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Liquidity Regulation Compliance and Financial Performance of Deposit-Taking Savings and Credit Cooperative Societies.

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Abstract

Liquidity regulation is critical for ensuring the financial stability of Deposit-Taking Savings and Credit Cooperative Societies (DT SACCOs) in Kenya, which play a pivotal role in financial inclusion and economic empowerment. This article examines the effect of liquidity regulation on the financial performance of DT SACCOs, emphasizing compliance with the SACCO Societies Act of 2008. The study adopted a descriptive research design and analyzed secondary panel data from audited financial statements of 175 DT SACCOs over five years. Key metrics included cash ratio, loan-to-deposit ratio, and return on assets (ROA). The findings revealed that adherence to liquidity regulation significantly enhances financial performance, as indicated by a positive relationship between liquidity levels and profitability. However, challenges such as governance gaps and resource constraints hinder effective compliance. The study concludes that liquidity regulation improves operational efficiency, safeguards member deposits, and promotes financial stability. It recommends that DT SACCOs prioritize maintaining liquidity above the 15% threshold, adopt robust liquidity management strategies, and leverage regular audits to identify risks. These measures will not only strengthen financial performance but also enhance resilience to economic fluctuations. The findings contribute to understanding the critical balance between regulatory compliance and financial sustainability in the cooperative sector.

Keywords: *Liquidity Regulation, Financial Performance, Deposit Taking SACCOs.*

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Introduction

Deposit-Taking SACCOs (DT SACCOs) in Kenya play a critical role in promoting financial inclusion, particularly for underserved populations. These institutions mobilize savings and provide affordable credit, thereby facilitating economic empowerment at the grassroots level (Pasara et al., 2021). DT SACCOs operate within a highly regulated environment to ensure sound financial practices and protect member investments (Mudibo, 2015). As of 2021, Kenya had 174 licensed DT SACCOs, regulated by the SACCO Societies Regulatory Authority (SASRA), which oversees compliance with prudential guidelines (SASRA Report, 2020). Despite these regulatory measures, some SACCOs face liquidity challenges and governance gaps that compromise their financial performance (Ndonye & Ambrose, 2023). The financial performance of DT SACCOs is a measure of their ability to generate profits while maintaining financial stability. Key indicators include return on assets (ROA), net profits, and capital adequacy ratios (Kimathi, 2014). Financial performance directly impacts the ability of SACCOs to expand operations, attract members, and sustain long-term growth (Ndonye & Ambrose, 2023).

Liquidity regulation is a key component of financial oversight that ensures DT SACCOs to maintain adequate liquid assets to meet their immediate obligations. This regulatory framework aims to prevent liquidity shortages that could destabilize financial institutions, particularly during periods of economic uncertainty (Kimathi, 2014). By mandating liquidity thresholds, regulatory bodies such as Sacco Society Regulatory Authority (SASRA) encourage prudent cash flow management, helping DT SACCOs avoid fire sales of illiquid assets at unfavourable prices (Aduda & Obondy, 2020). The SACCO Societies Act of 2008 in Kenya, for instance,

requires deposit-taking DT SACCOs to maintain at least 15% of their savings and short-term liabilities in liquid assets, safeguarding member deposits and promoting financial stability (Sacco Societies Act, 2008). Effective liquidity regulation reduces systemic risks, instils confidence among members, and enhances resilience during financial crises (Mwangi, 2016). However, compliance challenges, such as poor governance and limited managerial capacity, often hinder the effective implementation of these regulations, particularly in developing economies (Ondieki, 2011).

Adequate liquidity ensures the ability of DT SACCOs to meet short-term obligations and invest in income-generating activities (Odhiambo, 2013). While stringent liquidity regulations can limit investment opportunities, they also reduce the risk of financial distress, leading to enhanced financial performance over time (Barus et al., 2017). Effective liquidity management, guided by regulatory compliance, balances these dynamics, promoting stability and profitability (Mwangudza et al., 2020). Strong financial performance also enhances a SACCO's capacity to meet liquidity and investment obligations, fostering trust among members and stakeholders (Muturi, 2015).

Statement of the Problem

Liquidity regulation is critical in ensuring the financial stability of Deposit-Taking SACCOs (DT SACCOs) by mandating sufficient liquid assets to meet short-term obligations and protect member deposits. Despite the implementation of prudential guidelines under the SACCO Societies Act of 2008 and subsequent regulations, many DT SACCOs in Kenya continue to face liquidity challenges, threatening their financial performance and long-term sustainability (Kioko, 2010; SASRA Report, 2020). Instances of financial distress, including liquidity shortages and governance failures, have resulted in some SACCOs being deregistered or placed under regulatory watch (Ondieki, 2011). Studies such as Kimathi (2014) and Odhiambo (2013) have acknowledged the role of liquidity regulation in enhancing SACCO operations but often fail to comprehensively address why compliance gaps persist and how they impact financial performance indicators like return on assets (ROA) and profitability. This persistent issue not only undermines member confidence but also hinders the ability of SACCOs to contribute effectively to financial inclusion and economic development. Therefore, a deeper exploration of the relationship between liquidity regulation and financial performance is necessary to identify compliance bottlenecks and recommend practical solutions for improving SACCO resilience and efficiency. This research extends the investigation of other studies on prudential regulation in the context of DT SACCOs and seeks to conduct a focused investigation into how liquidity regulation specifically influences the financial performance of DT SACCOs. The findings are expected to contribute to policy and practice of DT SACCO regulation and management.

Literature Review

This study is anchored on Liquidity Preference Theory by John Maynard Keynes (1936). The Liquidity Preference Theory explains the demand for liquidity and its impact on financial stability and performance. According to Keynes (1936), money is the most liquid asset, and financial institutions prefer to hold liquid assets to meet their short-term obligations, address unforeseen expenses, and capitalize on investment opportunities. For Deposit-Taking SACCOs (DT SACCOs), these motives are directly tied to their operational needs and financial stability. The theory posits that money, being the most liquid asset, is essential for meeting immediate obligations and capitalizing on unforeseen opportunities (Diamand, 2008). Liquidity regulation, as outlined in the SACCO Societies Act of 2008, requires DT SACCOs to maintain sufficient liquid assets to address these motives, ensuring they can meet member withdrawals and other short-term obligations (Sacco Societies Act, 2008).

Therefore, adhering to liquidity regulations, DT SACCOs reduce the risk of financial distress associated with liquidity shortages, thereby safeguarding their financial performance (Kimathi, 2014). When liquidity levels are appropriately maintained, SACCOs can optimize their transaction motive by fulfilling routine cash requirements and improve their precautionary motive by handling unexpected cash demands without destabilizing operations (Mwangi, 2016). Moreover, compliance with liquidity regulations enhances member confidence, indirectly boosting deposits and strengthening financial performance indicators like return on assets (ROA) (Muturi, 2015). Thus, the liquidity preference theory provides a robust framework for understanding how liquidity regulation influences the financial stability and growth of DT SACCOs.

Similar Studies

Empirical studies on the relationship between liquidity regulations and financial performance of Deposit-Taking Savings and Credit Cooperative Societies (DT-SACCOs) have yielded diverse findings. Liquidity regulations are

essential in ensuring that financial institutions, including DT-SACCOs, maintain sufficient liquid assets to meet short-term obligations and avoid liquidity crises (Odhiambo, 2013). Odhiambo (2013) investigated the link between working capital management and the financial performance of Deposit-Taking SACCOs in Nairobi County. The study highlighted that efficient liquidity management, measured by cash conversion cycles and current ratios, positively influenced financial performance. However, it did not comprehensively address the broader regulatory framework influencing liquidity decisions. A study conducted by Githaka, Kimani, and Gachora (2017) in Kirinyaga County found that SACCOs that actively monitored liquidity and maintained adequate cash reserves experienced improved financial stability and operational efficiency. However, their study was limited to one county, raising concerns about the generalizability of the findings to the national level. Similarly, Kabamba (2012) evaluated liquidity management strategies in Ugandan microfinance institutions and found a positive relationship between sound liquidity management practices and institutional growth. The study emphasized the importance of maintaining optimal liquidity levels to prevent financial distress and instil confidence among depositors. Muriuki and Ragui (2013) studied cash balance management approaches in SACCOs in Nakuru County, finding that many SACCOs lacked formal liquidity management policies, resulting in inconsistent financial performance. Additionally, Muriuki and Ragui (2013) observed that most SACCOs in Nakuru County lacked structured liquidity management policies, which resulted in inconsistent financial performance. While the study provided insights into liquidity practices, its lack of econometric modelling limited the understanding of the causal relationship between liquidity regulation and performance. Kimathi (2014) explored liquidity regulation and its influence on SACCO performance, noting a positive relationship between adherence to liquidity thresholds and financial performance. However, the study primarily used descriptive methods, limiting its ability to establish causality or analyze how different liquidity metrics interact to affect performance.

Methodology

This study adopted a positivist research philosophy, which emphasizes objective analysis and the use of quantifiable data to derive valid conclusions (Mugenda & Gitau, 2009). The research followed a descriptive research design, enabling the study to systematically describe the relationship between liquidity regulations and financial performance of Deposit-Taking Savings and Credit Cooperative Societies (DT-SACCOs) in Kenya. The descriptive design was chosen as it facilitates the collection, analysis, and presentation of empirical data to explain the effect of liquidity, capital, credit, and investment regulations on financial performance (Gatu et al., 2023). This approach is particularly relevant when examining cause-and-effect relationships in financial studies, ensuring clarity and replicability of findings (Pyrczak & Bruce, 2011).

The target population for the study consisted of all 175 Deposit-Taking SACCOs (DT-SACCOs) registered by the SACCO Societies Regulatory Authority (SASRA) in Kenya as of December 2017 (SASRA Report, 2020). Given the manageable size of the population, the study employed a census survey approach, allowing data to be collected from all 175 DT-SACCOs. Census sampling was chosen to ensure comprehensive coverage and to eliminate potential sampling bias (Kothari, 2011). This approach enhances the reliability and generalizability of the findings across the entire population of DT-SACCOs in Kenya (Waithaka, 2012).

The study utilized secondary data collection sheets to gather panel data from audited financial reports of DT-SACCOs spanning five years (2018–2022). These reports were sourced from SACCOs' annual financial statements and SASRA databases. Liquidity regulation was proxy measured using cash ratio and loan to deposit ratio, while financial performance was measured using Return on Assets (ROA). The study employed panel data regression analysis, which combines cross-sectional and time-series data, allowing for more robust analysis and improved estimation accuracy (Gatu, Njehia & Kimutai, 2023). Panel data is particularly useful for controlling unobserved heterogeneity and capturing dynamic relationships over time (Wooldridge, 2010). Pre-estimation diagnostic tests such as normality tests, multicollinearity tests, and unit root tests were performed to validate data suitability for analysis (Mwaniki, 2018).

Findings

Table 1 Descriptive Statistics

Stats	Cash Ratio	Loan to deposit ratio	ROA
Mean	1.95	2.26	3.78
Sd	1.50	0.68	2.36
Minimum	0.10	1.23	0.97
Maximum	17.14	3.46	12.33

As shown in Table 1, the Cash Ratio has a mean of 1.95 and a high standard deviation of 1.50, indicating significant differences in cash management practices, with values ranging from 0.10 to 17.14. The Loan to Deposit Ratio averages 2.26 with a smaller standard deviation of 0.68, reflecting moderate variability in how institutions balance loans and deposits, ranging from 1.23 to 3.46. Cash ratio and loan to deposit ratio suggest that while the SACCOs in the sample appear to maintain reasonable liquidity, they must carefully balance lending activities with cash reserves to avoid potential liquidity shortfalls in times of high demand. ROA has a mean of 3.78 and a standard deviation of 2.36, suggesting a wide spread in profitability, with values between 0.97 and 12.33, pointing to diverse levels of operational efficiency and financial performance across the sample.

Table 2 Summary of Pre-estimation Test Results

Test	Method	Key Figures	Outcome
Normality	Skewness/Kurtosis	Skewness: -1.20 to 1.10; Kurtosis: 2.30 to 3.90	Normality assumption met
Linearity Test	Scatter Plots	Linear relationships observed	Linearity assumption met
Multicollinearity Test	VIF	1.67 to 1.92	No multicollinearity
Panel Unit Root Test	Levin-Lin-Chu Test	Liquidity (-3.45, $p < 0.01$);	Stationary data confirmed
Hausman Test	χ^2 Test	$\chi^2(4) = 18.67$, $p = 0.002$	Fixed-effects model preferred

The pre-estimation diagnostic tests in Table 2 above indicate that the model assumptions are satisfied. The Normality Test shows that the data is approximately normally distributed with skewness and kurtosis values within acceptable ranges. The linearity test confirms linear relationships among the variables, while the multicollinearity test reveals no significant correlation between predictors, as indicated by VIF values between 1.67 and 1.92. The panel unit root test confirms that the liquidity variable is stationary, with a significant p-value, ensuring reliable time-series analysis. Finally, the Hausman Test indicates that a fixed-effects model is preferred, as individual-specific effects are correlated with the explanatory variables. These results provide confidence in the suitability of the fixed effects model for further analysis as shown in Table 3.

Table 3 Findings on Fixed Effects Model

Number of Observations						524
Number of panels						105
R-sq	Within					0.1121
	Between					0.6421
	Overall					0.4743
	F (4,104)					6.02
	Prob > F					0.0002
Performance	Coef.	Robust St.Err.	t-value	p-value	[95% Conf	Interval]
Liquidity regulation	0.165	0.082	2.01	0.03	0.097	0.228
Constant	14.648	2.657	5.51	0	9.379	19.918

*** $p<.01$, ** $p<.05$, * $p<.1$

As shown in Table 2, the model's performance is summarized by the following statistics: the within R-squared is 0.1121, the between R-squared is 0.6421, and the overall R-squared is 0.4743. The F-statistic for the model is 6.02, with a p-value of 0.0002, indicating that the model is statistically significant. The coefficient for liquidity regulation practices is 0.165, with a standard error of 0.082. The t-value is 2.01, and the p-value is 0.03. This suggests that an increase in liquidity regulation is associated with a statistically significant increase in performance at the 5% significance level.

Discussion of findings

The findings from this study illustrate the significant role liquidity regulation play in determining the financial performance of Deposit-Taking Savings and Credit Cooperative Societies (DT-SACCOs) in Kenya. These results align with global and regional studies, confirming the critical balance between regulatory compliance and financial stability. Liquidity regulation emerged as a key determinant of financial performance, emphasizing the need for SACCOs to maintain adequate cash reserves and adhere to loan-to-deposit ratios. This finding was consistent with that of Gachora (2012) and Kabamba who assert that liquidity management practices have significant effect on DT-Saccos. If liquidity is well managed, the costs associated with it such as loss of public confidence; high administrative costs close of business will be dealt with. In that regard, liquidity management and liquidity regulation practices play a similar role in improving the financial performance of the DT-Saccos.

Conclusion.

The study concludes that maintaining appropriate liquidity regulation practices is crucial for the financial performance of DT-SACCOs in Kenya. Most DT-SACCOs have managed to keep their liquidity levels above the 15% threshold required by the SACCO Societies Act of 2008, which helps them balance their loan disbursements and manage short-term liabilities effectively. Proper liquidity management allows these institutions to accurately predict future cash flow demands and meet the loan application demands of their members. Failure to do so can lead to liquidity problems, resulting in mass member withdrawals and potentially severe declines in financial performance or even collapse. This conclusion supports the liquidity preference theory by demonstrating that maintaining required liquidity regulation practices allows deposit-taking SACCOs to meet their obligations promptly and fund loans efficiently. This aligns with the concept that liquidity preference is driven by the need to facilitate transactions and invest in projects, which is crucial for SACCOs' financial performance.

Recommendations

Based on the findings of this study, several recommendations are made to enhance the financial performance of deposit-taking savings and credit cooperative societies (DT-SACCOs) in Kenya through effective liquidity management. First, DT-SACCOs should continue to prioritize maintaining liquidity levels above the 15% threshold required by the SACCO Societies Act of 2008. Compliance with these regulations is crucial as it helps balance loan disbursements and manage short-term liabilities effectively. Adhering to this threshold supports financial stability and performance, ensuring that DT-SACCOs have sufficient funds to meet their obligations and member demands. Second, implementing robust liquidity management strategies is essential for accurately predicting future cash flow demands. Proper liquidity management allows DT-SACCOs to meet loan application demands promptly and avoid liquidity crises that could lead to mass member withdrawals and severe financial performance declines. Effective strategies can include maintaining adequate liquidity buffers and using financial forecasting to anticipate cash flow needs. Regular review and adjustment of liquidity practices is also recommended. DT-SACCOs operate in a dynamic financial environment, and it is important to continually assess and update liquidity practices to ensure they remain effective. Finally, engaging in regular financial audits is essential to ensure adherence to liquidity regulations and to identify potential liquidity risks early. Audits provide an objective assessment of a DT-SACCO's financial health, helping to detect issues before they escalate and enabling informed decision-making to mitigate risks. Regular audits strengthen accountability and transparency, further supporting financial stability.

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