classified as common stock, preferred stock or retained earnings. Asset quality has been studied as a determinant of financial performance (Olando, 2012). The clarity and flow of all broad assets must be prioritized during rating. The quality of assets can be realized through loans, investments, real estate owned and assets that impact adversely on financial condition (Karagu & Okibo, 2014).

Savings and Credit Cooperative offers financial services focusing on assembling of funds and provision of manageable credit to its members who are both the owners and users. Furthermore SACCOs are member owned firms which encourage growth and lending responsibilities among members and have diversity across the globe (McKillop & Wilson, 2011). Barrales (2012) notes that through new constitutional framework, prudential wise policies have been introduced to direct SACCO's financial growth and development. The first Savings and Credit Co-operative Society was started in Germany in 1849. In 1850 in England, the idea was moved to North America, later moved to Canada in 1901 and then in the USA. This gained momentum in Europe, Canada, United States, Australia and Ireland. Globally there is an estimate of 100 million individual members of SACCOs (Savings Plus, 2010). The world Credit Union system has a combined savings of 1.5 trillion US$, and an asset base of 1.8 trillion US$ out of which 1.2 trillion US$ comprises of loan portfolio. The average global entry rate of the Credit Union system stood at 8.2 percent (World Co-operative Monitor, 2014).

SACCOs in Kenya can be grouped into financial and non financial cooperatives. Indeed SACCOs, with their wide scope of products and services, have given a big meaning to the financial sector in Kenya. Saccos in Kenya contribute to 45% of the country's GDP. According to SACCO Review (2017) in Kakamega County over 152 co-operative societies are spread across 12 sub counties of Kakamega County with 115 of these Saccos being active and 39 remaining dormant (Tavasi, 2017).

Statement of the problem

Studies developed on financial distress factors on financial performance of Kenyan SACCOs show a series of results (SASRA, 2012). According to Mvula (2013) poor asset quality and low levels of liquidity are the two major causes of institution failures. Over time, SACCOs have been trying to address liquidity as a financial distress factor since they have not been able to perform well financially but instead recorded losses (Olando, 2012). According to Ayano (2016) financial distress factors debate is exciting since they are dynamic through time to time and differ with the nature of operation of the firm from place to place. Losses in SACCOs have made it difficult for financial soundness and attainability of goals (Ndagijimana, 2014). There have been few debates on liquidity's influence on financial performance but still most of the SACCOs have not been performing well, hence such gives rise to a researchable gap that makes it necessary for examination of liquidity as a financial distress factor on financial performance in SACCOs.

Objective of the Study

The study investigated liquidity influence on financial performance of SACCOs in Kakamega County; Kenya. The study was guided by the following research hypothesis;

- **H_{01}**: There is no significant influence of Liquidity on financial performance of Banks in the County Government of Kakamega; Kenya

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LITERATURE REVIEW

Theoretical review

Liquidity Preference Theory

According to Bibow (2005) liquidity preference theory is the individuals' value for money for both the transaction of current business and its use as a store of wealth. The most common financial ratios that reflect the liquidity position of an institution are customer deposit to total asset and total loan to customer deposits and cash to deposit ratio (Ongore & Kusa, 2013). According to this theory one will sacrifice the ability to earn interest on money that they want to spend in the present, and that they want to have it on hand as a precaution. On the other hand, when interest rates increase, they become willing to hold less money for these purposes in order to secure a profit. Elgar (1999) state that one needs money because one has expenditure plans to finance. SACCOs need to be liquid for speculative, precautions motive and the transaction motive. Inadequate liquidity or excess liquidity may be dangerous to the smooth flow of the firm (Janglani & Sandhar, 2013).

Signalling theory

According to Ross, (1977) Signaling theory is generated based on the idea that capital structure of the firm may signal information of the firm to outside investors rather than insiders. In this case it is assumes that, unlike outsiders, insiders such as the owner-managers know the exact state of the firm. Signaling theory assumes that, unlike outsiders, insiders such as the owner-managers know the exact state of the firm (Ndung'u, 2010). Given that insiders know exact state of the firm in SACCOs they can easily tell what determines financial performance. In general, signaling theory is of little benefit to SACCOS since they are not public companies listed on a stock exchange and cannot signal information to potential investors in the capital markets (Hafizah Mat Nawi, 2015). In this case SACCOs will undergo liquidity problems. In contrast, outsiders view outstanding debt levels in firms favourably since high debt levels signal to outsiders that firms are of high quality. This is because these theories have some assumptions which rarely apply to the SACCO environment (Olando, 2014). Asymmetric information between owner managers and investors is a driver to signaling games where the amount of debt and the timing of new issues are viewed as a sign of the performance of the firm. Several indicators such as losses may send worrying signal to a SACCO. This problem will also lead to moral harm and increased selection problems (Akerlof, 1970).

Agency Theory

In the agency theory a contractual relationship is entered by two persons that are the principal and the agent so as to perform some service. This involves assigning some decision making authority to the agent by the principal (Jensen & Meckling, 1976). At the same time an agent is a person employed for the purpose of bringing his principal into a contractual relationship with a third party and does not make a contract on his own behalf (Wright & Oakes, 2002). This was directed at the person presenting the agency relationship. This is where one party delegated work to another party who performed the duty on behalf of the principal (Eisenhardt, 1989). This person is authorized to perform legal acts within his competence and not on his own behalf but for the principal. SACCO managers are the agents while the shareholders are the principles. The management of Saccos is expected to work on the interest of the shareholders rather than their own interests. The assets were solely under the care of agents who responds on behalf of management to avoid conflicts of interests.

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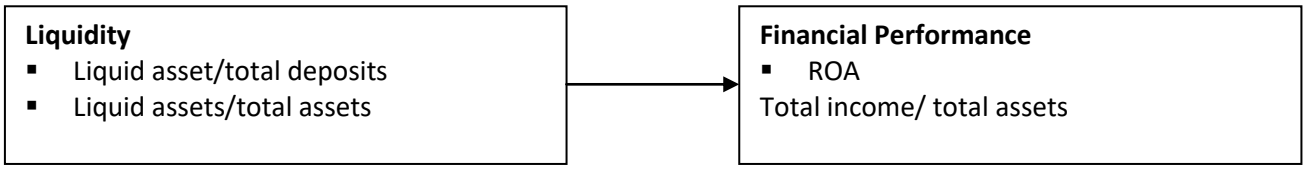

Figure 1: Conceptual Framework

Liquidity is how first you can get your hands on your cash (The Economic Times, 2014). This means that liquidity is to get your money whenever you need it. It is therefore the ability of a financial institution to fulfill its financial obligations. Liquidity is a key concern for financial institution and a short fall in liquidity would result into institution failure. The most common financial ratios that reflect the liquidity position of an institution are customer deposit to total asset and total loan to customer deposits and cash to deposit ratio (Ongore & Kusa, 2013).

Commercial lending institutions take liquidity as a vital management decision to the measurement of their needs related to the process of deposits and loans. Inadequate liquidity or excess liquidity may be dangerous to the smooth flow of the firm (Janglani & Sandhar, 2013). Funding sources evaporated during the recent financial crises due to uncertainty which made many financial institutions to find themselves less cash to cover their obligations as they came due (Bordeleau, 2010). There are high effects of increased liquidity for financial Institutions stating that even though more liquid assets increase the ability to raise cash on short notice, they also reduce management's ability to commit well to an investment strategy that protects investors which, finally, can arise in reduction of the firm's capacity to generate external funds (Uzhegova, 2010). However, Said and Mohd, (2011) affirms that liquidity level of financial institutions has no relationship with the performances of such institutions.

Earnings as well as savings greatly improve liquidity position of SACCOs. Ombado, (2010) asserts that SACCOs should strive to maximize on the earnings to build the institutional capital. SACCOs saving regulations are meant to set specific requirements on the instruments used to measure performance leading to a direct relationship (Ngui, 2010). The deposit and loan portfolio in SACCOs contributes to about thirty four percent of national savings. It is undisputable fact that loan demand by members has increased compared to minimal funds available, as a result SACCOs face a challenges emerging from liquidity shortage which has been a major cause of failure of many financial cooperatives (Sambasivam, 2013).

Investment opportunities set and cash holdings are recipes for liquidity. This is essential in management of liquidity in the organization and ensuring there is a balance between meeting the current obligation to solving liquidity short fall and investing in the interest of shareholders wealth maximization (Huseyin, 2011). Similarly, cash management is important for liquidity purposes and includes management of cash position, short-term borrowing, short term investing, cash forecasting. According to Huseyin (2011) cash management is important for operating transactions and financial transactions. It even becomes complicated when there is massive fraud of funds by SACCO leaders (Mugisa, 2010).

However, major challenge in access cash for liquidity purposes is due to emerging markets (Darek, 2012) and this is due to firms in emerging markets operating in an environment of imperfect legal structures (Cunningham & Rowley, 2010). There is funding liquidity risk that emerges which arises when it is prohibitively expensive both to borrow more funds and sell off its assets. Problems arise if both funding liquidity dries up high margins

and market liquidity evaporates fire sale discounts (Denis & Muganga, 2010).

METHODOLOGY

Descriptive research survey design was used to determine an association between the conceptualized independent and dependent variables as shown in the study's conceptual model. This study targeted 132 employees of SACCOs in the County Government of Kakamega; Kenya. A sampling frame is a list of all the items in the population (Cooper & Schinder, (2007). That is, it is a complete list of everyone or everything you want to study or a list of things that you draw a sample from. In this study it consisted of employees of SACCOs of the County Government of Kakamega; Kenya. The study employed Krejcie and Morgan Formula technique to determine a sample of 126 employees of SACCOs in the County Government of Kakamega; Kenya. Primary data was collected by means of self-administered questionnaires. The questionnaires had structured questions. These questionnaires were structured and designed in multiple choice formats. Section one introduced the researcher, topic of research and its purpose to the respondent.

Data collected from the field was coded, cleaned, tabulated and analyzed using both descriptive and inferential statistics with the aid of specialized Statistical Package for Social Sciences (SPSS) version 24 software. Descriptive statistics such as frequencies and percentages as well as measures of central tendency (means) and dispersion (standard deviation) was used. Data was also organized into graphs and tables for easy reference. Further, inferential statistics such as regression and correlation analyses was used to determine both the nature and the strength of the relationship between the dependent and independent variables. Correlation analysis is usually used together with regression analysis to measure how well the regression line explains the variation of the dependent variable. The linear and multiple regression plus correlation analyses were based on the association between two (or more) variables. SPSS version 24 is the analysis computer software that was used to compute statistical data.

Study conceptualized Regression Model;

$y = \beta_0+\beta_1X_1 + \varepsilon$

y = Financial Performance

β_0 = Constant

X_1= Liquidity

$\{\beta_1\}$ = Beta coefficients

ε = the error term

FINDINGS AND DISCUSSIONS

The response rate was 79.4% as 100 employees out of 126 turned up for the study. According to Kothari (2004) a response rate of above 50% is adequate for a descriptive study.

Descriptive Statistics

Descriptive statistics: Effect of liquidity on financial performance of SACCOs; 34% of respondents strongly agreed that there was effective SACCO regulations as noted by protection of members deposits, 30% of respondents strongly agreed that there was efficiency in cash management as always noticed by non occurrence of cash shortages. Therefore SACCOS has proper policies for financial performance. However respondents noted that there was efficiency in cash management as always noticed by non occurrence of cash shortages.

From the study 34% of respondents agreed that there was effective loan repayment policies therefore loan default in the SACCO is minimal. Furthermore 44% of respondents strongly agreed that there were competent managers who adhere to Credit administration policy. This concurs with Ombado, (2010) who asserts that SACCOs should strive to maximize on the earnings to build the institutional capital.

Inferential Statistics

Linear influence of Liquidity on Financial Performance

This tested the direct influence of Liquidity on Financial Performance of SACCOs in Kakamega County; Kenya.

The model summary shows that $R^2 = 0.268$; implying that 26.8% variations in the financial performance of SACCOs in the County Government of Kakamega; Kenya is explained by Liquidity while other factors not in the study model accounts for 73.2% of variation in financial performance in the County Government of Kakamega; Kenya. Further, coefficient analysis shows that Liquidity has positive significant influence on financial performance of SACCOs in the County Government of Kakamega; Kenya ($\beta = 0.956$ *at* $p<.01$). This implies that a single improvement in effective Liquidity will lead to 0.956 unit increase in the financial performance of SACCOs in the County Government of Kakamega; Kenya. Therefore, the linear regression equation is;

$Y_{distress} = 13.524 + 0.956$ Liquidity

From the regression equation it means that when liquidity increase by 1%, financial performance will decrease by 0.956 thus the relationship is positive and significant. The above result concurs with the one on correlation above as liquidity has a significant positive relationship with financial performance.

CONCLUSIONS AND RECOMMENDATIONS

The study concluded that liquidity as one of the financial distress factors was found to be the most influential on financial performance

The study concluded that SACCOs should embrace the idea of managing Liquidity properly if there has to be any improvement in financial performance.

Areas for further research

Similar study can be done on other organizations especially the other financial institutions using different methods of analysis for ease of comparison of the findings among institutions.

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