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Liquidity Risk Management and Financial Performance of Deposit-Taking Savings and Credit Cooperatives in Kenya

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ABSTRACT: All over the world savings and credits cooperatives societies have been playing vital role in promoting financial inclusion and financial deepening. Therefore, the financial performance of these institutions is critical. The specific research objective of the study are to examine the effect of liquidity risk management strategy on financial performance of deposit-taking savings and credit cooperatives in Kenya. The study is anchored on financial intermediation theory. The research adopted descriptive research design. The study employed census where the study population included all the 176-deposit-taking savings and credits cooperatives societies in Kenya. The study utilized secondary panel data for the period 2014-2023. The study used a data collection sheet to collect data from published financial statements. The study concludes that liquidity risk management has a significant and positive effect on the financial performance of deposit-taking savings and credits cooperatives societies in Kenya. Effective management of liquidity risk is therefore essential for improving financial outcomes in the savings and credits cooperatives societies sector. The study recommends that regulatory authority like Sacco Societies Regulatory Authority should enforce risk mitigation strategies among deposit-taking savings and credits cooperatives societies . Savings and credits cooperatives societies should enhance their liquidity planning frameworks by aligning loan issuance with stable and predictable funding sources. Given the sector's high loan to deposit ratio, institutions must strengthen liquidity forecasting, adopt dynamic cash flow projections, and ensure that lending growth does not outpace their liquidity capacity. Establishing optimal liquidity thresholds would help balance profitability and financial safety.

KEYWORDS: Liquidity risk, Liquidity risk management, financial performance, Deposit-Taking Savings and Credit Cooperatives, Kenya

1 INTRODUCTION

Savings and Credit Cooperatives (SACCOs) are intrinsic components in any financial sector. SACCOs provide financial intermediation by bringing together reserves or savings from its members and lending the same reserves to members in need of funds at an interest rate. Over the past two decades, the DT-SACCO subsector has undergone significant transformation characterized by institutional growth, product diversification, and increased integration of digital financial technologies. This evolution has enhanced the capacity of DT-SACCOs to contribute to socio-economic development and financial deepening However, the transition from member-based savings groups to regulated deposit-taking institutions has also exposed them to complex financial, operational, and regulatory risks such as credit risk, and liquidity risk that require robust risk management to ensure sustainability and financial stability (Sacco Societies Regulatory Authority [SASRA], 2022).

Zaharum et al. (2022) attest that liquidity risk management is a vital requirement in any organization that plans to meet its obligations on time and the most basic way to measure liquidity risk management assessing availability of liquid assets that can meet the short-term / current liabilities of an organization. Liquidity risk management involves assessing the uncertainty surrounding how well a firm manages its most liquid assets which is cash and cash equivalents in attempt to meet its maturing obligations. It is also concern with having the readily available liquid assets for smooth business operation. Etale and Sawyerr (2020) advance that liquidity is the ease and speed that an asset can be sold or converted to cash at a fair price to cater for short term and long-term financial requirements. Liquidity risk management addresses the potential loss that arises when a financial institution, such as a DT-SACCO is unable to meet its obligations or invest funds in assets as they mature without incurring excessive costs or losses. Importantly, liquidity risk is not confined to a shortage of financial resources; it also encompasses situations where

institutions hold excess funds that remain idle and unproductive. Both extremes insufficient liquidity and surplus unused liquidity can undermine financial performance and stability, highlighting the need for balanced liquidity planning and control.

2 STATEMENT OF THE PROBLEM

DT-SACCOs in Kenya continue to experience significant financial performance challenges, as evidenced by sustained declines in profitability over recent years. According to SASRA (2022), net profits after tax among deposit-taking SACCOs fell sharply by 14% in 2016, 21% in 2017, 16% in 2018, 19.2% in 2019, and 31% in 2020 signalling deepening financial distress within the subsector. One of the critical contributors to this deterioration is liquidity risk, which has emerged as a major threat to institutional stability. Liquidity challenges in SACCOs often arise from delayed member contributions, high loan-to-deposit ratios, excessive exposure to illiquid assets, and a growing portfolio of non-performing loans. These factors constrain the ability of SACCOs to meet short-term obligations, ultimately undermining their financial performance.

The Financial Sector Deepening Kenya (2021) report further illustrates the gravity of the situation, identifying that 12 out of 45 licensed SACCOs in Nairobi City County were at risk of collapse due to severe financial vulnerabilities including liquidity pressures resulting from unremitted deductions, mismanagement of funds, and inadequate capital buffers. These vulnerabilities have placed over Kshs. 117 billion in member deposits at risk. The regulator, SASRA, has already withdrawn licenses from four SACCOs Nyamira Tea SACCO, Uchongaju SACCO, Nanyuki Equator SACCO, and COMOCO SACCO highlighting how liquidity weaknesses can escalate into institutional failure and loss of member confidence.

Given that SACCOs contribute directly between 6% and 10% of GDP in developing economies and indirectly between 35% and 47% (Financial Sector Deepening Kenya, 2021), the impact of liquidity distress extends beyond individual institutions to the wider economy. Despite this importance, existing empirical studies on liquidity risk management have disproportionately focused on commercial banks (Siddique et al., 2022; Hacini et al., 2021), offering limited insight into SACCO-specific dynamics. Moreover, these studies vary in theoretical grounding, methodological approaches, and the economic contexts in which they were conducted, creating a knowledge gap relevant to Kenya's deposit-taking SACCO sector.

Therefore, the problem this study seeks to address is the inadequate understanding of how liquidity risk management practices influence the financial performance of deposit-taking SACCOs in Kenya. Despite the growing incidence of liquidity shortfalls, declining profitability, and regulatory interventions, there remains limited empirical evidence on the effectiveness of existing liquidity management mechanisms in safeguarding SACCO stability and sustaining financial performance. This gap necessitates a focused investigation into liquidity risk management as a determinant of financial performance among deposit-taking SACCOs.

3 OBJECTIVE OF THE STUDY

To examine the effect of liquidity risk management on financial performance of deposit-taking savings and credit cooperatives in Kenya.

4 RESEARCH HYPOTHESIS

Ho: There is no significant effect of Liquidity risk management on financial performance of deposit-taking savings and credit cooperatives in Kenya.

5 LITERATURE REVIEW

5.1 Theoretical Literature - Financial intermediation Theory

Financial Intermediation Theory was propounded by Goldsmith (1969) and later modified by Benston and Smith (1976), as well as Howells and Bain (2008). The theory explains that financial institutions such as banks and SACCOs act as intermediaries by transferring funds from surplus units to deficit units within the economy. According to the theory, financial intermediaries reduce market imperfections caused by information asymmetry, liquidity constraints, and risk uncertainty by screening borrowers, monitoring their performance, and enforcing contractual obligations. The theory further argues that intermediaries enhance liquidity provision and risk diversification by pooling savings from numerous depositors and allocating them across diversified investments, thereby promoting financial stability and economic growth (Zhang & Chen, 2022). Through these functions, financial institutions facilitate efficient allocation of financial resources and support productive economic activities.

The theory was relevant to this study because it provides a foundation for understanding how financial institutions manage risks and enhance financial performance through intermediation activities. Financial Intermediation Theory argues that institutions improve stability and profitability by mitigating credit, liquidity, and operational risks while maintaining adequate capital buffers. Capital adequacy enhances the institution's ability to absorb unexpected losses and sustain lending operations, whereas

governance mechanisms such as board gender diversity strengthen oversight and improve decision-making quality. The theory therefore supports the relationship between risk mitigation practices, capital adequacy, governance structures, and financial performance by demonstrating how effective intermediation contributes to institutional sustainability and long-term financial success (Nguyen, 2023).

5.2 Empirical Literature

The relationship between liquidity risk management and financial performance presents mixed findings across different banking environments. Studies conducted in Nigeria, the United Kingdom, Sri Lanka, Pakistan, Saudi Arabia, and the United Arab Emirates generally indicate that liquidity management practices significantly influence profitability, although the direction and magnitude of the effect vary depending on the liquidity indicators applied and the institutional context (Poroye & Okolie, 2024; Eltweri et al., 2024; Samarasinghe & Lakmal, 2024). Some studies established that adequate liquidity levels, strong capital buffers, and effective loan management enhance profitability and institutional stability, while excessive liquidity holdings and poor asset quality may weaken performance (Olofin et al., 2024; Alim, 2021). Other scholars found that liquidity risk negatively affects financial performance when institutions maintain inefficient cash positions or face liquidity mismatches (Hacini et al., 2021). In Kenya, Rop and Jagongo (2021) observed that although liquidity risk management remains important in improving organizational performance, empirical evidence within local state-owned enterprises and financial institutions is still limited, thereby creating contextual and methodological gaps that warrant further investigation.

6 RESEARCH METHODOLOGY

This study adopted positivism research paradigms. The positivism paradigm emphasized objective reality, deductive reasoning, and quantitative methods. It sought to establish generalizable laws and causal relationships. This study used descriptive research design. This design is appropriate for the study as it accurately described the situation at the time of the study. This study applied census and the population consisted of all the 176 Deposit-taking Savings and Credit Cooperatives in Kenya and that are legally authorized to operate by SASRA. The SACCOS must have been operational in the last ten years, that is, 2014 - 2023. This study utilized secondary data from SASRA publication relating to the176 DT-SACCOs in Kenya and more so the published financial statement for the period 2014-2023. This was collected using a data collection sheet. The collected data related to all variables of the study.

6.1 Descriptive Analysis

The study reported the descriptive statistics for the study variables as shown in the table 1 below

Table 1 Descriptive Statistics

	Mean	Standard deviation	Maximum	Minimum
Leverage Management Ratio	0.2725	0.6515	28.6014	-2.2918
Liquidity Coverage Ratio	0.8295	0.2297	2.1921	0.2754

The descriptive results show that the leverage management ratio has an average value of 0.2725 (SD = 0.6515), with values ranging from –2.2918 to 28.6014. This indicates that, on average, external borrowings account for approximately 27% of the core capital among DT-SACCOs. Such moderate leverage reliance is expected in a member-based financial cooperative sector where external funding is used to supplement internally generated capital and support lending activities. However, the extremely wide range particularly leverage ratios exceeding 20 or more times core capital signals that some SACCOs operate with highly aggressive leverage positions, while others remain conservative or experience negative leverage due to adjustments in capital or liability accounts. These patterns raise concerns regarding the prudential management of external debt, especially in institutions where borrowing levels may outpace capital strength.Empirical evidence from the broader financial-sector literature corroborates these concerns. Studies of Nigerian commercial banks show that loan expansion and leverage amplify profitability only when supported by adequate capital buffers, but may weaken performance if leverage exceeds sustainable thresholds (Oyetayo et al., 2019) Similarly, research in Nigeria's non-financial sector found that debt-equity ratios positively influence performance, while weak capital positions undermine firms' resilience (Ogunode et al., 2022), highlighting the need for leverage that is well-aligned with capital adequacy.

The average liquidity coverage ratio was 0.8295 (SD = 0.2297) with the highest liquidity coverage ration being 2.1921 and the lowest liquidity coverage ration being 0.2754. This indicates that gross loans average 83% of total deposits in all these firms. This also indicates that gross loans make up to four-fifths of the total member deposits. This is an indication that liquidity has a greater

influence on capitalization of a firm's earnings potential. This finding is supported by the Basel Committee (1974) argues that liquidity risk management through balancing of liquid assets leads to sustainable performance of financial institutions. Empirically, loan-intensive funding structures like this tend to make profitability highly sensitive to liquidity risk management. Post-Basel III evidence from the UK similarly finds that the liquidity–profitability link is context-dependent, varying with internal bank features and macro conditions; sound liquidity risk management strengthens resilience without unnecessarily tying up balance sheets in low-yield buffers. In Sri Lanka, panel results indicate deposits (as a funding source) can exert a negative effect on performance when not matched with effective risk controls, while capital adequacy mitigates that pressure again pointing to the importance of calibrating lending to stable funding and liquidity buffers (Samarasinghe & Lakmal, 2024).

6.2 Regression Analysis

The study sought to examine the effect of liquidity risk management on financial performance of deposit-taking savings and credit cooperatives in Kenya and tested the following hypothesis.

Ho There is no significant effect of Liquidity risk management on financial performance of deposit-taking savings and credit cooperatives in Kenya.

The testing of this hypothesis is discussed in the results displayed in the table below.

Table 2 Effect of liquidity risk management on financial performance

Variable	**Coefficient**	**Std Error**	**t-Statistic**	**Prob.**
Constant	-0.4893	0.0168	-29.1339	0.0000
Liquidity Coverage Ratio	0.5782	0.0193	29.9622	0.0000
Leverage Management Ratio	0.2394	0.0185	12.9622	0.0000
Effects Specification				
Cross-section Rando (dummy variables)				
Weighed Statistics				
R-squared	0.3810	Mean dependent var	0.3228	
Adjusted R-squared	0.3193	S.D. dependent var	0.1606	
S.E. of regression	0.1382	Sum squared resid	15.0519	
F-statistic	9.4028	Durbin-Watson stat	0.8346	
Prob(F-statistic)	0.0000			
Unweighted Statistics				
R-squared	0.3788	Mean dependent var	0.1326	
Sum Squared resid	15.9153	Durbin-Watson stat	1.4948	

Table 2 above indicates that the F-statistic = 9.4028, P=0.000. which means that the model is statistically significant. The R- square of 0.3810 means that the liquidity risk management explains 38.10% of the financial performance. The Beta coefficients $\beta = 0.5782$ and 0.2394 with p-value of < 0 indicates that the liquidity risk management has a significant effect on financial performance. Since $P = 0.000 < 0.05$ we reject the **Ho** and conclude that liquidity risk management has statistically significant effect on financial performance of deposit-taking savings and credit cooperatives in Kenya.

7 CONCLUSION AND RECOMMENDATIONS

The study concludes that liquidity risk management has a significant and positive effect on the financial performance of DT-SACCOs in Kenya. Effective management of liquidity risk is therefore essential for improving financial outcomes in the SACCO sector. The study recommends that regulatory authority like SASRA should enforce risk mitigation strategies among DT-SACCOs. SACCOs should enhance their liquidity planning frameworks by aligning loan issuance with stable and predictable funding sources. Given the sector's high loan-to-deposit ratio, institutions must strengthen liquidity forecasting, adopt dynamic cash-flow projections, and ensure that lending growth does not outpace their liquidity capacity. Establishing optimal liquidity thresholds would help balance profitability and financial safety. SACCOs need to adopt more rigorous leverage management practices. Institutions with excessively high leverage should implement clear borrowing limits linked to capital adequacy, asset growth, and risk-bearing

capacity. Strengthening internal oversight of external funding will minimize liquidity stress and ensure that leverage supports, rather than undermines, financial performance.

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