EFFECT OF RETAINED EARNINGS ON FINANCIAL PERFORMANCE OF SAVING AND CREDIT CO-OPERATIVE SOCIETIES IN NAIROBI COUNTY, KENYA

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International Academic Journal of Economics and Finance (IAJEF) | ISSN 2518-2366

Received: 4th October 2020

Published: 19th October 2020

Full Length Research

Available Online at: http://www.iajournals.org/articles/iajef_v3_i6_197_209.pdf

Citation: Nduati, N. W. & Wepukhulu, J. M. (2020). Effect of retained earnings on financial performance of saving and credit co-operative societies in Nairobi County, Kenya. *International Academic Journal of Economics and Finance, 3*(6), 197-209

ABSTRACT

Savings and Credit Cooperative Societies like other monetary foundations assume an extraordinary role in the economy by preparing reserve funds and providing credit for members. They provide financial services to members through existing products. Members have the opportunities to save with the cooperatives and get dividends from the SACCOs proceedings. The aim of the study was to assess the effect of retained earnings on financial performance of regulated SACCOs in Nairobi County. The study adopted descriptive survey research design. The target population of the study was 29 registered DTS. The study used secondary data from financial reports in Deposit Taking SACCOs. Descriptive data analysis which included mean, standard deviation, mode and frequencies was adopted. A univariate linear regression analysis was also done to assess the relationship between retained earnings and financial performance. The results revealed that retained earnings predict a significant and positive effect on financial performance in Deposit Taking SACCOs. The study recommends management and policymakers improve on total earnings to foster retained earnings that have a significant and positive relationship with financial performance of Deposit Taking SACCOs.

Key Words: *retained earnings, financial performance*

INTRODUCTION

Savings and Credit Cooperative Societies (SACCOS) are crucial in the provision of financial and banking facilities to low income earners who may not be covered by activities of a formal bank (Kaleshu & Temu, 2012). SACCOS are started locally and have concrete basis of small saving accounts constituting a stable and relatively low-cost source of funding and low administrative costs. Ideally, the financial capability is a key concern in the growth of SACCOs' wealth and it is the main issue in the sustainability of the SACCO. A SACCO needs to generate income which is adequate to cover all its financial costs, administrative cost and for loan loss provisioning.

In the Sacco societies which are financial institutions themselves, members contribute their money in form of deposits and create savings for investments (Co-operative Societies Act 1997 No.12 1997). These institutions use the same deposits for business mostly by giving the same funds out as loans to the same members thereby making returns for the Sacco as well as for the members. During the business period profits earned are distributed by directors to the members as a return for investment. Management decides to give dividends to the members guided by the policies they develop (SACCO Societies Regulations 2010). In this process the returns earned are shared and a portion of the same retained for future investment.

A Savings and Credit Cooperative's membership is open to all who belong to the group, regardless of race, religion, colour, creed and gender or job status. A SACCO is unique,

democratic, member driven and self-help cooperative organization. In a SACCO, members agree to save their money together and offer loans to each other at reasonable rates of interest. Interest is charged on loans, to cover the interest cost on savings and the cost of administration. The balance that remains is usually distributed to all members at an agreed rate (referred to as interest rebate). This means that only the members of these institutions can deposit and borrow from them (Ombado, 2016). Other than retaining profits earned for further investment, SACCOs accumulate saving through other fund mobilization methods such as encouraging members to increase deposits by holding education days where members are encouraged to save more.

Globally it is estimated there are over 800million members of SACCO institutions. In Europe, there are over 58,000 SACCOs with a membership of over 13.8million. In the US there are over 72,000 cooperatives with at least 140 million members generating at least one billion USD annually (Edna, 2015). In Malaysia, according to Spian, Ismail and Ziden (2015) the development of SACCOs is low. This associated to the challenges in the sector which include incapacitated management committees, lack of knowledge, poor participation in members, lack of accountability and transparency, inadequate support by cooperative promoters and NGOs and lack of awareness of the existing opportunities by the members are the main findings.

An assessment by Rai in 2015 of the performance of young and old SACCOs in India revealed that newly established SACCOs created better quality assets and grew faster as compared to the mature old SACCOs. The portfolios of the young SACCOs had grown with high margins. However, the mature SACCOs utilized their administrative and personal expense much better as compared to the young SACCOs. Rupa (2014) established that SACCOs in Indian obtain a better ROE and higher financial revenue by assets but were unable to cover the financial expenses in addition to total expense.

In Africa among other developing economies, SACCOs are the main source of funding for microenterprises and financial regulations play an important role in credit management. Chortareas, Girardone and Ventouri (2013) discovered that increasingly stringent capital necessities lead to upgraded credit association's productivity and execution. In like manner, Klomp and de Haan (2011) demonstrate that capital necessities lessen both capital and resource hazard while Boudrigua, Taktak and Jellouli (2009) report that such prerequisites are related with diminished dimensions of NPLs in the credit association division.

In Lesotho, an analysis by Mmari, and Thinyane (2019) on the factors Influencing Financial Performance of Savings and Credit Co-operative Societies found that socio economic characteristics of members were supportive to financial performance of the SACCOS. Furthermore, SACCOS in the study area achieved high performance in terms of ratios of members' capital; loan delinquency; volumes of savings in the SACCOS; and growth of total assets. On the other hand, the SACCOS realized poor financial performance in terms of ratio of fixed assets to total assets; and share capital owned by members.

In Tanzania, Sangali (2015) evidenced that the financial performance of SACCOs was determined by the liquidity, the capital, ratio of loan to members and the operating expenses. It was revealed that employee based SACCOs enjoyed the economies of scale much better than community based SACCOs making them have advantage on cost and hence better financial performance as compared to the community based SACCOs. Employee based SACCOs performed better in terms of loan to members, size and operating expenses. The community based SACCOS are however regarded as more liquid and enjoy flexibility in solving problems of unexpected losses.

In Kenya, the first co-operative society was Lumbwa co-operative Society formed in 1908 by the European Farmers with the aim of supporting agricultural activities and products to take advantage of economies of scale Kenya Union of Savings and Credit Co-operatives KUSCCO, (2006). In 1946 there was inclusion of Africans in the movement when the colonial government felt that Africans needed to participate in the economy through co-operatives resulting in the enactment of a new Cooperative Societies' Ordinance. The Sacco industry is part of the cooperative sector in Kenya, which has impacted on lives of many disadvantaged Kenyans over the years. The Government annual economic survey shows that as at December 2009 there were more than 2,400 active SACCOs with membership in excess of 1.5 million people. Share capital stood at Kshs. 65 billion while outstanding loans were Kshs. 59 billion. The structure of the cooperative movement in Kenya comprises of four tiers. These include the primary societies, secondary cooperatives, tertiary cooperatives and nationwide cooperatives. The Kenya National Federation of Cooperatives (KNFC) is the only apex society in the movement. By December 2015 there were over 6,000 registered non-deposits taking Saccos in Kenya, 1,995 of which were active (KUSCCO, 2015).

The statistical report indicates higher growth, to a point where some Saccos are bigger than commercial banks e.g. Mwalimu National Sacco with a membership of 47,179 with assets totaling to Kshs.22 billion with a monthly cheque of Kshs. 600 million from employers and Harambee Sacco with a membership of 98,640 with an asset base totaling to 13 billion and a monthly cheque of Kshs.454 million (Kenya cooperatives directory, 2015).

For SACCOs to be able to meet the capital adequacy requirements, they may opt to adopt dividend reinvestment plans (DRIPS) rather than cash dividend payment plan (SASRA CEO's speech during the launch of Stima SACCO FOSA license, 2011). The regulated SACCOs under the guidelines pay dividend to the shareholders from the profit earned during the year in operation. The yield of the dividend indicated that it affects the profitability of the SACCOs and contribute to capitalization. Investing divided for future earning may contribute to earnings and improve financial performance in a SACCO. The SASRA regulation, act 2008, section 14(4), 68(2) (a) stipulate that SACCO announce payment of dividend.

As indicated by the RoK (2009) for viable implementation of the directions, SASRA is allowed explicit powers in law to manage SACCOs that neglect to agree. This is basic as consistency can't be left at the carefulness of the SACCOs (Wanja, 2013). Notwithstanding the budgetary limit, permitting is declaration that SACCOs have the institutional limit, as far as human, innovation and business procedures to agree to the terms and states of the permit (WOCCU, 2014). SASRA emphasizes on establishing prudential regulation of DTS to enhance transparency and accountability in this subsector. SACCO's in Kenya have experienced significant improvement in profitability and growth post adoption of SASRA regulations.

STATEMENT OF THE PROBLEM

SACCOs have become important contributors to the Kenyan economy. SACCO's are member owned, member controlled institutions formed for the purpose of mobilizing savings from members and offering them good return after affording loans at competitive interest rates and providing other services on competitive basis. SACCOs play a significant role in financial intermediation. Their savings translates to 48.55% of the gross national savings. The performance of SACCOs is therefore of great importance for the overall stability of the financial sector, since they are a key component of the financial mobilization services within the SACCO population in Kenya (SASRA, 2013). According to the SASRA report for 2016/2017 despite the average Sacco institutions liquidity levels standing at 34.95% above the prescribed minimum ratio of 15% the majority of the institutions have been facing tremendous challenges in meeting their financial obligations. According to the SASRA report 2016/2017 the Kenyan Deposit Taking (DT-SACCO) segment recorded total assets of SACCOs grew in 2016 from Kshs.342.84 Billion recorded in 2015 to achieve Kshs.393.49. This showed 14.8% year to year development rate, and was financed chiefly by individuals' deposits which additionally developed to Kshs.272.57 Billion out of 2016 from Kshs 237.44 Billion recorded in the past year. The credits and advances established a tremendous segment of the aggregate resources, representing 73.42% of the aggregate resources and which remained at Kshs 288.92 Billion of every 2016 up from Kshs 251.08 out of 2015. This spoke to a multi-year to year development rate. The gross advances then again remained at Kshs 297.6 Billion of every 2016, up from Kshs 258.18 Billion out of 2015 showing a 15.3% year to year development rate. The factors determining the aforementioned performance was still not empirically tested. According to Uwuigbe, Jafaru and Ajayi, (2012) dividend attributes have an influence on operations and financial performance in financial institutions. Researchers' in Kenya have equally recorded a positive relationship in financial performance and dividend payout. SACCOs recorded a 4.71% profitability before application of divided policy as per SASRA and recorded a slight change on implementation of divided policy as SACCOs under SASRA divided recorded 5.2% (SASRA Report, 2018). Langat (2015) assessed the factors influencing the performance of savings and credit co-operative societies in Bomet County and found that market competition, financial stability technology and training were the performance determinants. Muchoki (2016) assessed the determinants of growth of savings and credit co-operative societies in Laikipia County revealing

that dividend policy was the main actor, inadequate capital base and payment of high dividends in cash. Mwangi (2013) evaluated the determinants of efficiency of Savings and Credit Co-operative Societies in Nairobi County and found out the factors influencing the efficiency of SACCOs were size, capital, credit risk and management quality. Mwasambu (2016) evaluated the relationship between credit risk management practices and financial performance of Deposit Taking Savings and Credit Co-operative Societies in Kenya and found a positive relationship. The aforementioned studies were conducted to reveal the relationship between diverse factors and SACCOs' performance. However, the effect of retained earnings on financial performance of SACCOs has not been satisfactorily empirically tested. This created the gap which the current study sought to fill by assessing the effect of retained earnings on financial performance of SACCOs in Nairobi County.

RESEARCH OBJECTIVE

The study's general research objective was to determine the effect of retained earnings on the financial performance of regulated SACCOs in Nairobi County.

THEORETICAL FRAMEWORK

Bird in the Hand Theory

Most of speculations proposed as clarifications of why organizations pay profits have concentrated on instinctive perceptions. Unmistakable among these is the "feathered creature in-the-hand" hypothesis, as indicated by which financial specialists put an incentive on the substantial idea of money dispensing with respect to a conceivable capital gain (Gordon, 1959). Gordon and Lintner (2005) in their Bird in Hand contended that investors incline toward a higher profit payout now that future capital increases. They incline toward profits now because of the assurance than future additions from sketchy speculations. Studies have exhibited that this mode falls flat if it's situated in an ideal market with speculators who have reasonable conduct. Speculators along these lines would prefer to get profits rather than capital increases (Amidu, 2007).

The hypothesis accepts that profits as appealing to investors since they are less unsafe than guarantees of development. That profit increments or diminishes speak to positive (or negative news since they flag administrative certainty about the future money streams to be earned by the firm; they are, accordingly, seen as a critical effect on offer value (McCluskey et al., 2006) lastly that the salary charge obligation on profits raises speculators' required pre-assessment forms on higher profit paying offers, in this manner making such values offer at a markdown with respect to their lower profit paying partners; the differential tax assessment treatment of profit pay and capital additions prompts a negative connection between offer costs and profits and enhance and decline firm budgetary income (Shefrin & Statman, 1984).

Profits are viewed as riskless not at all like capital picks up in this manner firms will in general go for a high payout proportion that will result to high profit respect expand stock cost. At the point when profits are expanded it builds the estimation of the firm. A firm that pays higher profits it lessens vulnerability that may exist about future money streams, on the other high an exceptionally high payout proportion will result to a decreased cost (Miller & Modigliani, 2001). Gordon and Litner (2005) noted that distribution of dividends contributes to limited future gain or profit (Frankfurter & Wood, 2002). This hypothesis is critical for the examination since it illuminates the investigation on the need of profit payout signal capital adequacy in firms and improve prospect of higher returns.

Residual Theory

The essence of the residual theory is that the firm will only pay dividends from residual earnings, that is, from earnings left over after all suitable (positive NPV) investment opportunities have been financed. Retained earnings are the most important source for financing for most companies (Darek, 2012). A residual approach to the dividend policy, as the first claim on retained earnings will be the financing of the investment projects. With the residual dividend policy, the primary focus of the firm's management is indeed on investment, not dividends. Dividend policy becomes irrelevant, it is treated as a passive rather than an active, decision variables. The view of management in this case is that the value of firm and the wealth of its shareholders will be maximized by investing the earnings in the appropriate investment projects, rather than paying them out as dividends to shareholders (Dhanani, 2005). Thus managers will actively seek out, and invest the firm's earnings in, all acceptable (in terms of risk and return) investment projects, which are expected to increase the value of the firm. Dividends will only be paid when retained earnings exceed the funds required to finance the suitable investment projects.

Conversely, when the total investment funds required exceed retained earnings, no dividend will be paid. The motives for a residual policy, or high retentions, dividend policy commonly include: A high retention policy reduces the need to raise fresh capital, (debt or equity), thus saving on associated issues and floatation costs. A fresh equity issue may dilute existing ownership control (Frankfurter & Wood, 2012). This may be avoided, if retentions are consistently high. A high retained earnings may enable a company to finance a more rapid and financial performance.

EMPIRICAL REVIEW

Kariuki (2014) studied the relationship between dividend and loan performance of saving and credit co-operative societies registered by Sacco society regulatory authority in Nairobi County. The study adopted a descriptive research design was employed on the study. A census was conducted on the target population of 43 Saccos in Nairobi County. Secondary data was collected from the financial statements of target population for the last five years. The regression model was used to find the relationship between the dependent variable (performance) and independent variables (Dividend, asset growth rates and organization growth). The results

revealed that dividends, asset growth rates and organization growth influence loan performance in regulated SACCOs in Kenya. Monogbe (2015) assessed relationship between dividend payout and financial returns. The study adopted a descriptive survey of the companies in manufacturing sector in Malaysia. Regression and correlation analysis techniques were employed. The study revealed that increased in financial returns was due to dividend distributed to shareholders.

Khadija, Maria and Nabil (2017) conveyed an examination on effect of dividend policy on investors' riches and firm performance in Pakistan. The direct of dividend strategy has been a standout amongst the most begging to be proven wrong issues in writing of corporate back. Various specialists have endeavored to uncover issues as for the profit approach; notwithstanding, despite everything we don't have a commendable clarification with respect to the conduct of profit strategy. The factors utilized in this exploration are profit arrangement, investors riches, and firm execution. Profit per offer and profit yield is utilized to gauge profit arrangement. For investors riches, procuring per offer and offer cost are utilized as intermediaries. Profit for value is utilized to quantify firm execution. From the panel result, it is discovered that profit strategy has decidedly noteworthy effect on investors' riches and firm execution.

Kibet (2012) directed an examination on the impact of liquidity on profit payout by organizations recorded at the NSE for a multi-year time frame (2007-2011). He tested 34 organizations out of the 57 recorded. Firms under back and venture division were not considered because they didn't have a uniform obligation and resources structure like different firms cited in different parts. He utilized a multivariate relapse examination where profit payout was the needy variable while liquidity, use, gainfulness, income, corporate assessment, deals development and profit per share were the free factors and revealed that dividend payout increases financial returns in the 15 companies surveyed, increase earnings per share. He additionally found a negative relationship between profits payout and income. They influenced it positively.

Ochieng (2018) assessed the factors affecting the profitability of savings and credit cooperative societies in Nairobi. A descriptive research design was adopted to carry out data collection for this study. The study population is comprised of one of the major saving and credit cooperative microfinance institutions in Kenya. Data obtained was through primary data achieved through means of questionnaires. The study established that there is no definite relationship between lending rates and profitability recorded in the SACCOs. Aspects that contributed to this conclusion were: customer sensitivity towards increases in lending rates set on loans, uptake of loans by customers based on the loan periods given to them which was established that the uptake was not influenced by the loan period.

A descriptive survey design was used by Langat (2015) on the factors influencing the performance of savings and credit co-operative societies in Bomet County. By the use of questionnaires, 150 respondents who were management staff of the Saccos, who in this case

were the target population, were interviewed. Data was also collected using observation and key informant interviews. Simple random sampling was the main method of sampling techniques that was employed in this study. The findings were that performance of SACCOs depends on the management competency, personnel, computerization, market competition as well as financial stability. The presence or absence of long term investment also influences the performance of the SACCOs.

Muchoki (2016) conducted an empirical study of factors affecting growth of savings and credit co-operative societies in Kenya: the case of Laikipia County. The elements studied were; operational area, information technology, implementation of projects. The study employed both correctional and descriptive survey designs. A total of 31 SACCOs in Laikipia County were studied where out of a possible 93 respondents, a 50% sample was taken totaling to 47 respondents. The main tool of research was a. questionnaire while the model of the research was multiple regression. The results were that all the variables contributed positively to the slowed growth of SACCOs. The main contributor was dividend policy which according to the data, contributed 67.4%. The main hindrance to growth of SACCOs was inadequate capital base made worse by payment of high dividends in cash form.

Kibor (2018) evaluated dividend and performance of savings and Credit Co-Operative Societies in Uasin Gishu County, Kenya. Primary data was sought from the SACCO's audited financial reports. The population of interest was the 120 registered SACCOs operating within Uasin Gishu County that was purposively sampled at 10% for dividend paying SACCOs to arrive at the workable sample size of 12 SACCOs. The study adopted quantitative research design to give the desired information relevant for this study. Statistical package for social science(SPSS) and STATA Version 12 of computer software were used to run multiple regression analysis in order to arrive at the relevant statistical tests for inference. The study findings were found that the calculated T values on net income and dividend payout ratio showed that there is a positive relationship between dividend and performance of SACCOs while that for the amount of dividend paid, the total value of and the percentage of dividend paid showed an inverse relationship at 5% level of significance.

RESEARCH METHODOLOGY

The study adopted descriptive survey research design. This is because it helps in gathering adequate data to answer to research questions (Kiariatha et al, 2013). Descriptive data help in collection of data on factual happening depicting the actual state of affairs of the situation being research on. A descriptive research design collect data to answer to research questions or test study hypotheses (Sekaran & Bougie, 2011). The population of this study was all 29 licensed DTS in Kenya regulated by SASRA guiding financial reporting framework. The study used secondary from financial reports from Deposit Taking SACCOs. The study carried descriptive and inferential statistic that included a univariate linear regression model.

RESEARCH RESULTS

Table 1: Summary of the Study Variables

	Mean	Standard dev	Min	Max	Skewness	Kurtosis
Retained Earnings	56.87(M)	25.08107(M)	9.35	130.77	0.66	2.45
Return on Capital Employed	0.7058	0.051	0.556	0.826	0.129	-1.674

The descriptive results indicated that there was a mean of Ksh 56.9 Million retain earnings recorded a mean score of 56.9 Million for the five years with a minimum mean of Kshs 9.35 Million, a maximum mean of Kshs 130.767Million and standard deviation of 25.08107. This implied that on average, Deposit Taking SACCOs increase retained earnings to cater for every increase in loan losses provision due to occurrence of loan losses in SACCOs. The study found retained earnings had Skewness of 0.66 and kurtosis of 2.45 exhibiting positively skewed and moderate peaked data distribution hence data was normally distributed.

The results were supported by Al-Tamimi (2010) that market performance and dividend policy impact on firm profitability level in the future. Results demonstrate the positive yet the superfluous connection between offer cost and Dividend Yield in the wake of controlling however the unimportant connection between Share Price and Dividend Yield. Return on Capital Employed recorded an average of 0.7058, a minimum of 0.556 and a maximum of 0.826 supported by standard deviation of 0.051 indicating that denoted a high financial performance variability among the SACCOs. ROCE had skewness of 0.129 and kurtosis of -1.674 exhibiting a positive, skewed and high peaked data distribution.

The study conducted a univariate linear regression to establish the relationship between retained earnings and financial performance.

Table 2: Regression Model Summary

R	R Square	Adjusted R Square	Std. Error of the Estimate
0.625	0.402	0.386	0.1281

Predictors: (Constant), Retained Earnings
Dependent Variable: Financial Performance

The model summary indicated that adjusted R^2 is 0.386, Std Error= 0.1281 indicate that 38.6% of financial performance can be explained by retain earnings of deposit taking SACCOs. This shows that 61.4% of the financial performance can be explained by other factors, other than retained earnings.

Table 3: Goodness of Fit (ANOVA)

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	12.1043	1	12.1043	15.9309	.000
Residual	20.5146	27	0.7598		
Total	32.6189	28			

Predictors: (Constant), Retained Earnings
Dependent Variable: Financial Performance

The study determined the goodness of fit of the model using ANOVA analysis. The study found that the regression model had a significant goodness of fit as F-Calculated =15.9309 that exceeded F-critical 4.2100 and P=0.000. This implied that the model was fit to explain the relationship between retained earnings and financial performance in Deposit Taking SACCOs.

Table 4: Regression Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	1.9334	.791		6.0510	0.0003
Retained Earnings	0.43184	0.8210	.2436	5.2599	0.001

Predictors: (Constant), Retained Earnings
Dependent Variable: Financial Performance

Regression coefficient analysis indicated that retained earnings predict significant and positive relationship with financial performance in Deposit Taking SACCOs (β = 0.43184, P=0.001<0.05). The result indicated that a unit increase in retained earnings contributed to a significant increase ROCE by 0.43184 units in SACCOs in Kenya. The results concurred with Monogbe (2015) that increase in financial returns was as a results of dividend distributed to shareholders. The results were also similar to Khadija, Maria and Nabil (2017) that retained earnings had a significant influence on financial performance of firms in Pakistan.

CONCLUSION

From the results, the study concluded that retained earnings have a significant and positive relationship with financial performance in Deposit Taking SACCOs. Increase in retained earnings increase the net income of the SACCOs and in turn influence profitability level of Deposit Taking SACCOs. Retain earnings impact on final returns and yield more dividend payout to shareholders. Indeed, retained earnings of a firm portray its financial performance.

RECOMMENDATIONS

The study recommends management and policy makers improve on total earnings to foster retained earnings that have a significant and positive relationship with financial performance in

Deposit Taking SACCOs. Increase in retained earnings increase the net income of the SACCOs and in turn influence profitability level of Deposit Taking SACCOs.

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