

**THE EFFECT OF OUTSOURCING OF ACCOUNTING SERVICES ON FINANCIAL  
PERFORMANCE OF DEPOSIT TAKING SAVINGS AND CREDIT COOPERATIVES  
IN NAIROBI COUNTY**

**BY  
JOSELINE NABWIRE OLUMBE**

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## DECLARATION

I declare that this research paper is my original work and to the best of my knowledge, has not been submitted to any university for a degree.

Sign.....

Date.....

Joseline Nabwire Olumbe

D61/64843/2013

This MBA research project has been submitted with my approval as the supervisor

Sign.....

Date.....

Dr. Cyrus Mwangi

Senior Lecturer,

Department of Finance and Accounting,

School of Business,

University of Nairobi.

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## **DEDICATION**

I dedicate this research project to my father Vincent, my brother Tony and my sisters Emma and Velma for their encouragement and moral support during this period, may Almighty God bless them.

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## LIST OF ABBREVIATIONS

<b>EPS</b>	Earning per Share
<b>NSE</b>	Nairobi Security Exchange
<b>PEARLS</b>	Protection Effective Financial Structure
<b>RBV</b>	Resource Based View
<b>ROCE</b>	Return on capital employed
<b>ROE</b>	Return on Equity
<b>ROI</b>	Return on Investment
<b>SACCOS</b>	Savings and Credit Cooperatives
<b>SASRA</b>	SACCOs Society Regulatory Authority
<b>SPSS</b>	Statistical Package for Social Science
<b>TCE</b>	Transaction Cost Economies
<b>WOCCU</b>	World council of credit unions

## **ABSTRACT**

The purpose of the study was to explore the effects of outsourcing of accounting services on performance of deposit taking SACCOs in Nairobi County. To satisfy the research objective, the study population was the 42 deposit taking SACCOs in Nairobi in Nairobi County. The data was collected using secondary data collection mode, by use of financial performance reports, journals and past studies. The data collected was analyzed using descriptive statistics and presented using tables. SPSS (statistical package for Social Sciences) version 22 was used in analyzing data. Regression analysis was also performed in establishing the relationship between outsourcing practices and performance of SACCOs in Nairobi County. The regression analysis revealed that outsourcing, liquidity and Managerial quality do not significantly affect the performance of SACCOs in Nairobi County. The researcher therefore recommends that SACCO's management be educated on the need to have outsourcing in SACCOs operations and come up with clear outsourcing strategies that will ensure that the benefits of outsourced services surpasses cost. SACCOs should also use bank and other financial institutions to benchmark their outsourcing practices, identify the gaps and come up with strategies of overcoming such gaps.

## CHAPTER ONE: INTRODUCTION

### 1.1 Background of the Study

In recent years, advances in information technology has revolutionized the way companies conduct business. Outsourcing of business process is one of the key outcomes of the technological advancement. Due to its IT-intensive business processes the potential for outsourcing appears to be particularly high in the banking industry. This is further enhanced by the fact that most of the data in the banking industry sector are in digital form coupled with increased use of internet (Gewald & Dibbern, 2005).

The accounting department exists as one of the key departments in many organizations where it plays a significant role to the achievement of the business objectives and goals. Accounting is primarily involved in the recording, classifying and summarizing business transactions, preparation and interpreting financial statements and reports (Glautier & Underdown, 2001). Accounting tasks are categorized as routine and non-routine tasks. The task of recording, classifying, summarizing financial transactions and preparation of financial statements are routine. They involve the day-to-day processing of payables, receivables, payroll, general ledger processing, costing, cashier, internal audit, bank and other reconciliations and the preparation of accounts and financial reports. These tasks are similar in all organizations and are commonly referred to as back office accounting activities hence approach to outsource the above task is of particular importance (Weru, 2006).

Co-operatives have played an important role in the development of the economies of Kenya, Uganda and Tanzania and have led to the uplifting of the standards of living of the people. It is

estimated that there are more than 6 million co-operative members in the region. In Kenya, there are more than 2.5 million members in savings and credit co-operatives (SACCOS) out of the 5 million co-operators while there are 3,000 SACCOS out of the 10,000 registered co-operatives. The savings mobilized by SACCOS in Kenya are Kshs 110 billion(US\$1.5 billion) and the loans outstanding Kshs 95 billion(US\$1.3 billion)Co-operatives have been involved in the provision of credit for the purchase of land farm inputs,housing,education,medication and development of various business ventures ( Wanyama,2007).

### **1.1.1 Outsourcing of Accounting Services**

Wood and Jumah (1999) define outsourcing as the replacement of inputs or value added previously created in house by provision of an external service provider within a long-term contractual relationship within which only some expected mutual benefit and obligations are formally defined. It is hiring an outside company to handle all or part of an organization's data processing activities (Romney&Steinbart,2006).Gelinas, Sutton and Hunton (2005) also refer it to as the assignment of an internal function to an outside vendor.

From an economic perspective an organization ought to specialize in producing products that is better to achieve competitive advantage (Smith, 1779). Outsourcing is increasingly being used as means of both reducing costs due to the scaling down of overhead in terms of staff costs the firm also benefits from having more to advance the strategy of the business, time that was spent previously on the outsourcing services. In addition, the firm also benefit from spreading of risks across the parties involved and achieving strategic goals(Basle committee,2005). Globally, regulators concern is how banks manage risks associated with a third party offering certain key

services(Basle committee,2005). In Kenya, there is significant rise in outsourcing activities by SACCOS. Surprisingly in a survey conducted by central bank of Kenya, a number of financial institutions have no risk management frameworks, Central bank of Kenya (2005).

The independent variable of interest is outsourcing at the industry level. There is no standard measurement of outsourcing in the literature. In the empirical trade literature Feenstra & Hanson (1999) proxy intermediate input outsourcing with the amount of trade in intermediate products. Abraham and Taylor (1996)measured outsourcing with the cost of business services such as machine maintenance services, engineering drafting services, accountingservices, computer services and janitorial services. Girma and Gorg (2004) separate the cost of purchased services into product related and non-product related costs. The product related costs are induced from the processing of inputs, which are sent back to the firm for final assembly or sales, forexample maintenance of production machinery, engineering or drafting services etc.Non-product related costs include accounting, consulting, cleaning or transportation services.

### **1.1.2 Financial Performance**

Armstrong(2006)defines performance in output terms as the achievement of quantified objectives; financial performance is measured in terms of profitability.Overall performance is very important because it enables managers to measure how well their SACCOS are performing as comparison with other SACCOS in the industry. Performance in this study is measured in terms of financial success, customersuccess, liquidity, membership growth and loan portfolio. Johnson and Mark (1997)states two major reasons why SACCOS should have performance measurement. First is to produce financial statements at the right time and secondly, to analyze

financial statements to produce information about the financial performance of the SACCOs, which must be used to improve the performance. Based on WOCCU's standards of measuring performance, the factors which determine the performance of SACCOs include; asset base liabilities, performance of the loan book, corporate governance, leverage and regulations in the industry.

Financial performance may be measured using ratios such as earning per share (EPS), return on capital employed (ROCE), return on equity (ROE), and return on total assets. It is used to measure firm's overall financial health over a given period of time and can also be used to compare similar institutions across the same industry or to compare industries or sectors in aggregation (Dann 2003).

### **1.1.3 Outsourcing of Accounting Services and Financial Performance**

The transactions cost economies (TCE) theory introduced by Coase (1937) and developed by Williamson (1975), sees outsourcing as a positive determinant of financial performance where it argues that outsourcing practice is appealing to firm's managements since it develops some of the metrics used to improve firm's performance. Resource Based View (RBV) originated by Penrose supports outsourcing as a key factor for better financial performance, however, the central tenet in RBV is that unique organization resources are the real source of competitive advantage; hence the RBV explains that the degree of competition is a vital factor affecting a firm's decision to outsourcing of their accounting functions. The RBV analyze firm capabilities, which can link outsourcing with performance.

Outsourcing is gaining popularity as a means of reducing financial and operational risks by making businesses easier to manage. As White (2001) points out, improved risk management has a direct correlation with improvements in financial performance and shareholder value and as continued pressure for improved financial performance and so do the levels of competency and demands for consistency in accounting functions. Outsourcing doesn't work in every situation, but when it does, it is hard to argue with better financial reporting, decision making and professionalism as well as lower costs compared to in-house accounting (Mutherin,2006). While great ideas and entrepreneurial skills are fundamental to a business start-up, good financial management is considered critical to business survival (Gildea, 2005).This is where outsourcing the accounting function becomes an alternative for businesses to consider in order to remain competitive.

#### **1.1.4 SACCOS in Kenya**

SACCOS in Kenya are currently among the leading sources of the co-operative credit for socio-economic development(Alila&Obado,1990). Cooperatives in Kenya were started in 1908 and membership was limited to white colonial settlers. The first cooperative was established at Lumbwa, present day Kipkelion area. In 1944 colonial officers allowed Africans to form and join cooperatives(Gamba&Komo,2012). The attempt to encourage Africans farming cooperatives was initiated by the need to implement the recommendations of the Swynnerton plan of 1953. The Swynnerton plan formulated to improve African farming, specifically the growing of cash crops and is recorded to have encouraged the progress and growth of Africans cooperatives(Alila&Obado,1990).

The SACCO bill 2008 tabled in parliament prohibits SACCOs from engaging in foreign exchange operations wholesale, retail trade, underwriting and pricing securities. Most SACCO securities rely on wholesale business to get revenue that earns dividends to members (GOK 2008). The bill is intended to regulate the sector which had savings of up to Ksh 210 million as at the end of December 2007. SACCO serves 17 percent of Kenyan and has grown at an average of 20 percent the year 2003 to 2007 (KUSCO). . According to SASRA, the SACCO society regulations are meant to improve the competitiveness of SACCOS by setting financial and operating standards commensurate to the deposit taking business conducted by SACCOS. This is ultimately expected to drive efficiency and improve the level of savings in the SACCOS societies as envisaged in the financial sector strategy in vision 2030. SACCOS regulations and performance relate in that the regulations are meant to set specific requirements on the tools used to measure performance (PEARLS) leading to a direct relationship (Financial Sector deepening 2009).

In order to be more effective and efficient on core competences, Savings and credit societies have resorted to outsourcing some of their services. However, according to Bartheleny (2003), though outsourcing is a fast growing phenomenon it does not imply that every firm benefits from it. On the contrary, as Dun and Bradstreet's Barometer of Global outsourcing (2000) reports, outsourcing arrangements are characterized by unexpected high failure rates. For example, KPMG (2007) indicates that only 42 percent of 659 surveyed firms show that outsourcing had improved their performance.

## **1.2 Research Problem**

Business processes and functions are essential and important for the business to be relevant in today's ever changing business environment. Accounting which entails classifying, summarizing business transactions and the preparations and interpretation of financial statements and reports are important to a business and none can do without them if they so wish to remain as a going concern. In spite of all this, the accounting function is not necessarily a core function of the business. Generally, accounting practices are not organization specific implying that it is standard across all business sector. Similar standard format, regulations and even computer applications have been developed to facilitate accounting profession. This is due the routine nature of the accounting profession. Outsourcing has proven to be a valuable business approach or model where realize firms that they tend be more relevant in the business circles by handing over their non-core processes and functions to firms that consider them their core competencies, (Weru,2005).

Savings and Credit Societies(SACCOs) play an important role in the social economic development of Kenya. They act as an instrument for economic growth through influencing members toward social economic changes by way of adapting to innovation and technology. They encourage members to save money by offering them attractive interest on their savings (Mina 2007). However, according to Mudibo (2005),SACCOs in Kenya face various challenges among them being lack of trust of board of directors by employees. He further cited that very important decisions on urgent matters such as change in interest rates, introduction of new products and services have to await approval by the Annual General Meeting. According to him, board members in most cases are non-professional volunteers, yet they assume very highly

technical issues such as loan analysis and disbursement, budgeting and financial expenditure control. As a result SACCOs ought to outsource some activities to avoid this from happening.

So many studies have been done on outsourcing of different functions within firms in Kenya. (Lutta,2003) carried out a study on outsourcing of distribution logistic within supply chain of East Africa Breweries Ltd. Kipsang (2003) did a study on outsourcing of information technology services by commercial banks in Kenya, Serem (2002) did a study on outsourcing of human resources services by banks in Nairobi. Weru (2006) did a study on the outsourcing of accounting services among firms listed in Nairobi Security Exchange (NSE) and concluded that a similar study ought to be carried out on non-quoted companies to determine how outsourcing of accounting services can be used to benefit through improved efficiency and reduced cost, if any research has been carried out on the effects of outsourcing of accounting services on financial performance among SACCOS, not much is known or has been documented yet. This study therefore aims at determining the effects of outsourcing of accounting services on financial performance of SACCOS in Kenya. This study therefore finds the need to investigate on the effect of outsourcing of accounting services on financial performance of deposit taking savings and credit cooperatives in Nairobi County through answering the following research question: What is the effect of outsourcing of accounting services on financial performance of deposit taking savings and credit cooperatives in Nairobi County?

### **1.3 Research Objective**

The objective of the study was to investigate the effects of outsourcing of accounting services on financial performance of savings and credit cooperatives in Kenya.

#### **1.4 Value of the Study**

Cooperatives are the most practical way of pulling resources together and accessing credit easily among the low-income earners. There are over 10,642 cooperative societies in Kenya with a membership of over 6 million. The role of cooperative societies in the economy need to be overemphasized co-operatives operate in all sectors of the economy Prakash and Olson(2003).This study will benefit a range of interest groups which include :SACCOS management, they will knowhow other SACCOS outsource their accounting services and thus enhance performance. To the SACCOS that are currently outsourcing some of their accounting functions or the ones that are aspiring to do so, this study is going along way in making known what to expect in terms of merits and challenges of outsourcing.

SACCO employees are going to have a deeper understanding of the effect of outsourcing of the accounting services and hence concentrate more on their core business Academicians and researchers are going to gain an understanding of the SACCO business in Kenya.

## **CHAPTER TWO: LITERATURE REVIEW**

### **2.1 Introduction**

The purpose of literature review is to provide background of the information that was taken in the area of study. In this chapter the research presents an overview of literature in respect to the impact of outsourcing of the accounting services among SACCOS.

### **2.2 Theoretical Review**

Business environments are unstable and unpredictable as a result of economic globalization, technological change, customers increasing demands and stiff competition; hence business management has become more complicated. In such business environment, the sustainability of many firms' is threatened and face significant challenges due to resource constraints. To overcome such challenges, it is suggested that firms should outsource their activities by shifting what they traditionally handled in-house and particularly, their accounting functions. The following theories explain why it is important for a firm to outsource its accounting functions.

#### **2.2.1 Transaction Cost Economies Theory**

Coase (1937) introduced Transactions Cost Economies (TCE) which was developed by Williamson (1975), this theory conjectures that there are costs for a firm to provide an activity internally, which is termed the production cost while the cost of purchasing an activity is termed a transaction cost. The transaction costs associated with any activity depend on key factors associated with the function such as asset specificity and trust in accountant. The central theme of transaction costs theory is that the properties of the transaction determine the governance

structure(Mcivor,2000).TCE is focusing primarily on governance skills, it indicates that the functions that are not firms specific should be outsourced(Gilley,2004).

TCE can improve our understanding of whether it is more appropriate to insource or outsource an activity (Stratman,2008). This theory indicates the functions that are not firm specific should be outsourced. According to TCE, when asset specificity is low, and transactions are relatively frequent, transactions might be governed by outsourcing (Watjatrakul, 2005,Jiang et al., 2007, Chang et al., 2009). In other words, higher levels of asset specificity would lead to a lower amount of the core business being outsourced (Chang et al.,2009, Jiang et al.,2007).However,human asset specificity is an important driver for the outsourcing in internal audit function (Spekle et al., 2007), and accounting services (Everaert et al., 2010) To this study, this theory implies that for internal activity to happen the company will incur some production costs hence to avoid this, Transactions Cost Economies suggests that outsourcing is the best option to cut for some costs.

### **2.2.2Resource Based View Theory**

Resource Based View (RBV) originated by Penrose(2010), has been employed for outsourcing decisions, shifting the attention from transaction costs and opportunism to competitive advantage, however, the central tenet in RBV is that unique organization resources are the real source of competitive advantage, hence the RBV explains that the degree of competition is a vital factor affecting a firm's decision to outsourcing of their accounting functions.RBV is defined as a unique bundle of asset and resources or capabilities that if a company utilizes it in distinctive ways can produce competitive benefit(Conner,1991,Barney,1991).

This theory focuses primarily on production skills(Gottschalk & Solli-Saether,2006).RBV indicates that functions not critical to core competencies ought to be outsourced(Gilley,2004).In practice, outsourcing is affected by the TCE and RBV(Gottschalk & Solli-Saether,2006).The theory explains that resources a company has is what drives the company to outsourcing for a competitive advantage. To this study RBV explains that the degree of competition is a vital factor affecting a firm's decision to outsourcing of their accounting functions.

### **2.2.3 The Contracting Organization Theory**

Another prominent theory of outsourcing is Domberger's theory of the contracting organization. Economist Simon Domberger (1998), in his book *The Contracting Organization*, elaborates at length on economic incentives that encourage business to contract out services to third parties. Based on various studies, Domberger and his team find that organizations contract out business to tap the benefits of specialization, market discipline, flexibility and cost savings.

Domberger argued that if a firm contract out something it is not so good at, it can devote its energies to doing more of what it is good at and both parties will benefit. There are three points to note about the benefits of specialization; when contracting out leads to specialization in the service provider, the purchasing firm gains access to higher quality services such as higher quality advice. The level of competition in the service-provider market determines the extent to which the purchasing firm might see additional benefits (beyond access to high quality services) in terms of lower costs. Where contracting leads to specialization in the purchasing firm, the benefits will be found not in lower costs, but in increased revenue. Revenues will increase

because the purchase will benefit from its own economies of scale, offer a better quality or lower cost product or service, and so attract more customers.

### **2.3 Determinants of Financial Performance of SACCOS**

Terence (1989) defined performance measurement as a way of ensuring that resources available are used in the most efficient and effective way. The essence is to provide for the organization the maximum return on the capital employed in the business. Financial Performance for SACCOS is very important because managers need to know how well the SACCOS are performing.

#### **2.3.1 Leverage**

In the quest to optimize their objectives which hinges primarily on quantifiable performance, financial managers have adopted various capital structures as a means to that goal. A firm can finance its investment by debt or equity. The use of fixed-charged funds such as debt and preference capital along with the owners equity in the capital structure is described as financial leverage or gearing (Dare and Sola 2010) An unlevered firm is an all equity firm whereas a levered firm is made up of ownership equity and debt, financial leverage takes the form of a loan or other borrowing (debt), the proceeds of which are reinvested with the intent to earn a greater rate of return than the cost interest. If the firm's marginal rate of return on asset (ROA) is higher than the rate of interest payable on the loan, then its overall return on equity (ROE) will be higher than if it did not borrow (Laurent 2005). On the other hand, if the firms return on asset (ROA) is lower than the interest rate, then its return on equity (ROE) will be lower than if it did not borrow. Leverage allows a greater potential returns to the investor than otherwise would have

been available but the potential loss is also greater. If the investment becomes worthless, the loan principal and all accrued interest on the loan still need to be repaid (Andy et al, 2002) This constitutes financial risk (Pandey, 2005).

### **2.3.2 Corporate Governance**

Labie and Mersland (2011) defined corporate governance as a system or set of mechanisms by which an organization is directed and controlled in order to its mission and objectives. One of the principal challenges which SACCOS face is that of establishing proper governance systems (Branch & Baker 1998). Good governance can improve the performance of a SACCO and help assure its long term survival (Thomsen, 2008). The issue of corporate governance has become of increasing to SACCOS as it is considered to be one the weakest areas in the industry (CSF,2008). According to Labie and Mersland (2011) there are several reasons for governance to be at the forefront of SACCOS debate of which among the major ones are firstly, the tremendous growth in service providers of various types translates to a greater number of clients and assets, as well as more elaborate structure to manage.

### **2.3.3 Outsourcing of Accounting Services**

Trust in the external accountant is an organization capabilities develop and affect its defined as the expectation of the owner-manager. Outsourcing potentially reduces bureaucratic complexity. Outsourcing of accounting services help firms to reduce cost of transaction by diminishing threat of production requirements and provide a mechanism for opportunism. For instance, if the professional firms share economies of scale with specialized services accountant and the management of the company, it transfers risks and reduce uncertainty trust-based relationship

hence creating opportunities to the organization. When outsourcing, is more in professional accountants, the higher is the likelihood efficient, firm are more likely to integrate and use that the owner-manager of firms will choose to specialized resources and capacity. Outsourcing of accounting activities mediates the competitive environment; smaller companies cannot relationship between asset specificity and firm survive because their internal resource gaps do not permit performance for them to adapt their products. In such circumstances, outsourcing is a major managerial method to obtain. Outsourcing is a critical element of organizational strategy, as a powerful vehicle to reduce the costs and improve performance (Holcomb & Hitt, 2007). (Jiang, Frazier & Prater, 2006), did abrader empirical research with a focus on performance. The authors assessed the results of outsourcing in terms of three distinct performance variables, cost, productivity and profitability. The study showed evidence that it can improve firm's costs, but failed to find that it can improve an organizations profitability and productivity.

## **2.4 Empirical Review**

Hayes (1999) did a study on outsourcing in which the objective was to determine the trend in the outsourcing of typical accounting functions. He collected data using face to face interviews, telephone interviews, questionnaires. Public listed companies identified from the listing of participants of the 1995 Australian stock exchange profitability study (SSERD,1995) were included in the sample. A trend was derived from responding firms,' actual outsourcing levels in 1992-1997 and firms' projected outsourcing levels beyond 1997.The TAFs for which outsourcing had increased between 1992 and the period beyond 1997 were accounts receivable and accounts payable. The trends in the outsourcing were well structured in the study.

M'mbone (2002) carried out a study on business outsourcing practices amongst private manufacturing companies in Nairobi. The objectives of the study were twofold: to establish the extent of outsourcing within private manufacturing firms based in Nairobi and to determine factors that influence outsourcing in the industry. The data was collected by use of structured and non-disguised questionnaire. According to the findings of the study, there is great drive towards the use of outsourcing as a strategy to cut costs, to pursue the core business activities and outsource the non-core or non-strategic activities. This study clearly showed how outsourcing can be used to cut costs as per the findings.

Nyamamba (2006) did a survey on outsourcing and performance of firms in the chemical industry in Nairobi, the survey sought to determine the influence of outsourcing on the level of performance of the firms in the chemical industry in Nairobi, to establish the factors that influence the choice of services/processes to outsource and the benefits of outsourcing. The pertinent primary data was collected using a questionnaire from a population of 22 companies in the business of manufacturing and selling chemicals in Nairobi. From the study, outsourcing had a positive effect on the level of performance for each respondent key amongst this is enhancement of cost estimation. Other positive results were enhanced growth in the market share, positive return on assets, increased staff morale and satisfaction. The researcher limited himself to a small sample size of only 22 companies within the large manufacturing industry; the findings would be of great value if the researcher would have used a bigger sample size.

A study done by Khumalo (2006) on critical success factors for outsourcing strategies in the Mpumalanga coal mining industry in South Africa suggests that the low impact of outsourcing in

most companies stems from lack of knowledge of the critical success factors and failure of the companies to focus on these areas in their outsourcing endeavors. Similar sentiments were echoed by Rono (2011) in his findings that managers are not very keen in the challenges posed by outsourcing as a business strategy but they rush into outsourcing activities. From the study the researcher was able to bring out clearly the factors for outsourcing strategies.

Ruto (2010) carried out a study on benefits and setbacks of the outsourcing accounting services among SACCOS in Nairobi, The study adopted a descriptive survey design, working sample of 200 SACCOS in Nairobi and used questionnaires to collect data. The study found out that not all the SACCOS outsource their accounting services. From the study it was identified that about 66% of the SACCOS had the ratio of accounting cost to total costs at 0 to 20 percent while 44% of the SACCOS had a higher ratio of between 41 and 60% to total cost. The study did not clearly explain the benefits and setbacks arising from outsourcing of accounting services.

Kamyambi and Devi (2011) did a study on the impact of accounting outsourcing on Iranian SME performance. The objective of the study was to identify the factors affecting outsourcing intensity of accounting activities and the impact of outsourcing on firm performance. They used questionnaires to collect data and selected a sample of 1750 manufacturing SMES. From the study they found out that outsourcing of accounting services fully mediates firm's performance. The sample size and mode of data collection was good enough to collect enough data for the study.

A study by Unal (2011) on the role of dynamic capabilities in outsourcing sales and marketing functions in the USA showed that the learning dynamic capabilities construct is the most important factor affecting in the outsourcing partnership performance in the context of headquarters selling task. The task-related resources of the outsourcer had a significant positive effect on potential complementaries. However; the positive effect of the outsourcee's task-related resources on potential complementaries was not significant.

Giustiniano (2013) carried out a study on the impact of outsourcing on business performance. His main objective was to identify how outsourcing affects business performance. Luca obtained sample by querying the Osiris database over the universe of the companies which had outsourced assets or activities during the time period of 2000 – 2009. Despite the statistics for testing the proposed hypothesis, the significance of the result was estimated by assessing the actual weight of observation. From the study it was found out that outsourcing could contribute to companies a sustainable competitive advantage ROE was the only indicator to worsen between variables of business performance, denominator of ROE was not analyzed, the observations were 54, equaling to 64 29% of the whole sample. According to the study, outsourcing does not generate a cost reduction and resources are promptly invested in activities where organizations are leaders. The sample size used by the researcher was not that worthy to give enough data that was required, the researcher could not only use one database to collect data.

## **2.5 Summary of Literature Review**

TCE and RBV are employed as independent methods of outsourcing decision (Mcivor, 2009) but there is a growing body of literature that shows the RBV and TCE are complementary for

outsourcing decision (Poppo and Zenger, 1998, Madhok, 2002, Gottschalk & Solli-Saether, 2006, Espino Rodriguez, 2008, Mcivor, 2009).

Firms are encouraged to go ahead with outsourcing as seen from various studies; outsourcing has great positive impacts on firm's performance at large. Outsourcing enhances growth of companies, is a strategy to cut costs by firms. Outsourcing also increases staff morale towards activities of the company hence improving the firm's performance. In other words outsourcing mediate to the firm's performance.

## **CHAPTER THREE: RESEARCH METHODOLOGY**

### **3.1 Introduction**

The chapter was concerned with the design and methodology of the study. It looked in details the target population. Samplesize, samplingdesign, data collection method and procedures and finally data analysis.

### **3.2Research Design**

The study adopted a descriptive survey design in order to produce accurate descriptions of variables relevant to the decision being faced, withoutdemonstrating that some relationships exist between variables. A descriptive research is used when the purpose is to estimate the proportion of people who behave in a certain way or carry out a certain task in a certain way (Churchill jr&Lacabucci,2005). The design deemed suitable because of the need to describe the outsourcing of the accounting services and financial performance of the SACCOs.

### **3.3 Population and Sampling**

The population of the study comprisedthe 42 deposit taking SACCOs in NairobiCounty, registered in the role of cooperatives, at the Kenya Union of Savings and Credit Cooperatives Union (KUSCO) and its members were formally employed in private companies, government parastatals and other government departments. The study targeted all the 42 SACCOs in Nairobi County.

### **3.4 Data Collection and Techniques**

The data that was collected from SACCOs was of a period of five years from 2010 to 2014.Secondary data was used for the study, the secondary data sources was mainly through a

review of previous works in the subject matter with a view to finding out any gaps that existed. These secondary sources included information sought from journals, government reports and financial report from SACCOs in the past five years. The data obtained was used to establish the relationship between outsourcing and performance of SACCOs in Nairobi County.

### 3.5 Data Analysis Technique

Data analysis was done using descriptive statistics, data was collated and coded. The statistical package for social sciences (SPSS Version 22) was used for data entry and the result was analyzed using descriptive statistics of tables for ease of interpretation. Regression analysis that was used to calculate the relationship between outsourcing and performance of SACCOs was of the form.

$$Y = \beta_0 + \beta_1 x_1 + \beta_2 x_2 + \beta_3 x_3 + \beta_4 x_4 + e$$

Where:

Y=performance measured by the return on Assets (ROA) ratio. Return on Asset is the ratio of the profit before tax to the average total assets of a business during a financial year. It is calculated as  $ROA = PBT / \text{Total Assets}$ .

X1=outsourcing of accounting services measured by cost incurred when outsourcing is done

X2=liquidity measured by ratio of SACCOs cash accounts assets (liquidity indicator).

X3=Non-performing loans measured by ratio of non-performing loans to total gross loans.

X4=Managerial quality measured by ratio of SACCOs earning assets to total assets.

$\beta_0$ =constant.

$\beta_1, \beta_2, \beta_3, \beta_4$ =coefficient of correlation

$\epsilon$ =Error term.

### **3.6 Test of Significance**

Test of significance was done and the coefficient of determination was used to check if outsourcing of accounting services had an effect on SACCOs' financial performance. The significance of the regression model was determined. Coefficient of determination ( $R^2$ ), was used to establish the variance in the dependent variable resulting from the changes in the independent variables. ANOVA was used to determine whether there are significant differences between the dependent and the independent variables.

## CHAPTER FOUR: DATA ANALYSIS AND FINDINGS

### 4.1 Introduction

This chapter presents the data findings to determine the effects of outsourcing of accounting services on financial performance of SACCOs in Nairobi County. The data were collected from journals, financial reports of SACCOs and past studies. It also contains data analysis on SACCOs' performance, relationship between outsourcing practices and SACCOs' performance and discussions. The study covered a period of five years from 2010 to 2014.

### 4.2 Descriptive Statistics

A brief summary and discussion of the descriptive statistics of the variables under study is shown in the table below.

**Table 4.1 Descriptive Statistics**

	Mean	Std. Deviation	N
Performance (Return on Assets (ROA) Ratio)	0.019	0.0219	210
Outsourcing of Accounting Services	0.071	0.0646	210
Liquidity	0.866	0.0555	210
Non- performing loans	0.105	0.1004	210
Managerial quality	0.116	0.1140	210

As per the table above, there were 210 observations that were used for this study for all the variables. Mean score for financial performance of SACCOs is 0.019. Mean scores for outsourcing accounting services, liquidity, non-performing loans and managerial quality are

0.071, 0.866, 0.105, and 0.116 respectively. The mean scores do show the average values of the variables over the period under study.

### **4.3 Inferential Statistics**

In this section, the inferential statistics helps us to infer from the sample to the population i.e. generalizing to the population. Moreover, an assessment is made on the strength and direction of the relation between the response variable and the predictor variables.

#### **4.3.1 Correlation Analysis**

The strength of linear relationship between the dependent and independent variables is determined using the Pearson correlation. The correlation coefficient value lies between -1 and 1. The sign of the correlation coefficient indicates the type of relationship between the response and predictor variables; when the coefficient is positive it implies a positive relationship while when negative it implies a negative relationship. The results of the Pearson correlation are presented in the table below.

**Table 4.2 Correlations**

	Return on Assets (ROA)	Outsourcing of Accounting Services	Liquidity	Non-performing loans	Managerial quality
Return on Assets (ROA)	1				
Outsourcing of Accounting Services	-.431**	1			
Liquidity	0.288	-0.007	1		
Non-performing loans	-.401**	-0.056	-0.02	1	
Managerial quality	-0.085	-0.163	-0.082	.790**	1

\*\* Correlation is significant at the 0.01 level (2-tailed).

From the table above, we will be focusing on the correlation between performance and outsourcing of accounting services, liquidity, non-performing loans and managerial quality. The negative correlation coefficient (-0.431) between performance and outsourcing accounting services indicates that there is a statistically significant negative relationship between the two variables implying that outsourcing of accounting services reduces the performance of the SACCOS. There is a weak positive relationship between performance and liquidity as indicated by a positive correlation coefficient of 0.288 that is not statistically significant.

The negative correlation coefficient (-0.401) between performance and non-performing loans indicates that there is a statistically significant inverse relationship between the two variables

implying that non-performing loans do reduce the performance of SACCOs. Finally, the negative correlation coefficient (-0.085) between performance and managerial quality indicates that there is a statistically insignificant very weak inverse relationship between the two variables.

### 4.3.2 Regression Analysis

A multiple regression model is used to determine the impact of predictor variables (outsourcing of accounting services, liquidity, non-performing loans and managerial quality) on the response variable (financial performance of the SACCOs in Nairobi County) per unit increase in each of the independent variable while holding the other variables constant. The results of the regression are shown below.

**Table 4.3 Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.743 <sup>a</sup>	0.552	0.503	0.01546

a. Predictors: (Constant), Managerial quality, Liquidity, Outsourcing of Accounting Services, Non- performing loans

From the table above, R is the multiple correlation coefficient between the independent variables and the dependent variable. As indicated above the value of R is 0.743 that indicates that there is great proportion of variance shared by the predictor variables and the response variables. The second statistic, R Square, describes the goodness-of-fit that is the percentage variation in the dependent variable being explained by the changes in the independent variables. For our study,

$R^2$  equals 0.552 that is outsourcing of accounting services, liquidity, non-performing loans and managerial quality explains 55.2% of financial performance of the SACCOs in Nairobi County only of leaving 44.8 percent unexplained.

**Table 4.4 ANOVA**

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	0.054	4	0.014	63.072	.000 <sup>b</sup>
	Residual	0.044	205	0.000		
	Total	0.099	209			

a. Dependent Variable: Performance (Return on Assets (ROA) Ratio)

b. Predictors: (Constant), Managerial quality, Liquidity, Outsourcing of Accounting Services, Non-performing loans

The table above gives the total variance accounted for in the model. The key statistic for our case is the F-statistic and the p-value associated with it. This helps in testing the following hypothesis:

Null hypothesis: The expected values of the regression coefficients are equal to each other and are equal to zero that is  $\beta_1=\beta_2=\beta_3=\beta_4=0$

Alternative hypothesis: The expected values of the regression coefficients are not equal to each other and are not equal to zero

As shown by the table above, we do reject the null hypothesis in favour of the alternative hypothesis because the p-value is less than our 5% level of significance. This implies that all the model coefficients are statistically significant at a 5% level of significance and they can be used to predict the response variable.

**Table 4.5 Regression Coefficients**

Mode 1		Unstandardized		Standardized	t	Sig.
		Coefficients		Coefficients		
		B	Std. Error	Beta		
1	(Constant)	-0.072	0.016		-4.423	0.000
	Outsourcing of Accounting Services	-0.132	0.016	-0.387	-8.117	0.001
	Liquidity	0.124	0.019	0.313	6.656	0.008
	Non- performing loans	-0.186	0.017	-0.851	-11.036	0.000
	Managerial quality	0.106	0.015	0.549	2.982	0.005

a. Dependent Variable: Performance (Return on Assets (ROA) Ratio)

The table above shows the coefficient estimates for our predictor variables. From the table above the unstandardized coefficients for  $\beta_0$ ,  $\beta_1$ ,  $\beta_2$ ,  $\beta_3$  and  $\beta_4$  are -0.072, -0.132, 0.124, -0.186 and 0.106 respectively that indicates the impact of individual independent variables on the dependent variable. Thus, the resultant model will be of the form:

$$\text{SACCOs' Financial Performance} = -0.072 - 0.132\text{outsourcing of accounting services} + 0.124\text{liquidity} - 0.186\text{non-performing loans} + 0.106\text{managerial quality}$$

Holding outsourcing, liquidity, non-performing loans and managerial quality to a constant zero, financial performance would stand at -0.072. The coefficient for outsourcing of accounting services (-0.132) indicates that a unit increase in outsourcing accounting services leads to 0.132 reduction in the SACCOs' financial performance holding the other variables constant. A unit increase in the SACCOs' liquidity leads to a 0.124 increase in the SACCOs' financial performance ceteris paribus. The non-performing loans coefficient (-0.186) indicates that a unit increase in the variables leads to a 0.186 reduction in financial performance holding other factors constant. Finally, a unit increase in managerial quality results to a 0.106 increase in financial performance of the SACCOs holding other factors constant.

To make a relative comparison of the impact of the independent variables on the dependent variable, the standardized coefficients gives an objective comparison. This is because they are expressed in the same units of measurement with a mean of zero and a standard deviation of one. The standardized coefficient of non-performing loans (-0.851) indicates that they do have a huge impact on the performance of the SACCOs followed by managerial quality (0.549), outsourcing of accounting services (-0.387) and liquidity (0.313).

Moreover, the table above gives a significance test for each of the independent variables in the model. This helps in testing the following hypothesis:

Null hypothesis: The unstandardized regression coefficient of the individual predictor variable is equal to zero that is  $\beta_i=0$  where  $i=1, 2, 3$  and  $4$

Alternative hypothesis: The unstandardized regression coefficient of the individual predictor variable is not equal to zero that is  $\beta_i \neq 0$  where  $i=1, 2, 3$  and  $4$

The null hypothesis for all the cases can be rejected in favour of the alternative hypothesis since all the p-values are less than our 5% level of significance. Therefore, the unstandardized regression coefficients are statistically significant at a 5% level of significance and they can be relied upon in predicting the SACCOs' financial performance.

#### **4.4 Discussion of Findings**

The study found a statistically significant negative relationship between SACCOs' financial performance and outsourcing of accounting services. This can be attributed to increased expenses after outsourcing the accounting services. This finding is in agreement with (Kotlarsky, Oshri and Willcocks (2011) findings that there are cost increases associated with outsourcing. According to Williamson, (1985) such expenses include, drafting of the contract and evaluation of the tenders of the various accounting service providers.

On the other hand, majority of the studies are of the opinion that outsourcing of services does lead to cost savings and letting the organization focus on its areas of expertise. For the SACCOs in Nairobi County, the negative impact of outsourcing of accounting services on financial performance may be due to the huge fees demanded by the accounting service providers and this tends to increase their costs hence reduction in profitability. Moreover, there is a legal and reputational risk that is associated with legal suits and poor performance respectively of the SACCOs. Therefore, a decision whether to outsource accounting services should be evaluated

properly by factoring both the direct and indirect costs involved if the SACCOs are to realize the benefits of the same.

As shown above an improvement in liquidity leads to the improvement of the financial performance of the SACCOs in Nairobi County. This finding concurs with Tesfai (2015) findings that an increase in liquidity leads to an increase in the profitability of Habib Bank AG Zurich. This is very important for the SACCOs to meet their liquidity obligations.

The study found a statistically significant negative relationship between non-performing loans and financial performance of SACCOs in Nairobi County. This is agreement with Wambua (2008) findings that non-performing loans do have a negative impact on the interest income and profitability of the Kenyan banks.

Managerial quality is also important in the performance of the SACCOS because the study clearly show that with a better management in place the financial performance of the SACCOS is improved by 0.106.

## **CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS**

### **5.1 Introduction**

This chapter provides a summary of the findings, conclusions and recommendations, limitations of the study and suggestions for further research. Conclusions are based on findings of the empirical tests conducted and recommendations are based on objectives and the findings of the study. Challenges encountered in this study are discussed in detail under limitations of the study from which suggestions for further study have been developed.

### **5.2 Summary of Findings**

The objective of the study was to determine the effects of outsourcing of accounting services on financial performance of deposit taking SACCOs in Nairobi County. Multiple regression analysis was applied to the data to examine the effects of outsourcing of accounting services on financial performance of deposit taking SACCOs in Nairobi County.

From the findings, outsourcing of accounting services and non-performing loans do reduce the performance of SACCOs by 0.132 and 0.186 respectively. Liquidity and managerial quality do increase performance of SACCOs by 0.124 and 0.106 respectively. The model in general and slope coefficients were found to be statistically significant at 5% level of significance. This shows the reliability of the model and the predictors in forecasting the financial performance of the SACCOS.

### **5.3 Conclusions and Recommendations**

The study revealed that outsourcing of accounting services does limit the performance of the SACCOs. This may be attributed to the various risks like legal and reputational risks that do expose the SACCOs legal expense and a possibility of lawsuits if they are not in compliance and a negative opinion that the public may have due to the poor performance of the SACCOs respectively. As much as outsourcing of accounting services is crucial for an objective and independent opinion about the SACCOs' financial performance, they need to take into account the risks and indirect costs associated with the same. This will enable them to determine if the benefits of the risks associated do outweigh the costs associated. Therefore, SACCOs need to rethink on the risks and costs associated with outsourcing of accounting services and on how to mitigate the same to ensure their performance is not compromised.

Non-performing loans do reduce the performance of SACCOs and they need to put in place mechanisms that will ensure that they fully screen their customers before advancing any loans to them. This will avoid the aspect of adverse selection.

Liquidity increases the performance of the SACCOs and thus they need to ensure that they have a healthy liquidity position to ensure that the loans are available when the customers demand. Moreover, the SACCOs have to ensure that they get the best management since they do play a pivotal role in ensuring that the SACCOs' goals and objectives are realized.

#### **5.4 Limitations of the study**

In attaining its objective, the study was limited to SACCOs in Nairobi County. Secondary data was collected from the SACCOs registered by SASRA in Nairobi County. The study was also limited to the degree of precision of the data obtained from the secondary source. While the data was verifiable since it came from the SACCO's publications, it nonetheless could still be prone to these shortcomings. The study was based on a five year study period from the year 2010 to 2014. A longer duration of the study would have captured periods of various economic significances. This may have probably given a longer time focus hence given a broader dimension to the problem.

The study was limited to 42 SACCOs registered by SASRA in Nairobi County in order to determine the effects of outsourcing of accounting services on the performance of deposit taking SACCO's in Nairobi County, inclusion of SACCOs in other counties could have given broader outlook of the study.

#### **5.5 Suggestions for further research**

Since this study is considered as the first attempt to investigate the effect of outsourcing of accounting services on financial performance of deposit taking SACCOs, there is need for further research. Further comparative studies with other Government Parastatals, financial institutions and other service providers is needed in order to determine the effects of outsourcing of accounting services on performance of deposit taking SACCOs. There are many factors that influence performance and it was difficult to identify all those practices that influence performance of SACCOs in Nairobi County.

The study findings were narrowed into the three independent variables namely outsourcing, liquidity and managerial quality that were addressed by the research objective. These factors cannot be fully relied upon to address all factors influencing outsourcing. Suggestion for further studies is therefore advisable to contribute towards identification of more other factors influencing outsourcing and assist in implementation of strategic outsourcing measures in SACCOs. A research study can focus on the in-depth outsourcing strategies and the gains of outsourcing on any other public institution of SACCO's nature. Finally critical success factors in implementation of outsourcing practices should be subjected to review, critique and discussion for an extended period before generalizing.

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## APPENDIX

### Appendix I: List of Deposit taking SACCOs in Nairobi County As At 2013

1.	AFYA SACCO SOCIETY LTD
2.	AIRPORTS SACCO SOCIETY LTD
3.	ASILI SACCO SOCIETY LTD
4.	ARDHI SACCO
5.	CHAI SACCO SOCIETY LTD
6.	CHUNA SACCO SOCIETY LTD
7.	COMOCO SACCO SOCIETY LTD
8.	FUNDILIMA SACCO SOCIETY LTD
9.	HARAMBEE SACCO SOCIETY LTD
10.	HAZINA SACCO SOCIETY LTD
11.	JAMII SACCO SOCIETY LTD
12.	KENPIPE SACCO SOCIETY LTD
13.	KENVERSITY SACCO SOCIETY LTD
14.	KENYA BANKERS SACCO SOCIETY LTD
15.	KENYA POLICE SACCO SOCIETY LTD
16.	KINGDOM SACCO SOCIETY LTD
17.	LENGA TUMAINI
18.	MAGEREZA SACCO SOCIETY LTD
19.	MAISHA BORA SACCO SOCIETY LTD
20.	MILIKI SACCO SOCIETY LTD
21.	MWALIMU NATIONAL SACCO SOCIETY LTD

22.	MWITO SACCO SOCIETY LTD
23.	NACICO SACCO SOCIETY
24.	NAFAKA SACCO SOCIETY LTD
25.	NAKU SACCO
26.	NASSEFU SACCO SOCIETY LTD
27.	NATION SACCO SOCIETY LTD
28.	NEST
29.	ORTHODOX SACCO
30.	RELI SACCO
31.	SAFARICOM SACCO SOCIETY LTD
32.	SHERIA SACCO SOCIETY LTD
33.	STIMA SACCO SOCIETY LTD
34.	TELEPOSTA SACCO
35.	TRANSCOM
36.	UFANISI SACCO SOCIETY LTD
37.	UKRISTO NA UFANISI SACCO SOCIETY LTD
38.	UKULIMA SACCO SOCIETY LTD
39.	UNITED NATIONS SACCO SOCIETY LTD
40.	WANAANGA SACCO SOCIETY LTD
41.	WANANDEGE SACCO SOCIETY LTD
42.	WAUMINI SACCO SOCIETY LTD

**Source: SASRA (2013)**