

EQUITY COSTS AND FINANCIAL PERFORMANCE OF LICENSED DEPOSIT TAKING CREDIT CO-OPERATIVE SOCIETIES IN KENYA

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Abstract

International and local researchers have extensively studied the impact of equity financing on business financial performance, as the cost of equity represents the required return investors expect for assuming ownership risk (Kenton, 2025). This metric is vital for capital budgeting and investment decisions. Compliance with equity regulations can be complex and costly, sometimes involving borrowing, non-declaration of dividends, and other financial sacrifices that may affect shareholders and employees negatively. In Kenya, Savings and Credit Cooperative Societies (SACCOs) play a significant role, directly or indirectly impacting around 10 million Kenyans and holding over 80% of the country's saving. The Sacco Society Regulatory Authority (SASRA) licenses and regulates deposit-taking SACCOs, imposing strict equity adequacy requirements. Out of 245 SACCOs applying for licenses by 2019, only 177 were approved; by 2022, after suspensions and new approvals, 176 remained licensed. Many SACCOs struggle to meet these equity thresholds. Balancing compliance costs without compromising financial performance or shareholder wealth maximization is critical. This study investigated the relationship between equity cost compliance and financial performance of licensed deposit-taking SACCOs in Kenya. Using secondary data from audited financial statements, the study employed logistic multiple regression analysis focusing on Shareholders' Equity, Total Liabilities, and Dividends Paid. Results indicated that effective management of equity financing, minimizing equity costs, is essential for the financial stability and improved performance of SACCOs.

Keywords: Equity Costs, Compliance, Financial Performance, SASRA, SACCO

1. Introduction

Equity cost, defined by scholars such as Sharpe (1964), Fama and French (1992), and Botosan (1997), is the minimum return investors require for investing in a firm. It plays a critical role in capital raising, investment decisions, and portfolio valuation (OECD, 2012). The cost of equity financing directly influences a firm's profitability, value, and growth. Modigliani and Miller (1958) argued that higher equity costs tend to reduce profitability and growth. Compliance with regulatory requirements, while necessary, can impose significant financial burdens on firms, sometimes draining resources and affecting financial performance (Pandey, 2010). Failure to comply may lead to penalties or corrective actions, underscoring the importance of managing equity costs effectively within the legal framework.

Research shows that corporations often follow a hierarchical financing approach, prioritizing internal funds, then debt, and lastly equity issuance (Abhor, 2005). Studies indicate that firms relying more on equity financing tend to perform better in the long run

compared to those dependent on debt, though issuing shares can sometimes result in short-term underperformance (Bassey et al., 2015). Musila (2015) found a positive but insignificant relationship between equity financing and financial performance among energy firms in Kenya, recommending equity use to boost asset growth. Similarly, Noor (2020) observed that for SMEs in Garissa County, retained earnings and donations positively impacted financial performance, with retained earnings reducing borrowing costs and donations enhancing capital. Both studies highlight the significant role of equity financing in fostering firm growth and profitability.

SACCOs in Kenya are required by law to obtain a license from SASRA before engaging in deposit-taking activities. The Sacco Societies Act (2008) mandates minimum capital requirements, including a core capital of at least KSh 5 million and 8% of total assets, with half of the core capital coming from retained earnings and reserves. By 2022, SASRA updated these requirements, increasing core capital to at least KSh 10 million or 10% of total assets, along with liquidity and institutional capital standards. SACCOs must also have robust policies on liquidity management, credit, and risk, and comply with strict reporting standards, including monthly and quarterly regulatory submissions and annual audited financial statements.

Despite these clear regulatory requirements, many SACCOs struggle to maintain capital adequacy and meet other prudential standards. Challenges include failing to meet minimum core capital levels, negative core capital balances, and insufficient institutional capital ratios. Additionally, compliance issues stem from limited financial resources, resistance to regulatory changes, unrealistic business projections, inaccurate reporting, and inadequate internal audit functions. These challenges have resulted in only a fraction of SACCOs qualifying for licensing, with many unable to transition successfully to meet SASRA's standards.

Out of 245 SACCO applicants, only 176 were licensed by 2022, with some losing their licenses due to non-compliance. This study is motivated by the need to investigate how compliance with equity cost requirements affects the financial performance of licensed deposit-taking SACCOs. Understanding this relationship is crucial, as non-compliance with equity costs may partly explain why a significant number of SACCOs fail to meet licensing criteria, highlighting the importance of regulatory adherence for sector stability.

2. Theoretical Background

2.1 Theoretical Literature

Capital Cost Theory posits that the cost of capital, including equity and debt, represents the minimum return a firm must generate to satisfy its investors and maintain its market value. It emphasizes that the cost of equity is the expected return shareholders demand for bearing the risk of investment (Dang et al., 2021; Dunbar, Browne, & O'Connor, 2021). This theory is crucial to this study because managing equity costs compliance is key for licensed deposit-taking SACCOs to maintain financial health and profitability. High equity costs can reduce profitability and growth, so understanding their influence supports the study's objective of analyzing how equity cost compliance affects SACCOs' financial performance (Dang et al., 2021).

The Pecking Order Theory, formulated by Myers and Majluf (1984), proposes that firms prioritize their financing sources by first using internal funds (retained earnings), then debt, and lastly equity issuance. This preference is due to information asymmetry and the higher costs or signaling issues associated with issuing new equity. In the SACCO context, this theory explains why many societies rely heavily on retained earnings to meet

equity capital requirements, affecting their financial performance. Furthermore, firm size may moderate this relationship, as larger SACCOs typically have better access to external financing options (Myers & Majluf, 1984). Together, Capital Cost Theory and Pecking Order Theory provide a comprehensive lens through which to examine the impact of equity cost compliance on SACCOs' financial performance and the moderating role of firm size.

2.2 Conceptual Framework

In this study, equity costs compliance was taken into consideration as the independent variable while size of the Sacco was the moderating variable and, financial performance as the dependent variable.

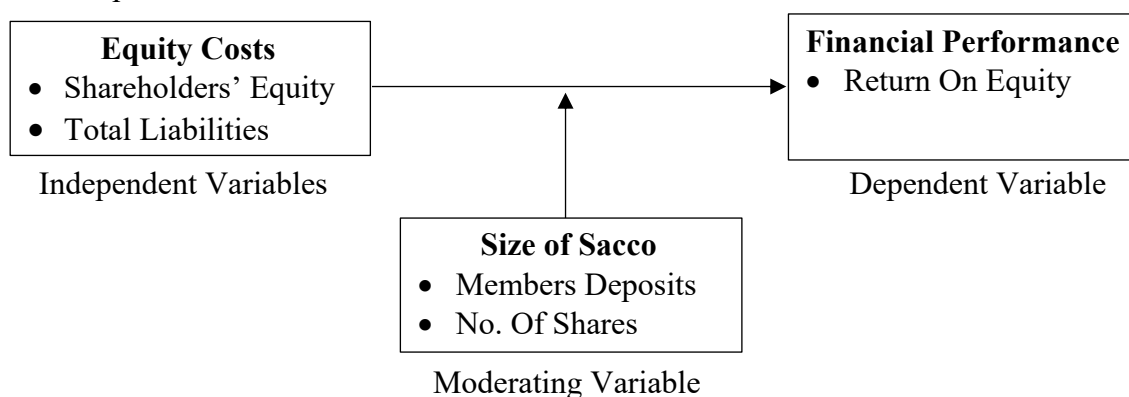


Figure 1. Conceptual Framework (Author, 2025)

2.3 Empirical Review

Mwende et al. (2019) examined the effect of equity financing on the financial performance of SMEs in Kenya and found a significant relationship between equity financing and firm performance, though trade credit had the strongest impact. The study concluded that no single financing source solely drives performance, and a mix of sources is preferable. Similarly, Shubita and Alsawalhah (2024) studied Jordanian industrial firms and reported a positive relationship between equity financing and performance, recommending retained earnings due to their lower cost. Moenga et al. (2024) found a strong positive correlation between cost of equity and financial performance among commercial and service firms listed on the Nairobi Securities Exchange, urging firms to prioritize equity over debt to reduce financial burdens.

Studies on firm size reveal its critical influence on performance and compliance. Muhindi (2018) found that size significantly affects financial outcomes in Kenyan commercial banks. Fernandez et al. (2018) emphasized that firm performance is largely driven by firm-specific factors, especially for large and small firms. Omar (2013) also found that asset growth and efficiency improved performance in microfinance banks. Mwangi (2014) highlighted that compliance costs are a burden to SMEs, while Irungu (2019) noted that firm size, liquidity, and asset tangibility positively influence financial performance. Chumo (2013), focusing on SACCOs, confirmed that regulatory compliance enhances financial performance but also identified challenges such as high costs, weak governance, and system inefficiencies. These studies collectively support the need to explore how equity cost compliance and firm size impact SACCO performance in Kenya. equity financing process and also aid governmental entities and policymakers in formulating effective policies about equity financing.

3. Methods

This study adopted both quantitative and qualitative research philosophies, aligning with ontology and epistemology to understand the implications of regulatory costs compliance on the financial performance of deposit-taking SACCOs in Kenya. A descriptive research design was employed, suitable for analyzing and interpreting data to reveal new insights based on existing conditions (Cooper & Schindler, 2003). The target population comprised all 176 SACCOs licensed by SASRA, as per the 2021 records from the Commissioner of Cooperatives, forming the study's census due to the accessibility and comprehensiveness of the SASRA database. Data was collected using a secondary data collection sheet focusing on statutory expenses, audit and accountancy costs, enforcement costs, and firm size as a moderating variable, with the board of directors, CEOs, and managers serving as the unit of analysis. Financial performance was measured using return on equity (ROE). The reliability of the data collection instrument was confirmed using Cronbach's Alpha, with a coefficient above 0.7 considered acceptable (Mugenda & Mugenda, 2013). Data was analyzed using SPSS (version 22), applying descriptive statistics (means, percentages, standard deviations), diagnostic tests (linearity, multicollinearity, normality, homoscedasticity, and sample adequacy), and inferential statistics including correlation and regression analysis to determine the relationship between regulatory cost compliance and SACCOs' financial performance.

4. Results and Discussion

4.1 Descriptive Statistics

The study sought to determine the mean regulatory costs influence on financial performance of licensed deposit taking credit co-operative societies in Kenya. The references included Annual Audited Reports between the years 2017-2022 of 176 licensed deposit taking credit co-operative societies in Kenya. The findings were as indicated in table 1

Table 1. Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Equity Cost	1056	.0000	63785758000	4328096621.06	9463113217.61
Size of the Sacco	1056	-44602158	71162118562	2911898134.53	7519715773.51
Financial Performance	1056	-198223487	8612158000	667287513.24	1333809511.23

Regarding equity cost, the mean was 4,328,096,621.06, and a standard deviation of 9,463,113,217.61, reflecting considerable heterogeneity in the cost of equity among deposit taking SACCOs. This high level of variability indicates that equity financing costs differ greatly among societies. Such discrepancies could be attributed to differing capital structures, market access issues, or risk profiles, which are critical factors that can affect the overall cost of capital and, subsequently, the financial performance of these institutions. These findings are in agreement with Maina and Kiplagat (2016) who noted that variations in financing structures can lead to significant differences in equity costs. Moreover, they also reported that optimized equity structures are key to reducing the overall cost of capital. Eba and Udo (2020), in their study of Nigerian firms, examined the factors influencing cost of equity and found that firm risk and market conditions played a significant role which similarly reflect differences in perceived risk and access to funding among SACCOs.

For the Size of the Sacco, the mean was 2,911,898,134.53, with a standard deviation of 7,519,715,773.51, suggesting significant diversity in scale among these institutions. The broad range, including negative minimum values, suggests a diverse scale of operations among the societies. While larger societies might benefit from economies of scale, the presence of negative values may also highlight instances of financial distress or measurement anomalies, indicating that size alone may not uniformly translate into better performance. The findings are in agreement with Abdi and Mahesh (2018) who found that the size of SACCOs plays a critical role in achieving economies of scale, and Kiptoo and Chebet (2020) reported that larger SACCOs typically enjoy competitive advantages in resource mobilization. Ojong and Ojong (2020), studying microfinance institutions in Nigeria, observed a wide range of sizes, reflecting the diverse nature of the sector. The findings reflect this natural diversity within the SACCO sector, with the large standard deviation indicating a wide spectrum of asset bases and membership numbers. Similarly, Maku and Anyaogu (2021), working with cooperative societies in Nigeria, found significant variations in size which they linked to factors such as membership base, access to resources, and operational scope.

4.2 Correlation Analysis

The researcher conducted a correlation analysis to determine the existence and intensity of the associations between the study's independent and dependent variables. The Pearson correlation coefficient measures the strength of a linear association between two variables and takes a range of values from +1 to -1. A value of 0 indicates no association between the two variables. A value greater than 0 indicates a positive association; meaning, as the value of one variable increases, so does the value of the other variable. A value less than 0 indicates a negative association; meaning as the value of one variable decreases, the value of the other variable decreases. A value of 1 indicates perfect positive correlation implying that an increase or decrease in one variable is followed proportionally with an increase or decrease in the other variable.

Table 2. Pearson Correlation between Equity Cost and Financial Performance

		Equity Cost	Financial Performance
Equity Cost	Pearson Correlation	1	.938**
	Sig. (2-tailed)		.000
	N	1056	1056
Financial Performance	Pearson Correlation	.938**	1
	Sig. (2-tailed)	.000	
	N	1056	1056

The correlation between equity cost and financial performance was also very strong and significant ($r = 0.938$, $p = 0.000$). This indicates that a higher cost of equity, when managed effectively, is associated with better financial performance of deposit taking SACCOs, likely reflecting a sound equity financing strategy. These findings are in agreement with Mutiso and Kiplagat (2021) who underscored the positive influence of optimized equity financing on financial outcomes. The study also concurs with the findings of and with Musimbi and Wangalu (2020), who reported that strategic management of equity costs contributes significantly to overall performance.

Table 3. Correlation with Moderating Variable

		Equity Cost	Financial Performance	Size of the Sacco
Equity Cost	Pearson Correlation	1	.938**	.842**
	Sig. (2-tailed)		.000	.000
	N	1056	1056	1056
Financial Performance	Pearson Correlation	.938**	1	.848**
	Sig. (2-tailed)	.000		.000
	N	1056	1056	1056
Size of the Sacco	Pearson Correlation	.842**	.848**	1
	Sig. (2-tailed)	.000	.000	
	N	1056	1056	1056

The analysis also revealed that equity cost is very strongly correlated with financial performance ($r = 0.938$, $p < 0.01$), indicating that the cost of equity financing plays a pivotal role in shaping financial outcomes. The correlation between equity cost and firm size ($r = 0.842$, $p < 0.01$) suggests that larger SACCOs experience higher equity costs, likely due to the complexities of managing larger capital structures. This finding concurs with research by Wewa and Egesa (2017) which demonstrated that optimized equity financing is particularly important in larger institutions, where effective cost management can significantly enhance performance.

Firm size, represented by the size of the SACCO, is strongly correlated with financial performance ($r = 0.848$, $p < 0.01$), indicating that larger SACCOs tend to achieve better financial outcomes. The moderating role of firm size is evident in its strong correlations with all cost variables: regulatory cost ($r = 0.771$), operational cost ($r = 0.795$), capital cost ($r = 0.864$), and equity cost ($r = 0.842$). These results suggest that as SACCOs expand, their capacity to manage and leverage these cost components improves, leading to enhanced financial performance. This observation is in line with the findings of Cherono and Chebet (2020), who noted that the scale of operations plays a critical role in resource allocation and overall institutional efficiency.

4.3 Regression Analysis Without the Moderating Variable

A model summary was used to establish the relationship between compliance costs and financial performance of licensed deposit taking credit co-operative societies in Kenya. The findings are shown in Table 4.4

Table 4. Multiple Regression Without Moderating Variable

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.953a	.909	.908	404641507.69

a. Predictors: (Constant), Equity Cost, Size of Firm,

The results show that equity costs 90.9% and size of the firm to financial performance of licensed deposit taking credit co-operative societies in Kenya while 9.1% is the variation due to other factors which have not been covered in this study.

Analysis of variance was used to determine the fitness of the model in predicting the relationship between compliance costs and financial performance of licensed deposit taking credit co-operative societies in Kenya. The findings are shown in Table 5

Table 5. Anova without Moderating Variable

Model	Sum of Squares	df	Mean Square	F	Sig.
1 Regression	7178539387528375.00	4	179463484688209380.00	1096.062	.000b
Residual	7204328988767487.00	1051	163734749744715616.00		

Model	Sum of Squares	df	Mean Square	F	Sig.
Total	78989722864051240.00	1055			

a. Dependent Variable: Financial Performance

b. Predictors: (Constant), Equity Cost, Size of Firm

The findings show F calculated =1096.062 and the sig value was less than 0.05 inferring that the model was statistically significant to predict relationship between study variables which were equity costs and size of firm on the financial performance of licensed deposit taking credit co-operative societies in Kenya

The study conducted a regression coefficient to establish the mean change in financial performance for a unit change in the equity costs and size of firm of licensed deposit taking credit co-operative societies in Kenya. The finding is shown in Table 6

Table 6. Coefficients without Moderating Variable

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1	(Constant)	98973841.749	21288843.678	4.649	.000
	Equity Cost	.053	.007	.375	.000

a. Dependent Variable: Financial Performance

The constant (intercept) is 98973841.749, indicating the baseline level of financial performance when all predictor variables are zero.

For instance, SACCOs that rely heavily on external financing may face challenges in maintaining profitability due to high-interest obligations, (Spear, 2016). On the other hand, SACCOs with lower capital costs, achieved through efficient capital structure management, often report better financial performance. Effective capital cost management involves optimizing the mix of debt and equity to minimize financing expenses while maximizing returns.

In addition, equity cost also positively influences financial performance, with an unstandardized coefficient of 0.053, this suggests that a one-unit increase in equity cost is associated with 0.053, suggesting that managing the cost of equity financing effectively is associated with improved financial performance. This reinforces the view that an optimal equity structure is essential for sustaining financial health. According to Valentinov, (2018) high equity costs can pressure SACCOs to generate higher returns to satisfy shareholders, potentially leading to risky financial decisions. SACCOs with high equity costs may prioritize short-term profitability over long-term stability, increasing vulnerability to financial risks. However, SACCOs that maintain a balanced approach to equity financing, ensuring reasonable returns for shareholders while reinvesting profits for growth, often achieve better financial performance, (Chaddad & Cook,2021). Effective equity cost management involves aligning shareholder expectations with the SACCO's strategic goals, fostering sustainable financial health.

Based on these coefficients, the regression model can be expressed as:

$$Y = 98,973,841.75 + 0.053X1 + \varepsilon$$

4.4 Hypotheses Testing without Moderating Variables

H01: Equity Costs compliance had no significant relationship on the financial performance of licensed deposit taking credit co-operative societies in Kenya. For equity cost, the analysis presents a p-value of 0.000 which was 0.05, indicating that its influence on financial performance is highly significant. Consequently, H01 is rejected, and it can be concluded that effective management of equity financing is associated with improved

financial outcomes. This finding supports the perspective that optimizing equity cost structures is vital for the financial health of these institutions. The findings are in agreement with those of Ouma et al. (2020) who examined the relationship between cost of equity and firm performance of listed firms in Kenya. Their study revealed a negative relationship between the cost of equity and firm performance, indicating that lower equity costs contributed to better financial outcomes. This aligns with the current study, which emphasizes the importance of managing equity costs for SACCOs' financial health. The study also supports the work of Ngugi et al. (2018) who explored the effect of financial leverage on firm profitability in the manufacturing sector in Kenya. Their findings suggest that optimal management of equity and debt financing is essential for achieving desired profitability levels, which is consistent with the current study's focus on the role of equity costs.

4.5 Regression with Moderating Variable

A model summary was used to establish the relationship between equity costs compliance and financial performance of licensed deposit taking credit co-operative societies in Kenya with firm size as the moderating variables.

Table 7. Model Summary with the Moderating Variable

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.954a	.910	.909	403338054.56

Predictors: (Constant), Size of the Sacco, Equity Cost

The results show that equity costs and firm size contributed 91.0% to financial performance of the deposit taking Saccos. This means that the presence of firm size increases the financial performance of deposit taking Saccos by a margin of 9.0%. It can also be reported from a different perspective that inclusion of the size of the firms to the model may increase the difference in the model outcome.

Table 8. ANOVA with Moderating Variable

Model	Sum of Squares	df	Mean Square	F	Sig.
1 Regression	7184800122732857.00	4	143696002454657140.00	883.296	.000b
Residual	7141721636722670.00	1051	162681586257919584.00		
Total	7898972286405124.00	1055			

a. Dependent Variable: Financial Performance

b. Predictors: (Constant), Size of the Sacco, Equity Cost

The findings shows that the f calculated = 883.296 and p value of less than .05 thus the model is statistically significant to predict the relationship between study variable which was equity costs with firm size as moderating variable on the financial performance of deposit taking Saccos.

Table 9. Regression Coefficients with Moderating Variable

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	98143339.195	21224489.415		4.624	.000
	Equity Cost	.052	.007	.369	7.113	.000
	Size of the Sacco	.011	.006	.063	1.962	.050

a. Dependent Variable: Financial Performance

From the findings, the constant (intercept) is 98,143,339.20, indicating the baseline level of financial performance when all predictor variables are zero. This finding aligns with research by Adom, Kyei, and Agyei (2020) in Ghana, who found that regulatory

compliance costs had a negative and significant impact on the profitability of rural banks. Their study emphasized that the burden of regulatory compliance, particularly for smaller financial institutions, can strain resources and hinder profitability. This resonates with the findings, suggesting that SACCOs, which often have limited resources compared to larger banks, may be particularly sensitive to regulatory cost increases. Similarly, Tetteh, Acheampong, and Amoah (2021) in their study on the banking sector in Ghana, found that regulatory burden had a negative influence on financial performance of banks. Their study demonstrated that increased compliance requirements and associated costs reduced profitability.

In addition, equity cost also positively influences financial performance, as evidenced by its unstandardized coefficient of 0.052. This suggests that a one-unit increase in equity cost is associated with a 0.052 unit increase in financial performance. Hence effectively managing the cost of equity financing is associated with improved financial performance. This interpretation would align with Adeyemi and Olamide (2019) who studied the effect of cost of capital on firm performance in Nigeria, and found that the cost of equity has a significant effect on firm performance.

Lastly, the size of the SACCO has an unstandardized coefficient of 0.011. This suggests that a one-unit increase in firm size is associated with a 0.011 unit increase in financial performance. This result suggests that larger SACCOs tend to experience a slight improvement in financial performance, likely due to economies of scale. This is consistent with the findings of Olanrewaju and Adedokun (2022) who found that size had a positive influence on the profitability of microfinance banks in Nigeria. Their research supports the idea that larger institutions can benefit from economies of scale, leading to improved financial performance. Similarly, Agyei-Mensah (2020) found a positive relationship between asset size and profitability of rural banks in Ghana.

Based on these coefficients, the regression model can be expressed as: $Y = 98,143,339.20 + 0.052X_4 + \epsilon$. H02: Moderating Role of Firm Size in the Relationship Between Equity Cost and Financial Performance. The study predicted that firm size would have no significant moderating influence on the relationship between equity cost and financial performance. The findings, however, reveal that equity cost significantly improves financial performance ($B = 0.052$, $t = 7.113$, $p = 0.000$), and the presence of firm size in the model ($B = 0.011$, $t = 1.962$, $p = 0.050$) suggests that larger SACCOs are better positioned to capitalize on equity financing benefits. Mbithi (2017) which revealed that firms with optimized equity structures tend to perform better financially, and that this positive effect is more pronounced in larger organizations due to their enhanced bargaining power and access to capital markets. Their detailed findings support our observation that firm size moderates the relationship between equity cost and financial performance, strengthening the benefits of efficient equity management.

1. Conclusion

The study concludes that effective management of equity costs is critical to the financial health of deposit-taking SACCOs in Kenya. A well-structured equity strategy that minimizes equity costs while efficiently utilizing available resources significantly enhances financial performance. Maintaining an optimal equity structure emerges as a key driver of financial stability. Furthermore, the study finds that SACCO size plays a moderating role in this relationship. Larger SACCOs are better equipped to manage the complexities of equity financing and are more likely to benefit from improved financial

outcomes. This suggests that organizational growth enhances a SACCO's capacity to optimize its capital structure, contributing to long-term financial sustainability.

Based on these findings, several recommendations are proposed. First, SACCO management should adopt optimal equity financing strategies that balance the costs of equity with the benefits of improved performance. Strategies such as mergers or strategic partnerships should be considered to promote growth and leverage economies of scale. Second, policymakers should review existing regulatory frameworks to eliminate redundant compliance burdens and create a more enabling environment for SACCOs. Regulatory bodies are encouraged to introduce incentive schemes that support innovation in managing equity costs and promote continuous improvement. Lastly, further research is recommended to explore the evolving relationship between firm size and financial performance using longitudinal methods. Such studies would provide deeper insights into the long-term effects of strategic investments in capital structure and inform sustainable growth strategies for SACCOs.

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