

## Risk Assessment and financial Performance of SACCOs in Bushenyi-Ishaka Municipality: Evidence from SACCOs in Ishaka Division; western Uganda

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**Abstract:** This study was about Risk Assessment and financial performance of SACCOs in Bushenyi-Ishaka municipality; evidence from SACCOs in Ishaka division, Western Uganda. It intended to analyse the relationship between risk assessment and financial performance of SACCOs in Ishaka Division. The study adopted descriptive cross sectional research design with both quantitative and qualitative approaches. A total population of 122 was involved which included employees, supervisory committee, loan committee and board members from which a sample of 93 respondents were selected using Slovine's formula. Out of 93 respondents, 90 respondents responded positively. Data was collected using questionnaire and interview guide and analyzed using descriptive statistics, chi-square for quantitative data and thematic analysis was used for analyzing qualitative data. The study findings established a significant relationship between risk assessment and financial performance of SACCOs. From the study findings, recommended that SACCOS in Bushenyi-Ishaka municipality should start investing in risk assessment to identify and analyse the risks that are likely to affect the financial performance of SACCOs.

**Keywords:** Financial Performance, Risk Assessment and SACCOs.

## INTRODUCTION

Globally, the turnover of cooperatives in the world grew by 11.6% in 2012 which is equal to the GDP of Brazil. The report further indicated that cooperatives that are offering financial services constitute 4% across the Globe, the biggest being those that offer insurance services constituting 41% (International Cooperative Alliance's world cooperative Monitor, 2012 & Njeru, 2016). This indicates that SACCOs are not performing well in terms of market share across the globe as compared to other cooperatives. Statistics indicates that 57000 SACCOs across the world, their savings stood at 1.5 trillion dollars, their asset base stood at 1.8 trillion dollars out of which 67% constitute a loan portfolio and on average SACCOs across the world occupy 8.2% of the financial market (Essandol, 2018). This indicates that SACCOs are not doing well as compared to other financial institutions in terms of market share. One would expect that since SACCOs are normally started used by local people should be the ones occupying a big financial market which is not the case.

In Africa, previous studies indicate that most of the people over 7% affiliated to SACCOs are still suffering a number of problems like rights to be heard and there is also limited protection related to SACCOs (Wamiori, 2019). In the same continent, cases have also existed in South Africa and Nigeria as well (Kamau, 2014). These cases have created a need to have internal controls in place to help senior management in making decisions.

In Uganda, there are over 17,000 registered cooperatives with over 200 deposit taking SACCOs (Masika & Simiyu, 2019). The SACCOs are estimated to have over Ugx500 billion in savings and over Ugx 650 billion in capital while employing about 500,000 directly and another one million indirectly. SACCOs contribute over 4% to GDP with one out of two deriving their lively hood from SACCO movement. The financial performance of SACCOs in Uganda is partly regulated by SACCO society Act, 2008. For example, SACCOs are required to maintain fifteen percent of its saving deposits and short term liabilities in liquid assets so that they can have smooth running of their affairs.

## Problem statement

SACCOs are voluntary association where members pool their savings together and get loans from which they can use for different purposes. They play an important role in mobilizing financial resources for most development activities especially for local population. SACCOs are also cooperative societies aimed at encouraging members to save for the purpose of creating capital which can be lent to members at a friendly interest rates and conditions than other financial institutions (Sichei & Njenga, 2012).

According to Clement (2012), SACCOs are able to operate in hard to reach areas and this makes them more desirable to customers than other financial institutions. However, Mugisha (2016), indicated that frauds have increased in SACCOs and Okwee (2010) also indicates that over 26% of the loans given to customers remained unrecovered by the SACCOs in Lira Sub region and could be attributed to failure to assess and control credit risks. Nkurunziza, Munene, Ntayi, & Kaberuka (2019) also indicate that over 60% of the SACCOs established are not able to celebrate their first birth day. Alfred (2011), indicates that SACCOs in Uganda have suffered many challenges in managing their liquidity and insufficient loan portfolio and Kyazze (2010) indicates that the SACCOs' profitability is still low.

SACCOs in Ishaka Division have been increasing in number since 2011 and by the end of 2016 had reached a total of seven and their average profitability stood at 2% and the average liquidity stood at 11% by 2016 which is below the required percentage of 15% as per the SACCO society Act 2008 (Bushenyi District Commercial Officer's Report, 2016). Given this unsatisfactory performance of SACCOs in Ishaka Division, the researcher believes that well-built and implemented internal control systems could be the solution to the SACCOs' low liquidity and return on assets ratios and it is this belief that inspired the researcher to undertake the proposed study.

### **Objective of the study**

To find out the relationship between risk assessment and financial performance of SACCOs in Ishaka Division

### **Hypothesis of the study**

There is no significant relationship between risk assessment and financial performance of SACCOs in Ishaka Division

## **LITERATURE REVIEW**

The vigor of financial sector has a significant role in the country and the malfunction of it affects negatively the economic development of any country (Saul, 2011). Financial performance according to Pauserberger and Nassauer (2000) is the organization's capacity to use its assets to generate new resources from its routine operations in a given period of time and it is measured by net income and cash flow operations. During the financial crises in the world in 1980s and 1990s, new risk assessment approaches were evolved. The failure at the end of 20<sup>th</sup> century created a need for more improved ways of enhancing the performance of financial system of many countries.

Risk assessment involves critically looking at the factors that reduce the chances of the organization for achieving its objectives (Kamau, 2014). The risks that might make the financial statement prepared not to be

in conformity with the GAAPs should be identified and analyzed before the statements are prepared. In maintaining internal control system that is effective, every business should frequently evaluate the internal and external risks and this should involve identification and analysis of all the important risks that affect the organization (CEIOPS, 2003). Every organization should make sure that plans and documents the risks assessment objectives and also formulate the assumptions and methods that are intended to be used in assessing the risks and this will boost the financial performance.

Risk assessment mainly involves reducing earning instability and preventing big losses in organizations. For one to manage risks very well, has to first identify them, determine the magnitude and come up with strategies to address them (Ndungu 2013). Laurentis and Mattei 2004) maintain that having a reliable risk assessment system enhances management to perform their duties. Ndungu (2013) also asserts that the efficiency of risk assessment is likely to drastically affect the financial performance of SACCOs.

Peterson and Bohman (2008) and Ndungu (2013) also maintain that for SACCOs to manage risks there must be a well documented system in place to enable them be in position to assess the borrowers. Lindo (2004) also found the financial performance of financial institutions is related to credit risks and insolvency risks. This implies that for financial institutions including SACCOs if they are to boost their financial performance, they have to put in place the reliable risk assessment system to address those risks. Holtalin (2004) in his study interest rates and exchange rates exposures of financial institutions in Korea also found out that the profitability of SACCOs is significantly affected by the exposure to the risks of interest rates and exchange rates. This indicates that the exchange rates and interest rates instabilities negatively affect the financial performance of SACCOs.

Ongwenso (2006) also discovered a relationship between credit risk assessment and financial performance of financial institutions. He further asserts that improper credit risk assessment in place leads to loan losses. This indicates that for SACCOs and other financial institutions to improve on their financial performance, there should be a proper risk assessment system in place. Magali (2014) notes that effective credit risk assessment reduces loan default.

Ndungu (2013) indicates that risk assessment is very significant in most financial institutions and if they are to financially perform well, they must observe risks like credit, liquidity, market and operational risks to make sure that they remain competitive in financial industry.

This shows that the risks undertaken by SACCOs have a significant effect on their profitability and if they are to be more profitable, they need to manage the risks very well. Carey (2001) also contends that the sustainable performance of financial institutions depends much on how they manage their risks and Akkizidis and Khandelwal (2008) maintain that managing risks in an efficient way gives improved returns to the owners of SACCOs.

Risk assessment is very vital in many financial institutions and this has been due to continuous change of financial environment which in turn has led to increased financial regulations (Ndungu, 2015). The financial regulations have constrained the SACCOs from creating many avenues of earning revenue. Pausenberger and Nassauer (2000) indicate that risk assessment techniques play an important role in improving and sustaining the financial performance of SACCOs. Furthermore, the previous financial crisis in the world has awaked the importance of risk assessment in an effort to achieve financial performance objectives sustainably (Ndungu, 2015). He further maintains that the risk assessment approaches are very significant to the firms in that they add value to their financial performance. These approaches reduce on the total risks and make the investors to eliminate the risks specified, thus increasing the market price of shares. IFSB (2010), maintains that tackling financial risks like market, operational and credit risks is becoming more fundamental in many financial institutions. Clarke and Cooper (2004) had earlier asserted that managing and monitoring all quantitative and qualitative risks is increasingly becoming more significant now days.

According to Ndungu (2015), risk assessment techniques are more beneficial to most financial institutions though the benefits are incomprehensible. They further maintained that risk assessment is not meant for tax purposes only but also for other purposes since it requires more resources. This enables firms to reduce on profit instability and improve on the management efficiency. Saunders and Cornett (2006)

notes that risk assessment is vital activity in many financial institutions including SACCOs and these institutions are faced with risks like liquidity risk, credit risk, foreign exchange risks among others and these risks affect the financial performance in a way that reduces the profitability of SACCOs.

## METHODOLOGY

The study adopted a descriptive cross-sectional research design, using both qualitative and quantitative methods in a methodological triangulation framework. Qualitative method was used to enable the researcher in collection and analysis of qualitative data and quantitative method helped the researcher in collection and analysis of quantitative data to establish the relationship between internal control systems and financial performance of SACCOs in Bushenyi Ishaka Municipality. The study population was 122 people from five SACCOs in Ishaka division and it included the board of directors, supervisory committee, loan committee members and employees of those SACCOs and a sample size of 93 was taken from total population of 122 using **Slovene's formula. Stratified sampling with simple random and purposive sampling was used to select respondents from different SACCOs. Descriptive statistics and inferential statistics were used to analyse data.**

## RESULTS

### Descriptive Statistics

This measures the level of agreement and disagreement about the existence and working of internal control systems in SACCOs in Ishaka division and how financially is performing. Questions were designed about risk assessment, control activities, control environment and financial performance of SACCOs and the responses of the respondents were measured on a five Likert scale were 5= strongly agree, 4= agree, 3= neutral, 2= disagree and 1 = strongly disagree. The researcher used mean and standard deviations to measure the level of agreement and disagreement as shown below.

**Table 4.1:** Descriptive statistics

statements	Mean	SD
The SACCO has a strong risk assessment system	3.95	0.787
The SACCO identifies the risks associated with different policies before implementing policies	3.87	0.859
The SACCO measures the magnitude of the risks	3.85	0.886
The SACCO invests in risk assessment	1.51	0.985
The SACCO has risk assessment policies and procedures in place	3.95	0.889
The SACCO regularly monitors the risks	3.75	0.871
The SACCO anticipate the risks	3.80	0.805
The SACCO assesses the clients before giving out loans	4.11	0.847
The insures the risks of un paid loans	2.03	0.885
The SACCO control the risks	3.92	0.784

Source: Primary data, 2019

From table 4.8 above, the results indicate that respondents agreed that SACCOs in Ishaka division have a strong risk assessment system in place (Mean=3.95, SD=0.787), identify risks associated with different policies before implementation (Mean=3.87, SD=0.859), measures magnitude of risks (Mean=3.84, SD=0.886), have put in place risk assessment policies and procedures (3.95, SD=0.889), assess clients before giving out loans (Mean=4.11, SD=0.847), anticipate risks (Mean=3.80, SD=0.805). The results also show that SACCOs in Ishaka division also try to put measures to control risks (Mean= 3.92, SD=0.784). However, the results indicate that SACCOs are not investing in risk assessment (Mean=1.51, SD= 0.985)

$H_0$  = there is no significant relationship between risk assessment and financial performance of SACCOs in Ishaka division ( $H_0 \neq FP$ )

$H_1$  = there is a significant relationship between risk assessment and financial performance of SACCOs in Ishaka division ( $H_1 = FP$ )

**Table 4.2:** the relationship between risk assessment and financial performance

	Model fitting coefficient	Likelihood ratio tests		
	2 log likelihood	Chi Square	df	Sig
Intercept	160.696	60.840	2	0.006
Final	99.866			

From table 4.9 above, since p-value (0.006) < level of significance (0.05), the null hypothesis which states that there is no significant relationship between risk assessment and financial performance of SACCOs in Ishaka division was rejected and alternative hypothesis accepted. This implies that there a significant relationship between risk assessment and financial performance of SACCOs in Ishaka division. Therefore, for SACCOs to improve on their financial performance, they need to carry out risk assessment to avoid the likely losses that arise due to risks.

## DISCUSSION

The study findings revealed that SACCOs in Bushenyi Ishaka municipality were assessing their clients before extending credit services to them (Mean= 3.95), had put in place risk assessment system and were also anticipating the risks that are likely to cause financial and physical losses (Mean=3.80). This was in agreement with Kamau (2014) who emphasized that evaluating internal and external risks is very important to identify the risks that are likely to cause financial losses and this can be achieved through putting in place a strong risk assessment mechanism, assessing the clients before extending loans and identifying the risks that are associated with different policies before implementation.

The results also indicate that SACCOs in Bushenyi-Ishaka municipality were not investing in risk assessment (Mean=1.51). This shows that the risk assessment mechanisms will not be sustainable and this might cause problems associated with not having them

and are not insuring the risks of unpaid loans (Mean=2.03, SD=0.885) which all these caused the SACCOs to incur losses due to unpaid loans. This implied that most practiced risk assessment practice was assessment of clients before giving out loans and the worst was not investing in risk assessment.

### Bi-variant analysis (Hypothesis testing)

This involved establishing the relationship between risk assessment and financial performance of SACCOs in Ishaka division. The researcher did that by testing the hypothesizes using Chi-square as a statistical tool of analysis due to the nature the data that was collected and the hypothesizes tested were stated as below;

in place and they were not insuring the risks of unpaid loans with made them to incur financial losses. This is in disagreement with Ndungu (2013) who maintains that for SACCOs to financially perform well, they need to have all risk assessment practices functional.

The study findings also found a significant relationship between risk assessment and financial performance of SACCOs in Bushenyi-Ishaka municipality (P-value (0.006) < sig value (0.05)). This implies that for SACCOs in Bushenyi-Ishaka municipality to financially perform better, they must assess all the possible risks that are likely to affect their operations. This is in agreement with Lindo (2004), who contends that financial performance of financial institutions is related to credit risks and insolvency risks and also in agreement with Ongwenso (2006), who asserts that there is a relationship between risk assessment and financial performance of financial institutions. Akkizidis and Khandetwal (2007), supports the results by maintaining that managing risks which involve assessment improves returns to the owners of the SACCOs.

Results from interviews also indicate that SACCOs had a strong risk assessment system in place, management and employees were the one in charge of assessing the risks where one interviewee revealed that *"the board members have no time to assess the risks, most of them are busy."*



## CONCLUSION

From the study findings, it can be concluded that the most risk assessment practices in SACCOs of Bushenyi-Ishaka municipality was assessment of clients before giving out loans and the worst was failure to invest in risk assessment and insuring the risks of unpaid loans and this affected their financial performance.

The study also concluded that risk assessment significant relationship with financial performance of SACCOs in Bushenyi-Ishaka municipality and risk assessment affects the financial performance of SACCOs. This implies that if SACCOs in Bushenyi-Ishaka Municipality are to financially perform better, they need to assess the risks that are likely to affect them.

## Recommendations

The researcher recommends that the SACCOs in Bushenyi-Ishaka municipality should invest in risk assessment. This will enable them to have enough equipment and updated technology to identify all the possible risks that are likely to affect their financial performance

The researcher also recommends to SACCOs in Bushenyi-Ishaka municipality to always buy insurance policy to cover the risks of unpaid loans. This will save from the financial losses that arise from loan defaulters which in turn will increase on their financial performance.

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