The Effect of Liquidity Risk Management on Financial Performance of Savings and Credit Cooperative Societies (SACCOS) in Mwanza City Council, Tanzania

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ABSTRACT

Liquidity risk management remains a vital structural determinant of financial sustainability in member-owned microfinance institutions. This paper examines the effect of liquidity risk management on the financial performance of Savings and Credit Cooperative Societies (SACCOS) in Mwanza City Council, Tanzania. Anchored on the Financial Intermediation Theory, the study evaluated three qualitative operational constructs namely liquidity control policies, funding source diversification, and management and board competence, against key financial performance metrics namely; Return on Assets (ROA), Return on Equity (ROE), and Net operating surplus. A quantitative research design was employed across thirteen (13) formally registered and active SACCOS within Mwanza City Council. The target population comprised of board members, managers, accountants, loan officers, and supervisory committee members from thirteen selected SACCOS in Mwanza City Council. Primary data were collected using structured questionnaires, while secondary data was collected using record sheet. The data was analysed by Statistical Package for Social Sciences (SPSS) version 26. The study analysed descriptive statistics, Pearson correlation and multiple regression. The findings show that liquidity risk management had a positive and statistically significant effect on the financial performance of SACCOS ($\beta = 0.213$, $p < 0.001$). The results demonstrate that structured liquidity control mechanisms, proactive funding diversification, and managerial competence significantly mitigate mismatch risks and cash-flow blockages, thereby stabilizing net operating surplus, interest on members and also maximizing return on investment. The study recommends that cooperative regulators and SACCOS executives standardize prudent liquidity control frameworks and capacity-building programs to enhance financial resilience. The study contributes to the growing body of knowledge on financial risk management in cooperative financial institutions and provides practical evidence to support policy formulation and managerial decision-making aimed at improving the financial performance and sustainability of SACCOS in Tanzania.

Keywords: Liquidity Risk Management, SACCOS, Financial Performance, Mwanza.

1.0 INTRODUCTION

In modern financial aspect, liquidity risk management has evolved from a reactive, defensive solvency mechanism into a proactive strategy aligning financial statements with market dynamics (Saunders & Cornett, 2019; Liquidity Adequacy, 2026). For member-based institutions like Savings and Credit Cooperative Societies (SACCOS), effective risk management on funds ensures that member loan portfolios are backed by stable, well-managed funding sources and that cash inflows adequately meet member withdrawal demands without eroding the surpluses.

In Tanzania, the institutionalization of formal financial risk management practices was legally reinforced through the Microfinance Act of 2018 and the Tanzania Cooperative Development Commission (TCDC) Regulations of

2019 (TCDC, 2019). Furthermore, the Bank of Tanzania (BoT) maintains explicit liquidity parameters to promote structural stability across the microfinance sector (Saunders & Cornett, 2023).

Despite these regulatory frameworks, many Tanzanian SACCOS face operational constraints, including persistent liquidity strain, high default rates, and weak capital buffers (TCDC, 2021; Magashi et al., 2024). Poor liquidity coordination often leads to a liquidity trap, where funds are tied up in illiquid, long-term assets while short-term withdrawal demands mount (Mwanzia & Makori, 2023). Therefore, liquidity risk management, encompassing formal liquidity control policies, funding source diversification, and competent board and executive oversight is therefore a critical operational determinant of financial performance in Tanzanian SACCOS.

1.2 Problem Statement

While SACCOS play a central role in driving financial inclusion across Tanzania, their financial performance is frequently undermined by liquidity crises and maturity mismatches (Magashi et al., 2023). The latest information from the Tanzania Microfinance Regulatory Authority indicates that almost 40% of SACCOS are not adhering to liquidity management practices and risk management failures (TMRA, 2024). It is notable that systematic weaknesses are characterized by high default rates and liquidity crisis, which pose a risk to member's savings (Mwanzia & Makori, 2023).

This financial instability is rooted in an imbalance of managing cashflows. Hence, theoretically, liquidity risk management has been seen as a critical component of solvency. Previous studies have shown that SACCOS in developing countries, including Tanzania, still face cashflow crisis, especially the funding of long-term credit facilities using short-term deposits from members (Abebe, 2022; Otieno et al., 2025). This mismatch results in liquidity issue where most SACCOS cannot satisfy the immediate demand for their operations.

Existing literature on liquidity risk management and financial performance largely focused on large institutions or multi-country MFI networks (Peykani et al., 2023; Brown & Taylor, 2020), leaving a critical empirical gap regarding localized, smaller cooperative societies operating in urban centers like Mwanza (Towo et al., 2023; Abebe, 2022). Unaddressed liquidity risk management deficiencies expose these SACCOS to default hazards, loss of member confidence, and potential insolvency.

1.3 Objective

i. To evaluate the effect of liquidity risk management on financial performance of SACCOS in Mwanza City Council, Tanzania.

1.4 Research Question

i. What is the effect of liquidity risk management on financial performance of SACCOS in Mwanza City Council, Tanzania?

2.0 LITERATURE RIVIEW

Theoretical Review

Financial Intermediation Theory

Financial Intermediation Theory was developed by Goldsmith (1969) and later modified by Benston and Smith (1976), as well as Howells and Bain (2008). The theory posits 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 liquidity constraints, 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 (Kesanta, 2025). Through these functions, financial institutions facilitate efficient allocation of financial resources and support productive economic activities.

The theory is 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 surplus by mitigating liquidity control policies and operational risks while diversifying funding sources which enhances capital adequacy and liquidity reserves, expanding loan portfolio and financial inclusion, and mitigating operational and default risks. Whereas governance mechanisms such as board and management competence strengthen oversight and improve decision-making quality. The theory therefore supports the relationship between risk mitigation practices such as liquidity control policies, diversifying funding sources, board and management competence and financial performance by demonstrating how effective intermediation contributes to institutional sustainability and long-term financial success (Mmary & Kapaya, 2022).

Empirical Review

The relationship between liquidity risk management and financial performance presents mixed findings across different financial institutions environments. Studies conducted in Australia, United States, Kenya, Ethiopia 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 (Getahun, 2022; Njoroge & Gitonga, 2022; William, 2021; Mosioma & Amenya, 2025; 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 (Samarasinghe & Lakmal, 2024). In Australia, William, (2021) built on evolution of proactive liquidity frameworks and institutional development and found that managing liquidity and having a contingency funding plan were significantly more successful in growing their assets and more resilient in the market downturn than those that only relied on reactive compliance monitoring. Other scholars found that liquidity risk positively affects the financial performance when risk management process such as identification, mitigation and monitoring are observed (Mosioma & Amenya, 2025; Getahun, 2022). In Kenya, Njoroge and Gitonga (2022) observed that liquidity risk management remains important in contributing to member confidence and minimizes the need for members to use short-term emergency borrowing as a cost-effective way of managing their operations thereby improving earnings.

Gaps in literature

Existing studies on liquidity risks management literature, focused on other factors rather than liquidity control policies, diversification of funding sources and board and management competence affecting financial performance as measured by ROA, ROE and net operating surplus, in SACCOS performance within Mwanza, Tanzania. Methodologically, prior studies have relied heavily on subjective manager perceptions rather than objective, audited financial metrics like ROA, ROE and net operating surplus. This study bridges the contextual and methodological gaps by combining primary perceptual insights with objective financial records to evaluate the effect of liquidity risk management in Tanzanian SACCOS.

3.0 RESEARCH METHODOLOGY

The study employed a quantitative research design to examine the relationship between liquidity risk management and financial performance indicators. Data triangulation was carried out to eliminate biasness. The target population comprised of thirteen (13) active, formally registered SACCOS in Mwanza City Council operating under the supervision of the Tanzania Cooperative Development Commission (TCDC).

Table 3.1: Measurements of operationalization of the study variables.

Variable Type	Variable	Measurements
		• Liquidity control policies.

Independent Variable	Liquidity Risk Management	• Diversification of funding sources.
		• Board and management competence.
Dependent Variable	Financial Performance	• Net operating surplus.
		• Return on Asset (ROA).
		• Return on Equity (ROE).

Source: Researcher 2026.

4.0 RESULTS AND DISCUSSION

Descriptive Statistics

Descriptive statistics reported in table below provide a summary of the key variables used in the study.

Table 4.1: Descriptive Statistics of Study Variables.

	Min	Max	Mean
Our SACCOS has clear, written policies for controlling and monitoring daily liquidity levels.	1	5	4.64
We have diverse sources of funding (e.g., member shares, deposits, external loans) to avoid over-reliance on one source.	1	5	4.72
The board and management possess the necessary skills and experience to manage liquidity challenges effectively.	1	5	4.41

Source: Researcher 2026

Table 4.1 shows the descriptive statistics of the respondents' perception on the liquidity risk management practices in the selected SACCOS. The findings show that, overall, the respondents were satisfied that their SACCOS had implemented good liquidity risk management practices, with high mean scores for all the statements. The diversification of funding sources had the highest mean score of 4.72. This finding suggests that the majority of respondents were strongly in agreement that their SACCOS diversified their sources of finance, which in turn meant that they had lowered the liquidity risk of relying on one source of finance. Diversification of funding improves the institution's capacity to meet its financial obligations and to continue lending activities positively affecting financial performance.

Correlation Analysis

Table 4.2 Pearson Correlation

		LRM	**FP**
LRM	Pearson Correlation	1	.627**
	Sig. (2-tailed)	0	0
	N	195	195
FP	Pearson Correlation	.627**	1
	Sig. (2-tailed)	0	
	N	195	195

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

The results on table 4.2 shows that liquidity risk management is positively and statistically significant with the financial performance of SACCOS especially return on asset ($r = 0.627$, $p < 0.001$). This implies that better liquidity risk management is linked with better financial performance. The correlation is moderate, suggesting that SACCOS that has good liquidity risk management were more likely to have more surplus and to have better financial results. Thus, the results indicate that there is a positive relationship between liquidity risk management and financial performance of the SACCOS, which gives preliminary evidence that liquidity risk management has a positive impact on the financial performance of SACCOS.

Regression Results

Table 4.3 Multiple Regression Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
	(Constant)	0.907	0.213		4.264	0
	LRM	0.196	0.055	0.213	3.558	0

The results on table 4.3 indicates that liquidity risk management (LRM) positively and significantly related to the financial performance of SACCOS ($B = 0.196$, $p < 0.001$). This means that, all else equal, a 1-unit increase in liquidity risk management is linked to a 0.196-unit increase in financial performance. The positive coefficient indicates that good liquidity risk management can help SACCOS fulfil their financial commitments on time, sustain their operations and enhance earnings.

Effect of Liquidity Control Policies on Financial Performance

The findings that liquidity control policies significantly improve return on asset, equity and net operating surplus is not merely a compliance obligation towards Microfinance Act of 2018 but can be used as a proactive strategy that sustains solvency, and ensures member's trust. Clear, enforced liquidity control policies prevent non-performing assets from draining liquid reserves. SACCOS operating with strict liquidity thresholds maintain stable operating cash flows, ensuring they meet unexpected member withdrawal demands without resorting to costly liquidations or high-cost short-term credit. This result is consistent with Getahun (2022), who found that liquidity policies positively and significantly affect financial performance metrics like return on asset.

Contribution of Funding Source Diversification

The findings that funding source diversification significantly improve return on asset, equity and net operating surplus is not merely moving beyond sole reliance on traditional member share capital and monthly savings but enhancing capital adequacy and liquidity reserves, expanding loan portfolio and financial inclusion, and mitigating operational and default risks. Over-reliance on volatile, short-term member savings without secondary liquidity reserves leaves SACCOS vulnerable to seasonal withdrawal surges. Diversifying funding sources such as retained institutional capital, institutional share expansion, and structured inter-cooperative liquidity pools stabilizes net operating surplus and enhances return on assets. These results agree with Towo (2022), who found that controlled external financial leverage and capital diversification positively and significantly improved liquidity return on asset, stability, and overall financial performance of SACCOS.

Management and Governance Oversight

The findings that board and managerial competence significantly improve return on asset, equity and net operating surplus is not merely a regulatory compliance but a proactive measure that improves credit risk assessment and reduction of non-performing loans, safeguarding member shares and restoring SACCOS trust, operational self-sufficiency and expense control, and strategic planning and sustainable long-term growth. The implementation of liquidity risk management frameworks relies directly on board and managerial competence. Technical proficiency in monitoring cash inflow-outflow cycles and maintaining regulatory liquidity buffers

(such as BoT liquidity requirements) correlates positively with financial self-sufficiency and profitability (ROE). This result is consistent with Mlay et al (2023), who found that board financial skills positively and significantly affect return on asset.

5.0 CONCLUSION AND POLICY RECOMMENDATIONS

Conclusion

The findings confirm that liquidity risk management has a direct, positive effect on the financial performance of SACCOS in Mwanza City Council. Enforcing liquidity control policies, diversifying funding channels, and strengthening governance oversight significantly improve asset returns, protect member capital, and ensure long-term institutional resilience.

Policy and Practical Recommendations

i. For SACCOS Management: Establish standardized liquidity control policies and actively diversify funding sources beyond short-term deposits to insulate operations from liquidity shocks.

ii. For Regulators: TCDC & Bank of Tanzania to design tailored technical training modules focused on liquidity risk management and statutory compliance for cooperative leaders and management teams.

iii. For Academia: Extend localized empirical research into rural and agricultural SACCOS to compare urban versus rural liquidity dynamics across Tanzania.

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