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Examining the Role of Regulatory Regime and Funding Structure on the Nexus between Corporate Governance and Financial Performance of Deposit Taking Sacco's in Kenya

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Abstract
This study aimed to empirically investigate the relationship among corporate governance (CG), regulatory regime (RR), funding structure, and financial performance (FP) within deposit-taking Savings and Credit Cooperative Organizations (SACCOs) in Kenya. Utilizing a panel dataset from 163 SACCOs, the study assessed CG using metrics such as board size, board independence, board financial expertise, board diversity, and board activity. FP was measured through return on assets (ROA). The panel regression model was chosen for estimation following the Hausman specification test. The empirical results indicated a strong and statistically significant positive relationship among CG, regulatory regime, funding structure, and FP outcomes among the SACCOs studied. These findings suggest practical implications for policy development aimed at enhancing governance frameworks within SACCOs, potentially improving their operational efficiency and sustainability. They also underscore the strategic importance of board composition and activities in driving financial outcomes. Future research could explore the long-term effects of specific CG strategies, the impact of varied regulatory regimes across regions, and the role of emerging funding models like impact investing and digital finance on SACCOs' FP. Additionally, qualitative studies could provide deeper insights into governance practices and stakeholder trust, while examining technological advancements and digital transformation could offer valuable perspectives on future industry trends and adaptation strategies.

Keywords: *corporate governance, regulatory regime, funding structure, financial performance, deposit taking Sacco's*

Introduction

Globally, concerns about the influence of corporate governance (CG), funding structure, regulatory regime, and financial performance (FP) often focus on ensuring stability and protecting members' interests, particularly in financial institutions like SACCOs. In Kenya, the SACCO sector has undergone regulatory reforms to strengthen governance and FP, including the introduction of minimum capital requirements and enhanced supervisory regimes (Mwangi & Nyaaribo, 2022). In Europe, stringent regulatory requirements implemented after the 2008 financial crisis aim to improve governance and funding structures to prevent future crises (Gagan, 2023). In Asia, countries like India focus on improving corporate governance

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standards and access to diverse funding sources to enhance the FP of cooperative organizations (Hasan-Udin, 2023).

The primary goals of CG are to balance the interests of various stakeholders and encourage ethical and responsible behavior within a company. This approach significantly influences long-term growth while protecting shareholders' interests. CG fosters ethical operations by establishing clear lines of authority, facilitating effective communication, and ensuring fair and consistent decision-making processes (Feng et al., 2020). As a result, a company's image improves, financial solidity strengthens, and value is created for owners and other stakeholders. Effective CG is essential for organizations as they work towards their goals, comply with legal requirements, and improve FP (Hassan et al., 2023).

Corporate governance is described as framework regimes that regulates and guides entities, promoting answerability, clearness, and ethical conduct within firms (Al-ahdal, 2020). Accountability ensures that leaders and entities are held responsible for their actions and decisions. Transparency encourages openness and clarity in all aspects of operations and disclosures (Ali et al., 2021). Additionally, maintaining high moral and ethical standards in corporate actions is emphasized. CG alongside robust regulatory regime is crucial for enabling firms to operate responsibly, maintain stakeholder confidence, and achieve long-term goals in terms of superior FP (Queri, 2024).

Adopting good CG standards, such as transparent communication, fair decision-making, and diligent oversight, helps firms increase their value by building trust among stakeholders, optimizing FP, and fostering harmony between shareholders and directors (Ofoeda, 2017). This can lead to improved FP, higher market value, and greater investment opportunities. Beyond individual firms, effective CG practices positively influence the broader economy and entrepreneurship by enhancing efficiency and productivity (Peizhi & Ramzan, 2020). Furthermore, CG creates a favorable environment for entrepreneurs by increasing investor confidence and facilitating capital access for new businesses. Conversely, weak governance can deter investment and undermine trust, leading to negative effects on both the economy and entrepreneurship (Narella, 2022).

The nexus between CG, funding structure, regulatory regime, and FP is complex. Effective CG can enhance the firm's funding structure by attracting better financing terms and improving investor confidence (Nag &

Chatterjee, 2020). Strong regulatory regimes can complement good governance by enforcing standards that protect stakeholders and ensure stability. A balanced funding structure, combined with robust CG mechanisms and regulatory compliance, can mitigate financial related risks and enhance resilience against economic shocks (Bawuah, 2023) Together, these factors can drive improved FP by fostering a stable and predictable operating environment, encouraging prudent financial management, and promoting sustainable growth.

Research Problem

The performance and sustainability of deposit-taking SACCOs in Kenya are considerably influenced by the interplay of CG, regulatory regime, funding structure and FP. Despite the critical importance of these elements, many SACCOs struggle to balance them effectively, leading to suboptimal FP and sustainability issues. According to the SACCO Societies Regulatory Authority (SASRA), only 50% of SACCOs consistently comply with established governance standards, resulting in conflicts of interest, poor decision-making, and reduced stakeholder confidence, adversely affecting financial performance (SASRA report, 2023).

The regulatory regime plays a crucial role in shaping the operations and performance of SACCOs. In Kenya, regulatory reforms have been introduced to enhance the stability and reliability of SACCOs, including stringent capital requirements and comprehensive supervisory frameworks (Mwatu & Abdul, 2018). For instance, the minimum capital requirement for deposit-taking SACCOs was increased to Kshs 10 million, aiming to fortify financial stability. However, compliance costs and operational challenges associated with these regulations have strained many SACCOs, with 30% failing to meet the new capital requirements, as reported by SASRA in 2022 (SASRA report, 2023). This dynamic regulatory environment creates uncertainty, hinders growth, and affects the overall financial performance of SACCOs.

The funding structure of SACCOs, encompassing the mix of debt and equity, is pivotal in determining their financial health and growth prospects. An optimal funding structure can mitigate financial risks, lower the cost of capital, and enhance profitability (Mansour, 2022). However, many SACCOs in Kenya face challenges in diversifying their funding sources, often relying heavily on member deposits and short-term debt. This reliance can increase vulnerability to market fluctuations and liquidity risks (Junior, 2022). A SASRA report indicated that 60% of SACCOs rely on member deposits for over 80% of their funding, exposing them to significant financial risks. The interaction between funding structure, corporate governance, and regulatory compliance necessitates a holistic approach to ensure the financial performance and sustainability of SACCOs. Understanding the joint influence of these factors is crucial for developing strategies that enhance the value and stability of SACCOs in Kenya.

Research Objectives

The objective of this study is to establish the joint influence of corporate governance, regulatory regime and funding structure on financial performance of deposit taking Sacco's in Kenya.

Theoretical Background

This study is grounded in the principles of agency theory advanced by Jensen and Meckling (1976), which explains the potential divergence of interests between owners (principals) and managers (agents) due to the separation of ownership and control. Agency theory suggests that owners must implement mechanisms to ensure that managers act in the company's best interests, as managers might otherwise prioritize their own goals. Effective corporate governance structures are thus essential to mitigate conflicts and enhance firm value by aligning the interests of both parties (Indrawati & Hanif, 2023). Additionally, agency theory posits that agents may engage in opportunistic behavior, which conflicts with the principal's interests, necessitating structural methods for monitoring agents and providing appropriate incentives to curb such behavior.

One of the strengths of agency theory is its practical applicability. This theory suggests that business leaders can manage their enterprises efficiently without excessive effort, and granting a degree of autonomy to managers can lead to better outcomes if the interests of agents and principals are aligned (Dwaikat, 2023). The simple governance system and the trust established between agents and principals help reduce agency costs, benefiting both parties. However, when the interests of agents and principals diverge, the trust in their relationship can erode (Amosh & Khatib, 2021). To prevent this, principals should ensure agents act in the firm’s best interest, maintaining clear communication and well-defined roles. Although agency theory is effective, it also has drawbacks, such as the potential for agents to exploit their autonomy and the risk of financial fraud in the absence of proper regulations. Therefore, external controls, like activist owners and securities analysts, are necessary to ensure agents remain impartial and aligned with the principal's goals.

Linking this theoretical framework to the study of the joint influence of corporate governance (CG), regulatory regime, funding structure, and financial performance (FP) in Kenyan deposit-taking SACCOs, it is evident that these elements are interrelated and critical to mitigating agency conflicts and enhancing FP. Effective CG practices, supported by a robust regulatory regime, can provide the necessary oversight and accountability to align the interests of managers and shareholders, thereby reducing agency costs. A well-structured funding strategy can further strengthen FP by ensuring a balanced mix of debt and equity, mitigating financial risks, and enhancing profitability. By grounding this study in agency theory, we can better understand how these elements interact to influence the FP of SACCOs, offering insights into improving governance practices, regulatory frameworks, and funding strategies to achieve sustainable growth and value creation.

Empirical Review

This study draws on several empirical investigations to explore the relationship between CG, regulatory regime, funding structure, and FP among deposit-taking SACCOs in Kenya. In East Africa, Temba et al. (2023) investigated Tanzanian commercial banks, emphasizing CG's impact on FP through efficient equity utilization and asset quality, moderated by prudential regulations like capital adequacy and liquidity. Their findings highlighted a positive relationship between CG and FP, strengthened by adherence to regulatory standards. Similarly, Kyere and Ausloos (2021) examined UK non-financial listed firms, applying agency theory to evaluate CG mechanisms such as board independence and audit committees on FP indicators like ROA and Tobin's Q, with liquidity moderating this relationship. Their study underscored the critical role of selecting appropriate CG mechanisms in enhancing firm financial health.

In Pakistan, Tahir (2020) explored how CG practices influence FP in the non-financial sector, using liquidity as a moderator. By analyzing data from 63 firms over several years, Tahir demonstrated that CG positively impacts FP and that liquidity enhances this relationship. This study highlighted the importance of integrating liquidity considerations into CG frameworks to optimize FP outcomes. Furthermore, Nguyen and Dao (2020) conducted a meta-analysis across global studies to examine the relationships among CG, liquidity, and firm value. Their findings indicated that while liquidity challenges can adversely affect FP metrics like ROE and Tobin's Q, effective CG practices, such as strong board independence and institutional ownership, positively influence firm value, with liquidity acting as a moderating factor in these relationships.

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These studies collectively underscore the significance of CG, regulatory regimes, and funding structure in shaping FP outcomes across different organizational contexts and regions. They provide empirical evidence that effective CG practices not only enhance FP but also mitigate risks associated with liquidity and regulatory compliance. Understanding these dynamics is crucial for SACCOs in Kenya to adopt tailored governance strategies that promote stability, attract investment, and ensure sustainable growth in the face of diverse economic and regulatory challenges.

Conceptual Framework

The study examined how CG, regulatory regime and funding structure influences the FP of deposit-taking SACCOs in Kenya. Figure 1 depicts the conceptual model illustrating the connections between the variables under investigation.

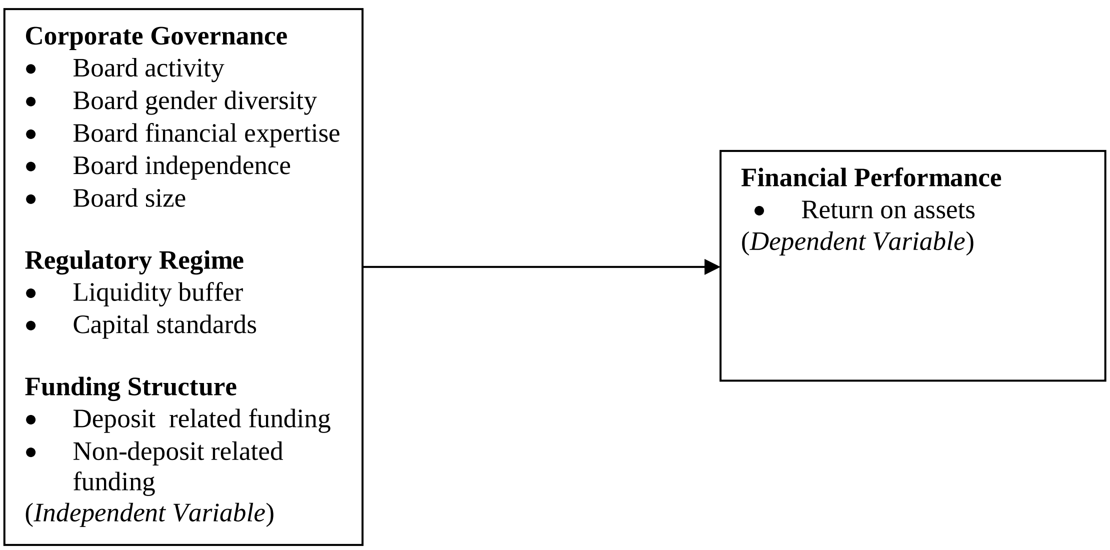

Fig.1. Conceptual Model

Research Hypothesis

H_{01}: There is no significant joint influence of corporate governance, regulatory regime and funding structure on financial performance of deposit taking Sacco's in Kenya.

Research Methodology

The study utilized panel data encompassing 163 SACCOs selected from a total population of 172 deposit-taking SACCOs in Kenya. This sample was carefully chosen to provide a diverse representation across the

SACCO industry, enhancing the study's ability to generalize outcomes across diverse corporate sizes and operational environments. Data sourced from SASRA's financial reports provided comprehensive insights into various aspects of CG practices, including board size, financial expertise, activity levels, diversity, and independence. Moreover, regulatory regimes such as adherence to capital standards and liquidity buffers were incorporated to explore their impact on shaping FP outcomes.

The research employed a descriptive research design to systematically analyze the relationship between CG practices, regulatory regime, funding structure, and FP among deposit-taking SACCOs in Kenya. This methodological approach was selected to thoroughly investigate how CG mechanisms, regulatory regime such as capital adequacy and liquidity buffers, and funding structures proxied by deposit and non-deposit funding collectively influence FP within the SACCO sector. Quantitative data were collected from financial statements obtained from the SASRA, ensuring a robust foundation for detailed analysis.

Data and Variable Description

When examining the linkages among between CG, regulatory regime, funding structure, and FP among deposit-taking SACCOs in Kenya, numerous vital variables come into play. Firstly, CG indicators encompass dimensions such as board size, which signifies the number of directors overseeing SACCO operations; board financial expertise, measuring directors' competency in financial matters; board activity levels, reflecting the engagement of board members in SACCO decision-making; board diversity, which considers the range of backgrounds and perspectives on the board; and board independence, highlighting the autonomy of board members from SACCO management. Secondly, regulatory regime variables include adherence to capital standards, assessing SACCOs' compliance with minimum capital requirements mandated by regulatory bodies to ensure financial stability and solvency. Liquidity buffers are also crucial, measuring SACCOs' capacity to maintain adequate liquid assets to meet short-term obligations and unexpected financial demands.

Thirdly, funding structure variables are characterized by deposit and non-deposit funding sources. Deposit funding indicates the proportion of SACCO liabilities funded through member deposits, indicating reliance on member savings for operational liquidity and growth. Non-deposit funding entails other financing sources such as loans from financial institutions or external investors, diversifying SACCOs' funding base and influencing their financial flexibility and cost structure. Lastly, FP indicators include metrics like ROA, which evaluates SACCO profitability relative to their total assets, and other financial ratios assessing efficiency, asset quality, and overall financial health.

Econometric Model

The study employed a panel regression model with a fixed effect estimator, selected following the Hausman test. This choice was justified by the need to control for SACCO-specific characteristics that remain constant over time and could otherwise distort the relationships between CG, regulatory regime, funding structure variables, FP metrics. By using fixed effects, the model effectively accounts for variations within SACCOs across time periods, thereby minimizing potential biases stemming from unobserved factors. To facilitate estimation, a general linear model is defined as follows:

$$\mathbf{FP_{it} = \beta_0 + \beta_1 CG_{it} + \beta_2 RR_{it} + \beta_3 FS_{it} + \varepsilon_{it}} \quad \ldots\ldots\ldots\ldots\ldots\ldots \textbf{(1)}$$

Where: $\boldsymbol{FP_{it}}$ *= Financial performance of deposit taking Sacco's i at time t;* $\boldsymbol{CG_{it}}$*= Corporate governance of deposit taking Sacco's i at time t;* $\boldsymbol{RR_{it}}$ *= Regulatory regime of deposit taking Sacco's i at time t;* $\boldsymbol{FS_{it}}$*= Funding structure of deposit taking Sacco's i at time t;* $\boldsymbol{\beta_0}$ *= constant;* $\boldsymbol{\beta_{1-3}}$ *= Coefficients;* $\boldsymbol{\varepsilon_{it}}$ *= Error term deposit taking Sacco's i at time t.*

Estimation Results

The analysis encompasses three main approaches: descriptive statistics, correlation analysis, and panel regression. Descriptive statistics provide a snapshot of the data, presenting central tendencies and variability across key variables. This helps to outline the overall patterns and characteristics within the dataset. Correlation analysis delves into the connections between different aspects of CG, regulatory regime, funding structure, and FP, uncovering the strengths and directions of these relationships. Finally, panel regression, specifically utilizing a fixed effect model, delves deeper into how CG practices, regulatory regime, funding compositions, and FP metrics interact over a span of 5 years. This method allows for a comprehensive exploration of the relationships and the dynamics influencing SACCO performance in Kenya.

Descriptive Statistics

Table 1 presents the descriptive statistics summarizing CG, regulatory regime, funding structure, and FP variables.

Table 1: Descriptive Statistics

Variable	Mean	Standard Deviation
Corporate Governance	1.42	0.07
Regulatory Regime	0.34	0.26
Funding Structure	0.67	0.11
Financial Performance	0.02	0.05

Table 1 displays the descriptive statistics for variables related to CG, regulatory regime, funding structure, and FP. CG, exhibits a mean of 1.42 (SD = 0.07), suggesting generally elevated levels within the sample. Regulatory regime, gauged, presents a mean of 0.34 (SD = 0.26), indicating a moderate adherence to regulatory standards across the deposit taking SACCOs. Funding structure demonstrates a mean of 0.67 (SD = 0.11), indicating a predominant reliance on deposit funding sources. FP displays a mean of 0.02 (SD = 0.05), suggesting relatively modest average profitability or other financial metrics among the SACCOs.

Correlation Analysis

Table 2 presents the results of the Pearson correlation analysis examining the relationships between CG, regulatory regime, funding structure, and FP among SACCOs. This statistical method assesses the strength and direction of linear relationships between variables.

Table 2: Pearson's Correlations Analysis Outcomes

Variable	CG	FS	RR	FP
CG	1			
FS	0.63	1		
RR	0.42	0.37*	1	
FP	0.81*	0.84*	0.43*	1

The correlations among CG, funding structure, regulatory regime, and FP in SACCOs were examined using Pearson correlation coefficients, as shown in Table 2. The results reveal significant relationships between these variables. Specifically, stronger CG practices are strongly positively correlated with FP ($r = 0.81$, $p < 0.05$), indicating that SACCOs with more robust governance practices tend to achieve superior FP. Similarly, a well-managed funding structure exhibits a strong positive correlation with FP ($r = 0.84$, $p < 0.05$), suggesting that effective management of funding sources contributes significantly to improved financial outcomes. CG also moderately correlates positively with funding structure ($r = 0.63$, $p < 0.05$), implying that effective governance practices may influence how SACCOs manage their funding sources.

However, the regulatory regime demonstrates a weaker positive association with FP ($r = 0.43$, $p < 0.05$), suggesting that adherence to regulatory standards plays a relatively smaller role compared to governance and funding structure in impacting FP.

Empirical Findings and Discussion

To evaluate the relationship between corporate governance, regulatory regime, funding structure, and financial performance, the study tested the following null hypothesis.

H_{01}: There is no significant relationship among corporate governance, regulatory regime, funding structure, and financial performance of deposit taking Sacco's in Kenya.

Table 3: Estimation Results

Model:	Fixed Effect Model			
Period:	5 years (2018 -2022)			
R^2	within	= 0.92		
	between	= 0.27		
	overall	= 0.57		
F (3, 649)	= 2, 665			
Prob > F	= 0.00			
FP	**β**	**SE**	**t**	**P**
Constant	-0.33	0.03	-12.48	0.00
CG	0.29	0.02	14.34	0.00
RR	1.48	0.09	16.08	0.00
FS	0.46	0.04	11.97	0.00

Table 3 presents the results of a fixed effect model analysing the association between CG, regulatory regime, funding structure, and FP across SACCOs over a period of 5 years. The model's explanatory power is notable, with an overall R-squared of 0.57, indicating that 57% of the variation in FP can be attributed to CG, regulatory regime, funding structure. Specifically, CG shows a positive coefficient of 0.29 ($SE = 0.02$, $t = 14.34$, $p < 0.05$), indicating that stronger CG practices are linked to higher FP. Similarly, regulatory regime demonstrates a larger coefficient of 1.48 ($SE = 0.09$, $t = 16.08$, $p < 0.05$), highlighting that adherence to regulatory regime significantly enhances FP. Funding structure also displays a positive coefficient of 0.46 ($SE = 0.04$, $t = 11.97$ $p < 0.05$), suggesting that effective management of funding sources contributes positively to SACCOs' FP.

These findings underscore the crucial roles of CG, regulatory adherence, and funding structure in influencing FP among SACCOs. Moreover, the statistically significant F-test {$F (3, 649) = 2,665$, $p < 0.05$} confirms the robustness of the model, affirming that the combined effects of CG, regulatory regime and funding structure significantly explain variations in FP among SACCOs in Kenya from 2018 to 2022.

The current findings are consistent with prior research by Queiri (2024), Ali and Alim (2021), Bawuah (2023), and others, demonstrating a shared conclusion regarding the positive and significant combined impact of CG, regulatory regime, funding structures, and FP. These studies collectively affirm that effective CG practices, appropriate funding structures, and adherence to regulatory regimes contribute positively to FP outcomes. Queiri (2024) and Bawuah (2023) highlight the critical role of strong CG and regulatory regimes in bolstering FP, while Ali and Alim (2021) emphasize the influence of CG and funding structure on financial indicators.

Conclusions, Limitations and Areas for Further Research

The synergy among CG, funding structure, and regulatory adherence is pivotal in shaping the FP landscape of deposit-taking SACCOs, representing a comprehensive approach to organizational success. Strong CG practices are essential for fostering sound decision-making, managing risks effectively, ensuring lucidity, responsibility, and bolstering investor trust. SACCOs with robust CG mechanisms not only attract capital more cost-effectively but also exhibit exceptional operational efficiency and value creation, thereby augmenting FP outcomes. Furthermore, aligning funding sources strategically with corporate objectives optimizes capital allocation and scales down funding risks, supporting sustainable growth and profitability. Simultaneously, adherence to regulatory frameworks serves as a cornerstone in defining SACCOs' operational environment, ensuring financial stability, and safeguarding stakeholder interests. By complying with capital adequacy and liquidity standards, SACCOs strengthen their resilience, credibility, and long-term investor trust, ultimately enhancing FP.

While this study offers valuable insights into CG, funding structure, and regulatory regime influence FP in deposit-taking SACCOs, it is important to acknowledge several limitations. Firstly, the reliance on panel data from a specific period (2018-2022) restricts the ability to generalize outcomes over longer timeframes or diverse economic horizons. Moreover, the study's focus on Kenyan SACCOs may limit applicability to SACCOs in other regions with different regulatory landscapes and market conditions. Furthermore, while fixed effect models used in the analysis control for time-invariant factors, they may overlook dynamic changes within SACCOs or fluctuations specific to the industry. Moreover, using financial statement data from SASRA could introduce biases or inconsistencies across SACCOs, potentially affecting the accuracy of CG and FP assessments. Lastly, the complexity of regulatory regimes and its interaction with CG and funding practices may not be fully captured, suggesting a need for qualitative research or case studies to provide deeper insights.

Based on the study's outcomes, several avenues for further exploration can be identified to enrich comprehension and contribute to the advancement of deposit-taking SACCOs. Firstly, examining the enduring impacts of specific CG strategies beyond the current timeframe could yield insights into strategies for resilience. Investigating how regulatory regimes diverge across numerous regions or states and their effects on SACCOs' FP could offer comparative insights into regulatory effectiveness and implications for industry practices. Furthermore, qualitative research could complement quantitative findings by delving into the nuanced aspects of governance practices and their influence on stakeholder perceptions and trust. Exploring the role of emerging funding models, such as impact investing or digital finance solutions, in shaping SACCOs' financial well-being could offer innovative strategies for growth and resilience in evolving economic environments. Lastly, investigating the influence of technological advancements and digital transformation on CG and FP in SACCOs could offer valuable perspectives on future industry trends and strategies for adaptation.

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