CONTROL ENVIRONMENT AND FINANCIAL PERFORMANCE OF SAVINGS AND CREDIT COOPERATIVES (SACCOs) IN MID-WESTERN UGANDA

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ABSTRACT

Purpose: To establish the relationship between control environment and financial performance of SACCOs in Mid-Western Uganda.

Methodology: A cross-sectional research design and positivist paradigm were used to collect data from 93 SACCOs in Mid-Western Uganda. A closed-ended questionnaire was used to collect data. Correlation and standard linear regression analyses were conducted.

Findings: The study findings reveal a strong, positive and significant relationship between control environment and financial performance of SACCOs in Mid-Western Uganda.

Unique contribution to practice and policy: This study emphasizes the need for top management to emphasize the importance of designing and implementing effective and efficient control environment. In addition, the government of Uganda needs to review its strategies that are geared at ensuring that SACCOs achieve sustainable financial performance.

Key words: *Control Environment, Financial Performance and SACCOs*

INTRODUCTION

Savings and Credit Cooperatives (SACCOs) are member-based Microfinance institutions (MFIs) whose major objective is to promote savings among its members, and to intermediate savings into loans to enable the members access credit at fair and reasonable interest rates (Ndiege, Mataba, Msonganzila, & Nzilano, 2016) The majority of the population in the emerging economies is excluded from the formal financial institutions' banking system due to lack of collateral, high transaction costs, high risk of default, low rate of loan recovery, and information opacity (Marwa & Aziakpono, 2015). To bridge the financing gap, SACCOs are considered as engines for increased access to affordable credit and other financial services by the active poor (Ndiege, Mataba, Msonganzila, & Nzilano, 2016); (Marwa & Aziakpono, 2015)). Through increased access to credit, the economically active poor in emerging economies are expected to become entrepreneurs and start small and microenterprises.

Although SACCOs are identified as engines for fostering social-economic welfare of the active poor, they (SACCOs) can only achieve this by having sustainable financial performance. Whereas existing literature indicates that there are several factors that can foster financial performance of SACCOs, control environment is a major aspect in influencing sustainable financial performance. Control environment is considered as the overall attitude, awareness and actions of directors and managers regarding the internal control systems and its importance to the entity (Oyoo, 2014)). Committee for Sponsoring Organizations (COSO, 2013) provides that a control environment is a set of standards, structures and processes that set a base for carrying out internal controls across the entire organization. Control environment sets a tone in influencing the control consciousness of managers and employees of the firm in as far as their actions, attitudes and awareness are concerned. In addition, control environment keeps all actors within the firm from committing any wrongdoing (Magu & Kibati, 2016)

Control environment encompasses integrity and ethical values, management philosophy and operating style, organization structure, management and employees' commitment to competence, Board of directors' participation, human resource policies and practices, audit committee participation, and assignment of authority and responsibility ((COSO, 2013); (Oyoo, 2014); (Magu & Kibati, 2016)). Financial performance is conceputalised in terms of portfolio quality, profitability and liquidity(Association of Microfinance institutions of Uganda (AMFIU, 2014/2015); (Asiligwa, 2017); (Magu & Kibati, 2016)

In spite of the role played by internal controls, microcredit institutions have continued to face challenges relating to liquidity, profitability, efficiency; in terms of cost per borrower, and alleged malpractices ((Oyoo, 2014); (Sama & Niba, 2016)). The above challenges could be attributed to weak control environment, as this sets a base for misappropriation of organization's resources ((Oyoo, 2014)). (Mutua & Ali, 2017) downplays the role of control environment by revealing a negative and significant between internal controls and financial performance of MFIs in Kenya. However, Sahabi, Diibuze and Abubakar insist that control environment has a positive relationship with financial performance as indicated by the Pearson correlation coefficient of 0.522987, though insignificant (Sahabi, Diibuze, & Abubakari, 2017). In addition, institutions still struggle with liquidity and misuse of institutional resources even when internal audit departments exist (PROCASUR, 2012) . However, this is refuted by Ngari who provides internal audit function is a

key tool in ensuring that profitability of financial institutions is achieved (Ngari, 2017). Therefore, this study was aimed at making a contribution on the ongoing debate on the relationship between control environment and financial performance.

The empirical literature on financial performance of SACCOs in Uganda is scanty, hence a need for this study that examined the relationship between control environment and financial performance of SACCOs in Mid-Western Uganda. Whereas many empirical studies have looked at financial performance in the perspective of profitability and liquidity, to the researcher's belief, no single study has considered financial performance of SACCOs in the perspectives of liquidity, profitability and portfolio quality. There is no one measure of financial performance should be considered on its own, hence making this study relevant in closing the empirical literature gap (Fujo & Ali, 2016).

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

MFIs have continued to face liquidity challenges, increased operating and financial expenses, and cases of alleged corruption and financial malpractices, in spite of the existence of internal controls (Oyoo, 2014). Moreover, internal controls are put in place to safeguard MFIs' resources from probable frauds and misappropriation. Control environment is considered to be the key component of internal controls. Control environment is significantly linked to financial performance, specifically, liquidity ($r = 0.447$, $P = 0.00$) (Oyoo, 2014). Whereas the study considers control environment as a key driver of financial performance, it only focuses on liquidity as a measure of financial performance, and yet Fujo and Ali recommend the use of more than on measurement of financial performance. (Fujo & Ali, 2016)

The study conducted by Sahabi, Diibuze and Abubakar reveals a positive but insignificant relationship between control environment and financial performance ($r= 0.522987$, $P = 0.427$) (Sahabi, Diibuze, & Abubakari, 2017). Thus, control environment is considered a none significant variable in making valuable recommendations on improving financial performance among health institutions in Upper West Region. Financial performance was measured in respect of liquidity, and accountability. The study findings cannot be generalized on SACCOs, hence making the current study relevant in filling the empirical literature gap. In addition, in the event that the SACCOs' main assets are loans, there is need portfolio quality and profitability as measurements of financial performance.

Control environment is the foundation of all other components of internal controls (Shafawaty, Ram, & Abu, 2016). The same study reveals that the overall system of internal controls will not be as effective as it should be if control environment is not positive. The study implies that effective control environment leads to increased profitability of cooperatives. However, the study does not reveal the relationship between control environment and financial performance. Additionally, the study focused on profitability, and did not consider other measurements of financial performance as suggested by (Fujo & Ali, 2016) These gaps in the empirical literature were addressed by the current study.

Despite the existence of internal controls in banks, there is still liquidity challenges, frauds, delays in the preparation of financial reports, inefficient allocation of resources, and misappropriation of banks assets (Channar, Khan, & Shakri, 2015). The study reveals a positive relationship between

control environment and financial performance of banks. The study justifies the relevance of effective control environment by indicating that ineffectiveness of control environment significantly explained the unsatisfactory level of financial performance of public banks as compared to private banks. The study measured financial performance in terms of profitability, and yet Fujo and Ali recommend the use of more than one financial performance measurement (Fujo & Ali, 2016). The empirical gap was filled by the current study that considers financial performance in the perspectives of liquidity, profitability and portfolio quality.

Internal controls are put in place to safeguard the firm's resources from misappropriation and probable frauds (Ireri & Wagoki, 2014). In spite of the existence of internal controls in public Universities, there is still a lot of liquidity challenges, frauds and misuse of university resources. As a remedy, control environment is considered as a driver for the provision of disple and structures for the achievement of the internal controls' objectives, and also putting into place a conducive climate for the overall quality of internal controls (Ireri & Wagoki, 2014). The study considers control environment as one that promotes and nurtures internal controls. However, the study did not reveal the correlation between control environment and financial performance, hence an empirical literature gap that the current study filled. In addition, this study was conducted in publics institutions whose objective is not to make profits, but offer a service. Therefore, the current study focused on SACCOs that are formed with economic-social motives.

There is a need to enhance internal control environment if companies quoted on the Nairobi securities exchange are to improve financial performance (Kinyua, Gekure, Gekara, & Orwa, 2015). The study revealed a positive and significant relationship between internal control environment and financial performance ($r = 0.420$, $P = 0.000$). The study focused on state-owned companies in Kenya, and only profitability was considered as the measure of financial performance. Thus, the current study filled the empirical literature gap by considering more than one measurement of financial performance, as suggested by (Fujo & Ali, 2016) Furthermore, the current study focused on SACCOs in Mid-Western Uganda; examples of non-state enterprises.

Huge losses are incurred by Kenya Farmers associations Limited, and increased indebtedness due to failure to meet their financial requirements (Magu & Kibati, 2016). There is a positive relationship between control environment and financial performance. The study suggests a need for effective and efficient implementation of control environment if the companies are to achieve their desired financial objectives (Magu & Kibati, 2016). In the event that farmer associations deal in majorly goods, there was need to link control environment to the financial performance of SACCOs, and specifically, in Western Uganda.

Stewardship and stakeholder theories link well with this study. In 1984, Edward Freeman developed the stewardship theory that emphases stakeholder involvement, if the stakeholders are to achieve their desired benefits. The stakeholder theory discourages opportunistic behaviour through avoidance of dominance of an individual stakeholder's interests over those of other stakeholders (Lasisi, 2017) Like the stakeholder theory, the stewardship theory discourages opportunistic behaviour through advocating for managers and owners being on the same footing ((Lasisi, 2017). By this, the stewardship theory advocates for a transition from agency-centered to stewardship-centered approach. All the above theories ensure that the firms' resources are

protected from external interferences, such as frauds and malpractices, hence affecting financial performance of SACCOs.

Based on the empirical studies highlighted above, it is clearly revealed that effective control environment is a key driver of financial performance. However, among the studies, there is no study that has focused on SACCOs in the Ugandan context. In the event that SACCOs are considered as engines for increased access to affordable credit by the active poor (Ndiege, Mataba, Msonganzila, & Nzilano, 2016), the current study filled the empirical gap by establishing the relationship between control environment and financial performance of SACCOs in Mid-Western Uganda.

From the reviewed empirical literature on control environment and financial performance, the following hypothesis was derived:

H01: *There is no statistically significant relationship between* control environment *and financial performance of SACCOs in Mid-Western Uganda.*

RESEARCH METHODOLOGY

The study employed a Cross-sectional research design. This is so because it attempts to explain the connection between the study variables at a point in time (Blumberg, Cooper, & Scindler, 2008). In addition, a positivist paradigm was used in the study because hypotheses were developed to establish the causal relationship between the study variables, and those hypotheses were tested, scientific analyses carried out, and conclusions were made based on the sample size (Bashabe, Kalu, & Amu, 2017)). Given a population of 122 SACCOs in Mid-Western Uganda (Microfinance Support Center ,2019), the study sampled 93 SACCOs, and these were obtained using the Yamane's formula of 1973 that directs the sample selection process. According to Yamane (1973), the sample size of the study was determined by:

$$n = \frac{N}{1+N(e)^2}$$

Where: n = Sample size; N = Study population; e = Error term = 5%.

$$n = \frac{122}{1 + 122*(0.05 * 0.05)}$$

$$= \frac{122}{1 + 0.305}$$

$$= \underline{\mathbf{93}}$$

Stratified sampling technique was used to obtain the representative sample from the study population, and the stratifying factor was a district. A multi-stage sampling approach was employed; where population was stratified, and probability used to provide equal chance of selection to all elements in the population, and then simple random sampling was carried out. Open-ended questionnaires were used to collect data from key SACCO staff.

The study ran a Standard linear regression analysis to ascertain the direction and strength of the relationship between the control environment and financial performance. The following is an analytical regression model for testing the relationship between control environment and financial performance of SACCOs in Mid-Western Uganda:

$$FP = b_{0} + b1CE + e$$

Where; FP = Financial performance; b_0 = Constant; b_1 = Beta coefficient; CE=Control Environment; e = Error term.

Measurement of Study Variables

Control environment items were in terms of integrity and ethical values, audit committee participation, Board of Directors participation, organization structure, assignment of authority and responsibility, management and employees' commitment to competence, management philosophy and operating style, and human resource policies and practices. Furthermore, all items of control environment in the questionnaire were anchored on to a five-point Likert-type of scale. This was in consistence with the study by Kamukama and Natamba that used scales ranging from 5(strongly agree) to 1(strongly disagree) (Kamukama & Natamba, 2013). The details of the measurement scales were as follows: **1** = Strongly disagree; **2** = Disagree; **3** = Undecided; **4** = Agree; **5** = Strongly agree.

RESULTS

Demographic Characteristics

Frequency distributions were developed to assess the demographic characteristics of SACCOs in Mid-Western Uganda, as indicated in table 1, 2 and 3.

Table 1: Years of operation of SACCOs

	Frequency	Percent	Cumulative Percent
Below 5 years	18	19.4	19.4
5-9 years	32	34.4	53.8
9-13 years	32	34.4	88.2
above 13 years	11	11.8	100
Total	93	100	

Source: Primary Data (2020)

Based on the study findings revealed in table 1, majority of the SACCOs have been in business for a period of more than 05 years. This can be evidenced by the fact that only 19% of the SACCOs have been in business for a period of less than 05 years. This implies that the Going concern principle was being implemented in the SACCOs studied. In addition, SACCOs with a substantial period in business are associated with experience in the operations of SACCOs, and also being conversant with the dynamics in the Microfinance institutions' business environment

Table 2: Location of the SACCOs

	Frequency	Percent	Cumulative Percent
Kasese	12	12.9	12.9
Bunyangabu	19	20.4	33.3
Kabarole	20	21.5	54.8
Kyegegwa	12	12.9	67.7
Kyenjojo	10	10.8	78.5
Kamwenge	11	11.8	90.3
Kitagwenda	9	9.7	100
Total	93	100	

Source: Primary Data (2020)

22% of the SACCOs studied were located in Kabarole district, while 20.4% were located in Bunyangabu district (table 2). The least of number of SACCOs studied (9.7%) were located in Kitagwenda district.

Table 3: Capital structure for the SACCOs

	Frequency	Percent	Cumulative Percent
Equity Capital	48	52	35
Equity and Loans	33	36	84
Donations	7	8	91
Loans only	5	5	100
Total	93	100	

Source: Primary Data (2020)

Besides, the study findings represented in table 3 indicate that majority of the SACCOs in Mid-Western Uganda (51.6%) financed their business operations by use of equity capital, while 35.5% used both equity capital and other peoples' money (loans). The least of the financing streams were from donations (7.5%) and loans only (5.4%). This implies that most of the SACCOs had a stable financing option since they used their own money to run their business operations, and this has an impact on their financial sustainability.

Table 4: Standard Linear Regression analysis results

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.549	.302	.294	.54636

ANOVA						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	11.727	1	11.727	39.287	.000
	Residual	27.164	91	.299		
	Total	38.892	92			

Coefficients						
		Unstandardized Coefficients		Standardized Coefficients		
Model		B	Std. Error	Beta	t	Sig.
1	(Constant)	-2.683	.836		-3.211	.002
	Control Environment	.017	.003	.549	6.268	.000

a. Dependent Variable: Financial Performance

The study findings in table 4 indicate a positive and significant relationship between control environment and financial performance of SACCOs in Mid-Western Uganda (R = 0.549, P = 0.000). This implies that a higher proportion of control environment is related to financial performance. Thus, H01 is rejected. In addition, 30.2% of the variation in financial performance is explained by control environment, while 69.2% of variation is explained by other factors outside the model. Besides, a beta coefficient (B = 0.017, F = 6.268, P = 0.000) reveals that for every unit of control environment, financial performance of a SACCO increased significantly by 0.17 units. This so because effective control environment leads to eradication of frauds and misappropriations in SACOs, hence increasing financial performance. The constant (-2.683) was statistically significant (P = 0.002 <0.05), implying that more variables could be needed in the model.

DISCUSSION

The Pearson regression analysis results represented in table 4 reveal that there is a strong, positive and significant relationship between control environment and financial performance. Hence, the hypothesis, H01, was not supported by the study findings. The significant contribution of control environment to the variation in the financial performance of SACCOs in Mid-Western Uganda is revealed by the beta value of 0.549. This implies that 54.9% of the variation in financial performance of SACCOs in Mid-Western Uganda is influenced by control environment. The study findings are in agreement with (Kinyua, Gekure, Gekara, & Orwa, 2015) that indicate a positive and significant relationship between control environment and financial performance of companies quoted on the Nairobi securities exchange. The study findings clearly bring out the general perception that improvement in financial performance will always emanate from effective control environment, since control environment ensures that all the companies' assets are safeguarded from misappropriation, and any probable fraud. The study findings tend to suggest a need for

SACCOs in Mid-Western Uganda to focus on ensuring that an effective control environment exists, as this will strengthen their financial performance. The study findings further reveal the relevance of stakeholder, systems, agency, institutional and stewardship theories among SACCOs in Mid-Western Uganda. Based on these theories, integrity and ethical values among stakeholders leads to the protection of resources from fraud and misappropriation, hence leading to better financial performance. Also, employees and management 's commitment to competence is keenly emphasized in the resource-based view, stakeholder and stewardship theories, as competence is an intangible asset that has a potential of driving the operations of firms. In contrast, the study by (Sahabi, Diibuze, & Abubakari, 2017) reveals a positive but insignificant relationship between control environment and financial performance among health institutions in the Upper West region. This contradiction renders the debate on control environment and financial performance inconclusive.

Theoretical implication

The study confirms empirical literature in terms of positive influence of control environment on financial performance. Thus, based on the study findings, financial performance of SACCOs in Mid-Western Uganda is revealed. The constructs of control environment were developed from agency, resources-based view, systems, stakeholder, institutional, stewardship and modern portfolios theories. Attempts have been made to establish the relationship between control environment and financial performance ((Kinyua, Gekure, Gekara, & Orwa, 2015); (Sahabi, Diibuze, & Abubakari, 2017)). However, no empirical study has attempted to explain the effect of control environment on financial performance of SACCOs in a Ugandan context, and specifically, Mid-Western Uganda. The empirical gap has been addressed by the current study.

In regard to the agency, stakeholder, resource-based view and stewardship theories, although opportunistic behaviour may exist among the managers and employees of the SACCOs, financial rewards can be offered to them in order to align their interests (agents) to those of the owners. In addition, focus should be made on none dominance of stakeholder(s) on the interests of other stakeholders. Putting managers and owners of SACCOs at the same footing will be yet another strategy of eradicating opportunistic behaviour among managers, since it will build a sense of belonging among managers. And this will create harmony among SACCOs' stakeholders. Above all, the SACCOs' resources are scarce, hence should be effectively and efficiently managed in order to maximize financial returns. Resources that effectively and efficiently utilized lead to improved financial performance. Agents have a role to exercise in safeguarding the firm's resources from fraud and misappropriation. To achieve this, SACCOs should hire competent staff with suitable capabilities to take care of the scarce resources. Furthermore, integrity and ethical behaviour among stakeholders leads to protection of organizational resources from fraud and misappropriation, and this can be translated into good financial performance.

Managerial implication

Besides, the results of this study suggest a need for management to put into place effective control environment if SACCOs are to improve their financial performance. The SACCO managers should focus greatly on ensuring that integrity and ethical values are upheld since they are revealed to have a strong and significant influence on the financial performance of SACCOs. For instance,

management, while carrying out recruitment of its staff, should not only consider skills possessed by persons, but also ensure that qualified staff with evidence of commitment to integrity and ethical behaviour are the ones recruited (Mwakimasinde, Odhiambo & Byarugaba ,2014).

CONCLUSION

This study focused on establishing the relationship between control environment and financial performance of SACCOs in Mid-Western Uganda. Based on the empirical literature review, control environment was taken into account as an independent variable, and the direction of its influence on financial performance was hypothesized. In lieu of the study hypothesis, the study concludes that there is a strong, positive and significant relationship between control environment and financial performance of SACCOs in Mid-Western Uganda. It can be concluded that financial performance of SACCOs could be strengthened by improving the effectiveness of the existing control environment.

RECOMMENDATIONS

1. In order to boost financial performance of SACCOs in Uganda, managers should make it a point to design and implement effective control environment, as this has been presented by the study findings as being significant. Consequently, Board of directors should not be contented with the study findings about control environment having a strong and significant relationship with financial performance, but should work harder to ensure continuity. From the indications, SACCOs need to rethink on the most effective methodologies to apply in managing its control environment. For instance, SACCO managers should aim at ensuring that all employees conform to integrity and ethical values-that have been identified as strong and significant influencers of financial performance.
2. Additionally, SACCOs' top management should endeavor to organize trainings at the start of every year to raise the level of awareness about integrity and ethical behaviour, as well as acting as a reminder to employees of their expected conduct within the institution.
3. Besides, all employees should be availed a copy of the code of conduct. It is not all about competence of staff, but both competence and morally uprightness of staff. Therefore, there is need for professional conduct and adherence to sound parctices by staff, as this leads to portfolio quality and profitability of SACCOs in Uganda.

LIMITATIONS

This study considered financial performance of SACCOs in Mid-Western Uganda in the perspectives of portfolio quality, profitability and liquidity. However, there could be non-financial performance indicators that would be relevant in this study. A single research methodological approach (quantitative) was used in this study. Besides, both quantitative and qualitative research approaches could be used to triangulate. The current study adopted a cross-sectional research design. However, using the same study hypotheses, a similar study could be carried out using a longitudinal research design. By doing this, the time element could be considered while conducting a similar study.

The current study considered 93 SACCOs to constitute the sample. A larger sample could be used so as to extrapolate the study findings. By doing so, the generalizability would be added to the current study findings.

AREAS FOR FURTHER RESEARCH

The study findings on control environment and financial performance of SACCOs contradicted the works of (Sahabi, Diibuze, & Abubakari, 2017) that revealed a positive but insignificant relationship. Therefore, there is need for more empirical research to be carried out. Furthermore, this study adopted a cross-sectional research design. The declining trends of financial performance of SACCOs in Uganda necessitates a longitudinal study to be carried out, so as to obtain a deeper understanding of the relationship between control environment and financial performance of SACCOs. However, the same basic study hypothesis could be used. Also, this study was conducted in Uganda, and specifically, in Mid-Western Uganda. A comparative analysis of SACCOs in other parts of the region, while considering the same variables (control environment and financial performance), could be beneficial.

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