Bank requirements and governance for savings and credit co-operative societies (SACCOS) in Tanzania and Kenya

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As suppliers of wholesale commercial funds to savings and credit co-operative societies (SACCOS) for on-lending to their clients, banks are key stakeholders. According to the agency theory, banks influence the operations of SACCOS. However, empirical knowledge remains scant on the measures banks apply to control these operations and on SACCOS' governance-related reactions to bank requirements. In an attempt to fill this gap, this paper explores measures used by banks to monitor and control SACCOS-partners in addition to assessing SACCOS' governance-related reactions to bank requirements. The paper utilizes data collected through in-depth interviews held with both the management of five banks selected primarily because of their active involvement in wholesale lending to SACCOS. In addition 11 SACCOS linked to these five banks were selected in Tanzania and Kenya. Thematic content analysis was used to analyse the data. The findings reveal that measures applied by banks to monitor and control SACCOS-partners include accessing and investing in information on SACCOS-partners and their clients, and requiring both guarantees and forced savings. Compliance with these measures was found to result into two governance-related reactions: 1) improved compliance with own by-laws, regulations, policies or procedures, and government regulations; and 2) realignment and/or reduced compliance with some of their own by-laws, policies, regulations, and procedures, and thus some of the government regulations, to accommodate bank requirements.

Keywords: bank requirements, financial linkages, governance, microfinance/SACCOS

Savings and credit co-operative societies (SACCOS) are a form of microfinance institution (MFI) established to provide financial services to their shareholding clients (members). They are aimed at encouraging saving among their members to create a source of financial services to their members (United Republic of Tanzania [URT], 2014), the majority of whom are usually excluded from the commercial banking industry. In Tanzania and Kenya, where SACCOS have been operating for more than 50 years, the majority of them are still rather small and, hence, considered to be in the initial stage of development (Ademba, 2010). As a result, Tanzania and Kenya, like other developing countries in the world, where the majority of SACCOS are in this initial stage of development, have adopted a mixed model of regulating SACCOS.

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In Tanzania, SACCOS whose deposits exceed their minimum core capital of Tanzanian shillings (Tshs.) 800,000,000 (approximately US$366,000) are supposed to be governed by the Banking and Financial Institutions Act, 2006 (URT, 2006) and the Banking and Financial Institutions (Financial Co-operative Societies) Regulations, 2005 (URT, 2005). These SACCOS are required to be licensed and supervised by the country's central bank, the Bank of Tanzania (BoT). However, to date, none of the big and mature SACCOS are licensed and supervised by the BoT. All the SACCOS, including deposit-taking ones, are supervised by the Co-operative Development Department (CDD) of the Ministry of Agriculture, Food Security and Co-operatives. They are supposed to be externally audited by the Co-operative Audit and Supervision Corporation (COASCO) and operate under the Co-operative Act of 2003, amended 2013, and Co-operative Societies Rules, 2004.

Unlike Tanzania, Kenya's deposit-taking SACCOS with minimum core capital of Kenyan shillings (Kshs.) 10,000,000 (approximately $99,000) are required to be licensed and supervised by the SACCO Societies Regulatory Authority (SASRA) and to operate under the Kenya Co-operative Act of 2008, revised 2012 (Republic of Kenya [RoK], 2012), and SACCO Societies (Deposit-taking SACCO Business) Regulations, 2010 (RoK, 2010). Other SACCOS in Kenya are registered and supervised by the office of the Commissioner for Co-operative Development, which is under the Ministry of Co-operative Development and Marketing. They operate under the Kenya Co-operative Act of 2008, revised 2012. Under the co-operative acts and regulations, SACCOS are required to formulate their by-laws, policies, regulations, and procedures at the organizational level to govern their operations.

The application of the mixed model of regulating SACCOS, involving both financial and co-operative authorities, tends to create a grey area for some SACCOS to fail to comply with respective regulations in the face of the inability of government agencies to supervise them effectively and enforce necessary regulations (Ademba, 2010). Government agencies which are non-financial institutions also lack the requisite financial skills and political independence needed to oversee financial intermediaries effectively (World Council of Co-operative Union [WOCCU] and Consultative Group to Assist the Poor [CGAP], 2005). In Tanzania, only 40 per cent of 5,344 SACCOS were audited by COASCO in 2009 (Ishengoma, 2012). In general, external supervision and regulation of SACCOS has largely remained weak, which is associated with limited capacities in government departments responsible for supervising SACCOS (Organization for Economic Cooperation and Development [OECD], 2013). In Kenya, 38 per cent of 215 deposit-taking SACCOS did not qualify for SASRA licensing in 2013 as they did not comply with national regulations (SASRA, 2013). Generally, self-regulation among SACCOS has remained weak because of the lack of trained staff (leaders, managers, and employees), and poor record-keeping systems (Triodos Facet, 2007), and great potential for leaders and management to maximize their own interests at the expense of SACCOS' members, the majority of whom suffer from financial illiteracy.

Non-compliance with national and own regulations, coupled with weak national and self-regulatory frameworks, results in poor lending practices (OECD, 2013), embezzlement of funds by SACCOS leaders, and moral hazard in loan repayment

(Ishengoma, 2013). These negative consequences limit the achievement of SACCOS' objectives as MFIs. In fact, after more than 50 years of operation, only 33 per cent of more than 6,000 registered SACCOS in Kenya (SASRA, 2013) and 75 per cent of 5,559 registered SACCOS in Tanzania (data from CDD; OECD, 2013) were active in 2013. In 2013, SACCOS' penetration rate in Kenya and Tanzania stood at 19 per cent and 4.4 per cent, respectively (SASRA, 2013).

Continued external governance (supervision, monitoring, guidance, and enhancement of self-governance, especially compliance with national and own regulations, standards, policies, and procedures) is crucial for SACCOS to grow and achieve their set objectives (Triodos Facet, 2007). Given the absence of most MFIs in the capital market, coupled with a weak labour market, weak government offices (OECD, 2013) and regulations to govern the behaviour of the management of MFIs (Hartarska, 2005), and weak self-governance, financial linkages (FLs) appear to be a viable alternative/supplementary option to external governance of SACCOS. FLs are forms of partnerships between MFIs/SACCOS and banks, which enable MFIs/SACCOS to access wholesale funds in the form of equity or debt from banks for on-lending to their clients (Pagura and Kirsten, 2006).

The role of FLs in influencing the governance of SACCOS is in line with the stakeholders' approach (Labie and Mersland, 2011) and the agency theory, whereby banks (viewed as principals) offering wholesale loans to MFIs/SACCOS (viewed as agents) for on-lending to their clients may establish governance mechanisms to direct, control, and monitor the operations of MFI/SACCOS-partners. Advancing from the transaction cost theory, the global value chain literature (see Gereffi et al., 2005; Humphrey and Schmitz, 2008, 2004) addresses the importance of key drivers (i.e. a buyer or a producer depending on the nature of the chain) in directing, controlling, and co-ordinating other actors integrated into the value chain. Yet, despite the growing linkages between banks and MFIs/SACCOS (see Pagura and Kirsten, 2006; Reille et al., 2011; Ishengoma, 2013), knowledge on the relationship between banks' requirements and governance in MFIs/SACCOS remains largely scant. Nevertheless, cases of banks compelling their MFIs/SACCOS partners to accept their requirements on staffing and equipment purchase decisions, lending models, and terms of loans to MFIs'/SACCOS' clients have been reported (Pagura and Kirsten, 2006). Cases of fraud and non-compliance with financial policies among SACCOS linked to banks have also been implicitly mentioned (Ishengoma, 2012).

Empirical studies (Ishengoma, 2012, 2010; Pagura and Kirsten, 2006; Development Alternatives Inc., 2005) on FLs focus on the implications of FLs for the performance of MFIs, whereas those on governance in MFIs (Galema et al., 2012; Mersland and Strom, 2009; Hartarska, 2005) concentrate on assessing the influence of corporate governance on the performance of MFIs. A review by Labie and Mersland (2011) of studies associating governance in MFIs with MFIs' performance reports on the presence of inconsistent findings and, thus, calls for considering the interactions between external and internal governance mechanisms as well as other governance mechanisms besides boards. Despite the presence of interactions between banks' requirements set to govern MFIs/SACCOS-partners and governance in MFIs/SACCOS, knowledge on the outcome of these interactions is scant. It is against this backdrop that this paper explores the measures that banks deploy to monitor and control SACCOS-partners and assesses SACCOS' governance-related reactions to bank requirements.

The results presented in this paper can contribute to the development of a framework for assessing the influence of banks on governance in their SACCOS-partners. Furthermore, the results are important to banks and SACCOS involved in and those developing FLs for the following reasons. Whereas the former can know the requirements for extending wholesale loans to SACCOS, the latter can know the effect of FLs on their governance. Results are also useful to policy-makers and regulators of SACCOS, who can encourage FLs to enhance SACCOS' compliance with regulations and self-governance in addition to impressing upon banks and SACCOS to take precautions against forces that make SACCOS reduce their compliance with government regulations through practising their by-laws, regulations, policies, or procedures not registered by the registrar of cooperatives.

Furthermore, results presented in this paper are useful to SACCOS operating not only in Tanzania and Kenya but also in other parts of the world such as Asia and Latin America. This is because in some countries in these continents (e.g. India and Indonesia), SACCOS or member-owned institutions that offer financial services are weakly regulated by non-central bank institutions (Chao-Béroff, 2008). Some Latin American countries (e.g. Ecuador) follow a mixed model of regulating savings and loan co-operative institutions, which also face challenges (Chao-Béroff, 2008) like Tanzania and Kenya. Also, member-owned institutions in Asia and savings and loan co-operative institutions in Latin America have been involved in FLs with banking institutions (Pagura and Kirsten, 2006; Chao-Béroff, 2008; Reille et al., 2011).

The rest of this paper is organized as follows. The next section presents theories guiding this paper. Then we describe the data and the analytical approach applied, followed by the presentation and discussion of the results and the conclusion.

Theoretical considerations

All SACCOS in Tanzania and the majority of them in Kenya are semi-formal MFIs as they are registered and regulated by government agencies that are non-financial authorities and not by the central banks. As noted above, in Tanzania they are registered and regulated by the office of the Registrar of Co-operatives, which is under the Ministry of Agriculture, Food Security and Co-operatives, whereas in Kenya, the majority of SACCOS are registered by the Commissioner for Co-operative Development, which is under the Ministry of Co-operative Development and Marketing and a few of them (135) – deposit-taking SACCOS – are licensed and regulated by SASRA.

SACCOS in Tanzania and Kenya have been involved in financial linkages with banks and non-bank financial institutions. In 2001, some 670 SACCOS in Kenya received loans from K-Rep Bank for on-lending to their clients (Hospes et al., 2002). In 2009, some 425 MFIs, the majority of which were SACCOS, accessed loans from CRDB Bank PLC for on-lending to their clients (CRDB Microfinance Company

Limited, 2009). Governments and development finance institutions have also been stimulating the development of FLs to enable MFIs to reach more poor people. In 2006, the Tanzania Government provided guarantees to commercial banks that offered loans amounting to Tshs. 21 bn ($9.6 m) to SACCOS for on-lending to their clients (URT, 2008).

FLs are about transactions between banks and MFIs, on the one hand, and MFIs and their clients, on the other. When these transactions occur in an imperfect market and the environment is characterized by weak contract enforcement mechanisms, transaction costs arise (see Williamson, 1998). Under FLs, the transactions involve an exchange between wholesale funds offered by banks to MFIs/SACCOS for on-lending to their clients and contracts accepted by MFIs/SACCOS to repay the funds and interests for a specified time. The nature of these transactions allows for agency relationship to exist between banks and MFIs/SACCOS, whereby the former are treated as principals and the latter as agents (see Ross, 1973; Eisenhardt, 1989). As the funds are for on-lending to their clients, MFIs/SACCOS also exchange loans and contracts with their clients. In this regard, the agency theory is complemented by the transaction cost theory, which is useful in facilitating the identification of measures that banks use to monitor and control MFI/SACCOS-partners. As an agent (an MFI/SACCOS), compliance with bank measures, which implies meeting requirements and accepting terms of contracts, has implications for its internal governance mechanisms.

When offering wholesale loans to MFIs/SACCOS for on-lending to their clients, banks strive to attain two objectives: first: they contribute to poverty reduction by making funds available to MFIs for on-lending to the poor; and second, they provide returns to investors (Krauss and Walter, 2008). MFIs/SACCOS also face dual objectives: providing financial services to the poor and becoming financially sustainable. The objectives of MFIs and those of their investors (banks) seem to be aligned but conflicts may arise when prioritization of objectives among them differs. This situation may lead to agency costs when banks fail to verify whether MFIs/SACCOS have behaved appropriately (see Eisenhardt, 1989; Shapiro, 2005). Agency and transaction costs may also arise when MFIs/SACCOS' attitudes toward risk differ from those of the banks, an obvious situation given the nature of MFIs/SACCOS' clients.

The magnitude of agency and transaction costs depends on the levels of bounded rationality and assets specificity, coupled with opportunism and uncertainty (Williamson, 1979; Martins et al., 2010). These occur when a party (e.g. an agent) fails to meet its contractual obligations due to low competencies or poor governance mechanisms which seem to characterize MFIs/SACCOS and their business environment. The majority of MFIs/SACCOS suffer from limited skills, poor internal auditing and record-keeping, and weak governance mechanisms (Yaron, 1994; Randhawa and Gallardo, 2003; Seibel, 2005; Ishengoma, 2010, 2012; Labie and Mersland, 2011). MFIs/SACCOS also face high risk as the majority of their clients are characterized by bounded rationality, opportunism, and uncertainty.

Advancing from the transaction costs theory, the global value chain (GVC) literature emphasizes the presence of a single powerful party (i.e. a buyer or a producer depending on the nature of the chain), which governs other parties in the chain by, among other things, setting requirements/standards about the product/service, source of inputs and delivery time. Drivers also apply to governance mechanisms – close supervision, sharing technology, on-the-job training, monitoring and control – to facilitate other actors' compliance with set requirements (see Gereffi et al., 2005; Humphrey and Schmitz, 2008, 2004). The transaction cost theory refers to these mechanisms as co-operative adaptation governance mechanisms (Williamson, 1998).

The agency theory, on the other hand, is concerned with solving agency-related problems through behaviour-oriented contracts (salaries, hierarchical governance) or outcome-oriented contracts (commissions, incentives, stock options, transfer of property right, market governance) (Eisenhardt, 1989; Shapiro, 2005). As the majority of MFIs are not quoted in the capital market and operate in an imperfect manager/labour market (Labie and Mersland, 2011), this limits the application of market governance mechanisms and stock options. As noted earlier, the application of the hierarchy governance structure is possible when banks have some level of equity ownership in MFIs.

Measures under the behaviour-oriented contracts, which the principal may use to solve agency problems, include investing in information systems such as budgeting, auditing, reporting and managerial supervision (Eisenhardt, 1989). From the empirical findings, additional behavioural- and outcome-oriented governance variables which scholars (Mori, 2014; Galema et al., 2012; Mersland and Strom, 2009, 2011; Hartarska, 2005) applied to assess their implications on MFIs' performance include the board of directors, board compositions/diversity/characteristics, CEO attributes, type of MFI, internal auditing reporting system, and number of board meetings.

The foregoing discussion on agency and transaction-cost theories as well as literature on business linkages show possible measures/requirements which banks may apply to monitor and control their SACCOS-partners. These measures could be behavioural (e.g. access to and investing in information) and/or outcome-oriented (e.g. incentives). Through its thematic content analysis, the paper uses this knowledge to identify measures applied by banks to govern SACCOS-partners.

The agency and transaction-cost theories do not address further the implications of measures for internal governance of controlled actors/agents/partners. Nevertheless, scholars applying these theories look at the implications of control measures for the performance of agents. As performance is associated with internal governance (Thomsen and Conyon, 2012; Mori, 2014), the latter is likely to be related to the principals' control measures (i.e. external governance mechanisms). This paper borrows from this understanding to assess SACCOS' governance-related reactions to bank requirements.

Data and methodology

This paper is aimed at generating new insights into measures applied by banks to monitor and control their MFI-partners and MFIs' governance-related reactions to banks requirements. To achieve this objective and following Collins (2010), we utilize the qualitative data collected in 2013 through in-depth interviews with the management of five banks (Co-operative Bank of Kenya Limited [CBK], the CRDB Bank Microfinance Services Company Limited [CRDB Bank], Uchumi Commercial Bank [UCB], Kilimanjaro Co-operative Bank Limited [KCBL], and the National Microfinance Bank [NMB]), which were selected purposively based on their active involvement in wholesale lending to SACCOS. During interviews with the bank management, the respondents were requested to name SACCOS-partners to which they extended wholesale loans for on-lending to their clients. Eleven SACCOS purposively selected from the list provided by the banks were interviewed. These SACCOS were involved extensively in borrowing from banking institutions. Sample SACCOS in Kenya accepted deposits but only one SACCOS was licensed by SASRA. In Tanzania, all the sampled SACCOS accepted deposits but were not licensed by a deposit-taking regulatory authority for SACCOS as it did not exist.

CRDB Bank and NMB are among the three largest banks in Tanzania. CRDB Bank started offering loans to SACCOS in 2001 (Piprek, 2008). In 2009, it had 425 MFIs-partners, of which the majority were SACCOS-partners operating in 23 regions (CRDB-MFL, 2009). NMB has been offering wholesale loans to SACCOS since the 2000s. Similarly, UCB and KCBL partner with SACCOS, whereas CBK partners with SACCOS with front-office activities. These SACCOS are also shareholders in the banks. The UCB's major shareholder is the Northern Diocese of the Evangelical Lutheran Church in Tanzania (ELCT-ND). KCBL's other shareholders include the Primary Co-operative Societies (RCS), the Kilimanjaro Native Co-operative Union, Vuasu Co-operative Union and G32 KNCI Limited (http://www.kilicobank.com/). CBK is a listed company; 64 per cent of its shares are owned by SACCOS and the rest by other investors (http://www.co-opbank.co.ke/about-us). In 2013, SACCOS accounted for 21 per cent of CBK asset portfolio (CBK, 2013). Like other commercial banks, the three banks offer financial services to other clients apart from SACCOS, which are shareholders, and are regulated by the central bank. Thus, a SACCOS with shareholding in these banks has low external influence on the governance of the banks, which are highly regulated by the respective country's central bank and capital market authority.

During interviews, the bank managers were asked to specify the requirements that SACCOS should meet when applying for wholesale funds, and during the loan period. Table 1 indicates a summary of these bank requirements. The table also indicates sample banks' respective SACCOS partners that were involved in the study.

Furthermore, the bank managers were asked to describe the usefulness of the requirements in monitoring and controlling SACCOS. Complementing data from banks, the managers of sample SACCOS were also asked to specify the requirements they had to meet to access loans from banks for on-lending to their clients, the criteria which their clients have to meet when accessing these loans from them, and how the bank requirements were linked with their systems (e.g. by-laws, policies, procedures) of governing their operations.

We semi-inductively and deductively applied thematic content analysis, as Robson (2011) suggests, to analysing the data. This is because we had an idea of governance variables as described by agency and transaction cost theories before establishing codes and themes. During the analysis, we tried to fit the codes and themes we identified into these theories.

Table 1 Attributes of sampled SACCOS by bank partner

Attributes	*Bank 1*				*Bank 2*			*Bank 3&4*			*Bank 5*
	Vision Africa SACCO	*Free Area Travellers SACCO*	*SIMA SACCO*	*DUME SACCO*	*Mwanza SACCOS*	*Mkolani SACCOS*	*WADOKI SACCOS*	*Karanga ELCT SACCOS*	*UAMKI SACCOS*	*Uswaa-Mamba SACCOS*	*Geita-T SACCOS*
Clients:											
Farmers	√		√		√	√	√	√	√	√	√
Employees	√		√	√	√	√	√	√	√	√	
Entrepreneurs	√	√	√		√	√	√	√	√	√	
Services:											
Loan	√	√	√	√	√	√	√	√	√	√	√
Savings/deposits	√	√	√	√	√	√	√	√	√	√	
Standing orders	√		√				√				√
Mobile money transfer	√				√	√			√		√
International money transfer	√										
Insurance						√		√			
Training	√	√	√	√	√	√	√	√	√	√	√
Number of clients											
Total loan portfolio											

Source: Data from interviews

Table 2 Bank requirements for SACCOS to access wholesale funds

Requirements	*Bank 1*	*Bank 2*	*Bank 3*	*Bank 4*	*Bank 5*
Submission of:					
– Minutes of credit committee		√		√	
– Minutes of annual general meeting (AGM) or board meeting		√	√	√	√
– List of borrowers		√	√	√	√
– Inspection report and certificate of maximum liabilities		√	√	√	√
– Audited financial statements	√	√		√	√
Legally selected board members		√			
Education of board members					√
Full-time employees		√			
SACCOS operates an account with the bank	√	√	√	√	√
SACCOS' clients operate accounts with banks	√				
Collaterals					
– Savings/deposits as % of loan		25%	50%	50%	40% of savings
– Employees' salaries	√	√			Up to 60% of salary
– Physical properties	√	√		√	√

Source: Data from interviews

Empirical findings and discussions

Bank monitoring and control mechanisms

Results from in-depth interviews established that the measures applied by banks to monitor and control SACCOS-partners start at the level of evaluating SACCOS and continues during co-operation, which occurs after the establishment of direct financial linkages. These measures are categorized into access to and investment in information about SACCOS-partners and their clients, forced savings, or other forms of collateral and guarantee.

Access to and investment in information. Banks ask SACCOS applying for wholesale funds for on-lending to their clients to meet certain organizational criteria and submit documents as presented in Table 2. The usefulness of these requirements in monitoring and controlling SACCOS' operations is described below.

- *Minutes of credit committee meetings*. Two out of five banks interviewed reported that they use minutes of credit committee meetings to determine whether SACCOS follow procedures in line with their by-laws, regulations, policies, or procedures when extending credits to their clients. Through this evaluation, the banks can establish whether the SACCOS are managing their lending process effectively. When the banks agree with the procedures SACCOS follow, they offer them loans. The reverse is also true: when they disagree with the procedures and, as a result, they advise the SACCOS on what they should do to access loans from them. Much of the advice the banks offer to SACCOS is aimed at reducing inherent credit risks for their SACCOS-partners and for themselves.

- *Minutes of AGM or board meetings*. These minutes are used by four out of five banks interviewed to establish whether the owners of SACCOS had agreed to borrow since they are liable for SACCOS' debt obligations. The consent of owners through the AGM or board meeting is important as failure by SACCOS to repay the loans as scheduled might force the owners to use their equity (shares and reserves) to repay the loan.
- *A detailed list of borrowers*. Four out of five banks interviewed used a detailed list of borrowers as one of the requirements for accessing wholesale loans. This list shows details (savings, repayment histories, amounts requested, purposes of loans, and contacts) of prospective borrowers whose applications are expected to be funded by the banks. The banks use the list to gather information on the SACCOS' markets and clients, which is crucial in evaluating SACCOS' abilities to repay loans. They further use the list to verify the authenticity of prospective borrowers' (i.e. SACCOS' clients) information by communicating with them directly or visiting them for monitoring and follow-up purposes. They also use the list to advise SACCOS on the optimal size of the loans they can offer to their clients. In this regard, the four banks indirectly approve the loan size SACCOS can offer to their clients.
- *Inspection report and certificate of maximum liabilities*. Four out of five banks interviewed required SACCOS to be inspected by the Regional Registrar of Co-operatives, who issues an inspection report and certificate of maximum liabilities. Beyond auditing financial records, the inspection involves auditing a SACCOS' operations and assessment of its capacity to repay the loan. The certificate of maximum liabilities indicates the possible room for borrowing before reaching the optimal debt-to-equity ratio in accordance with the SACCOS' by-laws/policy. The inspection report and certificate of maximum liabilities indicate the activeness and legality of SACCOS. They are also useful in establishing whether SACCOS can, from a regulation point of view, still access wholesale loans from banks.
- *Audited financial statements*. Four out of five banks interviewed use SACCOS' audited financial statements to evaluate the financial performance and the capacities of the SACCOS-partners to repay loans. They also use the statements to review and assess the investment and financing decisions conducted by the management.

To enhance the quality of information, banks require SACCOS-partners to meet the following organizational criteria:

- One out of five interviewed banks required SACCOS to have legally elected board members to both improve the reliability and legality of the decisions made by the board and hold the SACCOS owners legally accountable for any decision made by the board on their behalf.
- One out of five interviewed banks required SACCOS to utilize board members with impeccable credentials to ensure sustainability.

- One out of five interviewed banks required SACCOS to use full-time management and employees equipped with financial management skills. This enables the bank to get quality information as the regular use of casual employees disrupts continuity of record-keeping and the documentation learning process in addition to complicating issues of accountability.
- Two out of five interviewed banks required SACCOS to have permanent physical offices and to establish front-office activities to strengthen record-keeping and to separate duties for the enhancement of control and monitoring of activities.
- One out of five interviewed banks required SACCOS to participate in training on record-keeping, financial management, and application of accounting software, which it offers. This is useful in enhancing the quality of information prepared, which is required for easy control, monitoring, and supervision of SACCOS. The use of accounting software offered by bank-partners enables banks to easily process and/or understand different reports prepared by MFIs/SACCOS.
- Two out of five interviewed banks required SACCOS to utilize ICT facilities (computers and accounting software) to enhance the quality of their information. This enables SACCOS and banks to have records about SACCOS' clients and activities on time, and facilitate timely and informed decision-making.
- All the five banks interviewed required SACCOS to operate a bank account with them (banks). Thus, banks are able to learn about their cash-flows and monitor/control their cash outflows. One bank out of five banks interviewed also requires SACCOS' clients to maintain accounts with the banks to monitor the clients' transactions and direct deductions of loan repayment from the clients' account to the SACCOS' account, and then from the SACCOS' account to the bank account.

Incentivized measures. Apart from accessing and investing in information from SACCOS-partners, banks apply the following measures to encourage SACCOS and their clients to meet their contractual debt obligations:

- *Forced savings*. Four out of five banks interviewed require SACCOS-partners to save a certain percentage of the loan they apply for in their savings or fixed deposit receipt (FDR) accounts, which they operate with bank-partners. Savings range from 25 per cent (Bank 2) to 50 per cent (Bank 3 and Bank 4) of the loan they apply for. In case SACCOS' prospective borrowers, whose loan requests are expected to be financed by banks, fail to save the required amounts, some banks (e.g. Bank 2, Bank 3, and Bank 4) ask SACCOS-partners to leave the portion of loan equivalent to the required amount in their bank accounts when they receive the loans for on-lending to their clients. The FDRs and savings are treated as collateral and, thus, accessible by SACCOS after completing repaying their loans. The four banks use forced savings as an incentive for loan repayment and a motivating tool for further borrowings.
- *Employers' guarantee*. For employee-based SACCOS, three out of five interviewed banks require employers to guarantee loans requested by SACCOS. The guarantee assures access to employees' terminal benefits in case they retire before completing loan repayment. Therefore, employees are compelled to comply with the loan repayment procedures as defaulting may result in conflict with their employers and, thus, jeopardize their future employment.

- *Clients and SACCOS leaders' collateral*. Four out of five banks interviewed require board members to offer their personal guarantee of the loans to force SACCOS' leaders to institute effective monitoring and control of the SACCOS operations. One of the four banks extends collateral requirements to SACCOS clients.

Access to quality information as a strategy applied by banks to monitor and control SACCOS-partners to ensure repayment of their loans is in line with what the agency theory categorizes as behavioural-oriented governance mechanisms. Audited financial statements, board structure, number of meetings, the application of board members' education, training and experience are among variables scholars use (Galema et al., 2012; Mersland and Strom, 2009; Hartarska, 2005) applying the agency theory to capture the nature of governance mechanisms. Beyond variables capturing the board structure (i.e. diversity, size, independence, and duality), the empirical results show the need for including the legality of boards and qualifications of board members as banks emphasize these attributes when assessing the reliability and legitimacy of decisions made by the board.

The results further indicate that inspection reports and detailed records on the SACCOS' (i.e. agents') clients are important governance variables. Furthermore, the application of ICT in enhancing behavioural-oriented governance mechanisms (timely provision and adequate financial information and clients' records) and having a physical office, which may establish the nature or legality of a SACCOS, are other important governance variables. Measures such as close supervision of SACCOS and the provision of advice, training, and ICT facilities to SACCOS depend on the level of linkages (e.g. magnitude/depth/volume and/or duration of FLs) and are in line with the transaction cost theory on the application of adaptation governance mechanisms to reduce uncertainty (Williamson, 1998). The application of forced savings, employers' guarantees, and collateral from SACCOS' clients and/or SACCOS leaders in motivating SACCOS to meet their debt obligations is in line with the agency theory's postulations on the outcome-oriented governance mechanisms. Besides fear of losing collateral in the form of reputation to the public (Handy, 1995), empirical results reveal that banks require board members to offer personal guarantees in order to force them to exercise effective monitoring of their organization.

SACCOS' governance-related reactions

SACCOS, as registered institutions, have regulations/by-laws, procedures, and policies governing their operations. As noted above, guided by government/national acts and rules/regulations, SACCOS abide by their attendant by-laws, policies, regulations, and procedures to manage properly their operations and ensure their legality. Apart from these, SACCOS are required to comply with the bank requirements, including governance-related obligations to access wholesale commercial funds from banks. Empirical results show that compliance with bank requirements forces SACCOS to either follow, modify or/and stop abiding by some of their by-laws, regulations, policies, or procedures set to guide their operations. These governance-related reactions are described below.

Compliance with government regulations and own by-laws, regulations, policies, or procedures. As presented above, in countries such as Tanzania and Kenya, the enforcement of SACCOS' compliance with their institutions and government regulations is rather weak. Therefore, most of the SACCOS loosely conform to their by-laws, regulations, policies or procedures, and government regulations. On the other hand, their linkages with banks forces them to conform to the banks' requirements, some of which are in line with some of their by-laws, regulations, policies or procedures, and government regulations as described below:

- *Presence and functioning of credit committees*. The SACCOS interviewed reported that they have credit committees. However, 'Sometimes boards override the responsibilities of credit committees in our institution, and approve loans to themselves and some of unqualified loan applicants, which go against SACCOS by-laws', stated one of the SACCOS managers. The managers noted that when banks demand minutes of credit committee meetings, they force SACCOS to have the credit committee which, in turn, implies fulfilling their duties as well as complying with Tanzania's Co-operative Societies Rules, 2004 (CSR - 2004) section 78, and Kenya's SACCO Societies (Deposit-taking SACCO Business) Regulations, 2010 section 60(8) (Republic of Kenya [RoK], 2008; URT, 2004). 'The room for being overridden by boards and approving loans to ineligible clients is minimised as there should be consistency between minutes of the credit committee meetings and detailed lists of loan applicants prepared by the credit committee submitted to banks', claimed another SACCOS manager. 'To crosscheck the information we provide to them (banks), they sometimes communicated directly with our clients on the list', asserted one of the SACCOS managers.
- *Presence of AGM as a strategic decision-making organ*. Interviewed SACCOS have integrated this decision-making organ in their governance structure. However, some SACCOS reported delays in the organization of general meetings due to prior demanding preparations and related costs. In some SACCOS, board chairpersons override duties of the general or board meeting. 'Demanding for minutes of the AGM [by the banks] forces us to conduct these meetings', claimed one of the SACCOS managers. As a result, SACCOS comply with Tanzania's CSR-2004 section 33 or Kenya's Co-operative Societies Act Section 27 (RoK, 2008, 2012; URT, 2004).
- *Preparation of accounts and external auditing*. In both Tanzania and Kenya, the majority of the SACCOS do not engage external auditors. However, this is not the case for SACCOS linked to banks. 'We submitted audited financial reports to the banks during the loan application and we continue submitting quarterly and annual audited reports to them until we finish repaying the loans', claimed one of the SACCOS managers. The involvement of external auditors is indicative of enhanced governance in SACCOS and a manifestation of compliance with the Tanzania Co-operative Societies Act, 2003 Section 48 and the CSR-2004 section 29 and Kenya SACCO Societies Act 2008 Section 44 (URT, 2004; RoK, 2008). Furthermore, the requirement for SACCOS' participation in training enhances the quality of information in SACCOS.

- *Record-keeping*. SACCOS interviewed reported that the banks' insistence on submitting a list of loan applicants improved the accuracy and details of their records on their clients. Accurate client' financial records are the basis of proper establishment of accounts of income and expenditure, financial statements, and loan management. These are principles required by their by-laws, the Tanzania CSR-2004 and Kenya SACCO Societies Act 2008, which require SACCOS to maintain accurate records, including clients' passbooks, loan registers, and accounts.
- *Engagement in inspection*. In Tanzania and Kenya, most SACCOS are not inspected. Empirical results reveal that SACCOS linked to banks are forced to be inspected and submit inspection reports to the bank-partners. 'Because of submission of inspection reports to our lenders (banks) our institution is periodically inspected by the registrar', claimed one of the SACCOS managers. This is in line with the Tanzania CSR-2004 section 104 and Kenyan SACCO Societies Act 2008 section 48 & 49 (RoK, 2008; URT, 2004).
- *Legitimate board*. The banks' demand that the SACCOS boards comprise legally elected board members forces the SACCOS to comply with the Tanzania Co-operative Societies Act, 2003 section 62, the CSR-2004 and Kenyan Cooperative Societies Act section 28.
- *Engagement of permanent contract and skilled employees*. The SACCOS interviewed reported that they are forced by their bank partners to deploy full-time managers and employees equipped with financial management skills. By doing so they comply with the Tanzania CSR-2004 section 50, and the Kenya SACCO Societies Act 2008 section 13 (RoK, 2008; URT, 2004).

Realignment or reduced compliance with own by-laws, policies, regulations, and procedures as well as government regulations. Some of the banks' requirements conflict with some of the SACCOS' by-laws, regulations, policies, or procedures. To comply with these requirements, the SACCOS either make necessary adjustments or stop practising/complying with their own by-laws, policies, regulations, and procedures. These adjustments and/or stopping practising/complying with own by-laws, policies, regulations, and procedures are described below:

- *Minimum savings as collateral*. Some of the SACCOS interviewed reported that the savings requirement depends on the source of financing, which is sometimes determined by the amount of loan requested. Clients whose loans are financed by internal sources are required to save one-third of the loan whereas those whose loans are financed by funds from banks are required to save 50 per cent of their loans. The former requirement was in accordance with SACCOS' by-laws which were submitted to the Registrar for the purpose of guiding SACCOS' operations as stipulated by the Tanzania Co-operative Societies Act, 2003 section 45(3). The latter was introduced to accommodate the banks' requirement that SACCOS linked to them should have savings equivalent to 50 per cent of the loans requested. As the SACCOS interviewed did not register the amendment of their by-laws to incorporate the changes, they did not comply with the Tanzania Co-operative Societies Act, 2003 Section 45 (3) and 46(5) and Kenya Co-operative Societies Act Section 8(2) (RoK, 2012).

- *Interest rate policy*. SACCOS linked to banks also introduced parallel interest rates in their policies. Their clients, whose loans are financed by internal funds, are charged lower interest rates than those whose loans are funded through borrowings from banks. In consequence, there was unequal treatment of SACCOS clients/members. The interest rates linked to funds from banks were not consistent with their by-laws or policy registered by the Registrar as required by the Tanzania Co-operative Societies Act, 2003 section 45(3) and Kenyan SACCO Societies Act 2008 section 30.
- *Savings first*. SACCOS' by-laws spell out that loan applicants should have minimum savings. Some of the SACCOS and banks interviewed reported that when SACCOS clients have not met the bank requirement of minimum savings, the difference between the minimum amount and their actual savings is deducted from the loans they receive from banks. As such, SACCOS' clients whose savings are below the minimum requirement also get lower loan amounts than they applied for. The use of part of the loans to cover savings violates the SACCOS by-law of saving first as well as the Tanzania Co-operative Societies Act, 2003 section 45(3) and the Kenyan SACCO Societies Act 2008 section 28.
- *Loan approval*. Following their credit policies, SACCOS approve the provision of loans to their clients who have met requirements such as having the minimum savings and having guarantors and collaterals. When approved, the loan requests from the clients are financed by loans from banks. Bank-partners sometimes override the SACCOS' loan approvals. For example, they ask the SACCOS not to offer loans to their clients whose requested amounts exceed what banks consider optimal despite the applicants having met the SACCOS' requirements.

These empirical findings show how internal governance variables which interact with banks' requirements are perceived as external governance mechanisms. The variables are the boards' attributes, credits/loans evaluation and approval body (i.e. its presence and mandate), organization of meetings, financial information systems and control for accuracy, and credit policies. The latter comprise internal governance variables (eligibility criteria of minimum savings, savings first, and interest rate) which are adjusted to accommodate banks' requirements.

In summary, SACCOS enhance compliance with their own by-laws, regulations, policies, or procedures that are congruent with some of the banks' requirements. They adjust or reduce compliance with those deemed incongruent with banks' often stringent conditionalities. These SACCOS' reactions are comparable to the experience of suppliers with low bargaining power linked to buyers with high bargaining power as described in value chain and linkage literature (see Ishengoma and Kappel, 2006) as advanced from the transaction costs approach. Complying with buyers' requirements on product quality tends to make suppliers comply with regulations, while following the buyers' requirements on price/cost when they conflict with the regulations (e.g. labour laws) (Ishengoma and Kappel, 2006). When SACCOS forfeit abiding by their own by-laws, policies, regulations, and procedures to accommodate the banks' requirements, they also come into conflict with government regulations which require them to comply with the same by-laws, regulations, policies, or procedures registered in the office of Registrar of Co-operatives as the basis of their operations.

Conclusion and implications

To explore measures used by banks to monitor and control SACCOS-partners and assess SACCOS' governance-related reactions to bank requirements, this paper has utilized data from in-depth interviews held with managers from five banks that took part in the study. These banks were selected purposively. Data were also collected from 11 SACCOS linked to the five banks. The data collected were subjected to thematic content analysis.

The results reveal that measures applied by banks to monitor and control SACCOS-partners are in accordance with the agency theory and can be categorized into behavioural-oriented governance mechanisms (i.e. audited financial statements, board structure) and outcome-oriented mechanisms (forced savings, board members' personal guarantee, employers' guarantee, and collateral from SACCOS' clients). Apart from the commonly used governance variables in studies (Galema et al., 2012; Mersland and Strom, 2009; Hartarska, 2005) applying the agency theory, the paper identifies the board structure in terms of the legality of the board members, SACCOS' engagement in inspection of operations and financial situation, organization of meetings to make strategic decisions, and proper clients' record-keeping as additional behavioural-oriented governance variables. To enhance the quality of information, banks offer ICT facilities and training to SACCOS-partners. This is in line with the transaction cost theory regarding the application of adaptation governance mechanisms to reduce uncertainty (Williamson, 1998).

The SACCOS' compliance with the banks' requirements results in three governance-related reactions. First, it forces SACCOS to improve their compliance with their own by-laws, regulations, policies or procedures, and government regulations related to the nature of boards, loan processing and strategic decision-making organs, financial information systems, and employment policy. Second and third, it forces SACCOS to realign and/or reduce their compliance with their by-laws, regulations, policies, or procedures related to credit policies: eligibility, collateral, and interest rates. As a result, they also reduce their compliance with some government regulations, which require them to abide by their registered by-laws, regulations and procedures. These findings are inputs in the development of a framework aimed at assessing the influence of banks as external governance mechanisms on SACCOS' internal governance.

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