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EFFECT OF DIVERSIFICATION OF REVENUE SOURCES ON THE FINANCIAL PERFORMANCE OF SACCOS IN KENYA

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Abstract: **Savings and Credit Co-operative Societies (SACCOs) in Kenya have been studied over the years with the objective of maximizing members' wealth. Similar with other investment options, wealth maximization and member deposits mobilization strategies have been critical objectives for all SACCOs' investment avenues from a wide range of investment alternatives. Studies have indicated that despite SACCOs having been in existence since their inception in the 1960s, lack of sufficient wealth creation has made it difficult for them to absorb their operational overheads, ensure sufficient credit to members on a timely basis, finance capital projects and reduce delinquency thereby threatening their sustainability. This has led to the losses being absorbed by member's savings and or deposits hence loss in members' investments. It is in this line that this study assess effect of diversification of revenue sources on financial performance of Sacco's in Kenya, The specific objectives of this project was to determine the effect of money transmission on the financial performance of SACCOs in Kenya, to establish the effect of foreign direct investments on the financial performance of SACCOs in Kenya, to determine the effect of trade finance on the financial performance of SACCOs in Kenya and finally to find out the effect of properties investments on the financial performance of SACCOs in Kenya. The study targeted SACCOS in Nairobi County. The study adopted secondary data analysis research design. The quantitative data was analyzed using descriptive statistics. In addition the study used multiple regression analysis to analyze the data. This study concluded that investment in mobile banking significantly and positively influence the financial performance of SACCOs in Kenya. This implies that an increase in financial performance of SACCOs is likely through embracing investment in mobile banking. This study also concluded that trade finance significantly and positively influence the financial performance of SACCOs in Kenya. A positive increase of trade finance initiatives within the SACCOs sector increases the financial performance of SACCOs in Kenya. It is therefore concluded in the study that trade finance within the operations of the SACCO is positively significant on their financial performance. This study further concluded that trade finance significantly and positively influence the financial performance of SACCOs in Kenya. This was confirmed from the correlation analysis as the correlation coefficient was strong and also from both the multiple and linear regressions. The p values also show that real estate investment was significant on financial performance of the SACCOs. From the above conclusion, the study recommends that policy makers should consider consider mobile banking in their formulation of policies because of the technological developments and the expected switch from physical branch networks to technologically supported banking services. The researcher also recommended that the SACCO should carry out training on staff to improve on their skills, make more elaborate and friendly procedures to allow more customers to participate in trade finance and leverage on the products which were not frequently offered. The study finally recommends that management of the SACCOs in Kenya should consider increasing their asset allocations to real estate close to the maximum since the sector gives higher returns on investment although the returns tend to be long term.**

Keywords: **investment in mobile banking, trade finance and real estate investments.**

1. INTRODUCTION

Kenya has had an impressive economic growth over the last five years and the stage is set for the actualization of vision 2030 hinged on the economic, social and political pillars. The economy has been performing well but post-general election violence following disputed presidential election results of 2007 have shown that the political and social pillars

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have to be prioritized to enable the economic pillar to be firmly re-established. In the year 2006, GDP growth was 6.4% while in 2007, there was 7% GDP growth. The 7% growth was stimulated by sustained fiscal and monetary policies, a resilient private sector (including the informal sector) and prosperous trading partners. The overall average annual inflation rate stability with the average lending interest rate being 13.32 % in 2007, compared to 13.70% in 2006. The 91 days Treasury bill rate was 6.87% in 2007 (Amha, 2008).

The impressive economic growth rate is now attracting and creating confidence in the banking sector thereby Failure to control these risks, especially credit risk, could lead to insolvency (as cited in Alp et al, 2010) asserts, about 2 out of 3 SACCOs initially formed were not operational (either dormant or collapsed) or for some reasons ceased operations .As Alabdulkarim, 2012) asserts, there have been challenges of managing liquidity (Akinyele, 2011).For instance Barr SACCO in Lira had an insufficient loan portfolio of Ushs.12, 690,000 as well as low profitability resulting into some SACCOs failing to repay loans lent to them with recovery rate of loans advanced to SACCOs worse in the Gulu Zone (Ahoya, 2015).

Statement of the problem

SACCOs are attractive to their customers owing to their wide coverage to even rural and poor areas that are not usually served by other financial services providers. SACCOs have a solid base of small savings accounts that enable them access low cost source of funding. They also have low administrative costs making them advance loans to their customers at a lower cost than other financial services providers. SACCOs are therefore perceived to bring financial redemption to the poor and play a critical role not only in poverty alleviation, but also in economic development of the country (Brown, S., & Eisenhardt, 2010).

The existence and flourishing of SACCOs in Kenya have not been able to perform well as compared to the other mainstream financial institutions like commercial banks. SACCOS are formed to serve the special needs of its members, but this has not been possible because of the various challenges that impacts on their financial performance. One of the justifications of the advancement of a financial institution is one that is profitable and has financial sustainability. According to Bruhn & Georgi, (2006), Sacco's financial performance has been on a declining trend. This situation has been worsened with the capping of lending interest rate by commercial banks which lowered the bank lending rates hence increased competition with SACCOs for customers. In Bryman & Cramer, (2012), noted that SACCOs experienced poor financial performance in year 2016-2018 as compared to the traditional banking sector. The poor performance was attributed to costly lending methodology. They also noted that the sector experienced poor efficiency and poor profitability, which was attributed to funding and operational costs. These has led to SACCOs diversifying their revenue sources in order to enhance their financial performance.However,it is not clear which of these sources have the higher impact on financial performance.

However, despite SACCO experiencing those challenges, most of the literature reviewed linking diversification of revenue sources and financial performance are drawn from developed countries context like the USA, China and Sweden. Those studies reveal contextual gaps since they were conducted in other countries and hence cannot be generalized to the Kenyan context. Other studies revealed conceptual gaps since they do not focus on variables used in this study. Further, some studies indicate methodological gaps since they adopted different research methods from the ones used in this study (Cappa et al, 2015).

Though local studies like Chaddad & Cook (2004), Brown, S., & Eisenhardt,(2010), Athansasoglou,Brissimis,& Delis,2010) and Chaddad,& Cook,2004) were carried out on SACCOs in sectors in Kenya, they did not link diversification of revenue sources and financial performance of Saccos in Kenya. This has created a shortage in empirical evidence and studies on the local scene. It is against this background that the study intend to assess effect of diversification of revenue sources on financial performance of Sacco's in Kenya.

Objectives

i. To determine the effect of investment in mobile banking on the financial performance of SACCOs in Kenya

ii. To determine the effect of trade finance on the financial performance of SACCOs in Kenya

iii. To find out the effect of real estate investments on the financial performance of SACCOs in Kenya

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2. THEORETICAL REVIEW

Financial Intermediation Theory

Financial intermediation is a process which involves surplus units depositing funds with financial institutions who then lend to deficit units. Chen & Wong,(2004) identified that financial intermediaries can be distinguished by four criteria. First, their main categories of liabilities or deposits are specified for a fixed sum which is not related to the performance of a portfolio. Second, the deposits are typically short-term and of a much shorter term than their assets. Third, a high proportion of their liabilities are chequeable which can be withdrawn on demand and fourthly, their liabilities and assets are largely not transferable. The most important contribution of intermediaries is a steady flow of funds from surplus to deficit units. Chaddad & Cook, (2004) analyses the provision of liquidity that is transformation of illiquid assets into liquid liabilities by banks. In their model identical investors or depositors are risk averse and uncertain about the timing of their future consumption need without an intermediary all investors are locked into illiquid long term investments that yield high pay offs to those who consume later.

Profit Maximization Theory

The profit maximization theory was founded by to Marshall (1890). The theory is based on the argument that the key goal of enterprises is the maximization of profits. According to the theory every person who is part of the organization acts in his self-interest to make sure that the profits of the business are maximized. The theory is usually used in the economic perspective whereby organizations ensure their profits are maximized by equating marginal revenue to marginal costs. As Day et al. (2013) points out, a firm achieves its goals when it gets ample profits and more so when its resources are used to come up with goods and services that can be sold to customers so as to get revenue. He adds that the survival of any firm is dependent on the profits got from its sources of revenue. Today this theory can be used in various organizations especially in the banking sector. One of the key assumption is that banks seek to maximize their profits when providing servicesThe shareholders of the banks expect profits and thus banks have no choice but to conduct business in a way that maximizes the profits.

Modern Portfolio Theory

The Modern Portfolio Theory was founded by Markowitz in 1952. The author proposed that majority of investors are usually cautious with their investments and so they take the smallest possible risk to get a highest possible return, optimizing return on the risk ratio. This theory emphasizes that investors should not base their judgments by only looking at the expected risk and return of an individual stock. It support investment in various stocks for benefits of diversifications and decrease in the volatility of the entire portfolio (Das, & Pal, 2011). Crosby & Johnson, (2002) argues that the Modern Portfolio theory presents investors with two aspects. One aspect is that history might be repeated, implying the employ of past data in investment decision making. The second aspect is that not all assets fluctuate. The investors should, therefore, stop unity-grouping of assets and assumptions that they portray similar characteristics and so expectations

Resource Based View Theory

The Resource Based View is an approach to achieving competitive advantage that emerged in 1980s and 1990s, after the major work published by Wernerfelt, (1984). The supporters of this view argue that organizations should look inside the company to find the sources of competitive advantage instead of looking at competitive environment for it. The resource-based view (RBV) emphasizes the firm's resources as the fundamental determinants of competitive advantage and performance. It adopts two assumptions in analyzing sources of competitive advantage (Conner & Prahalad, 2011).First, this model assumes that firms within an industry (or within a strategic group) may be heterogeneous with respect to the bundle of resources that they control. Second, it assumes that resource heterogeneity may persist 14 over time because the resources used to implement firms' strategies are not perfectly mobile across firms (i.e., some of the resources cannot be traded in factor markets and are difficult to accumulate and imitate). Resource heterogeneity (or uniqueness) is considered a necessary condition for a resource bundle to contribute to a competitive advantage. The argument goes "If all firms in a market have the same stock of resources, no strategy is available to one firm that would not also be available to all other firms in the market" (Chukwuma, 2013).

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Conceptual Framework

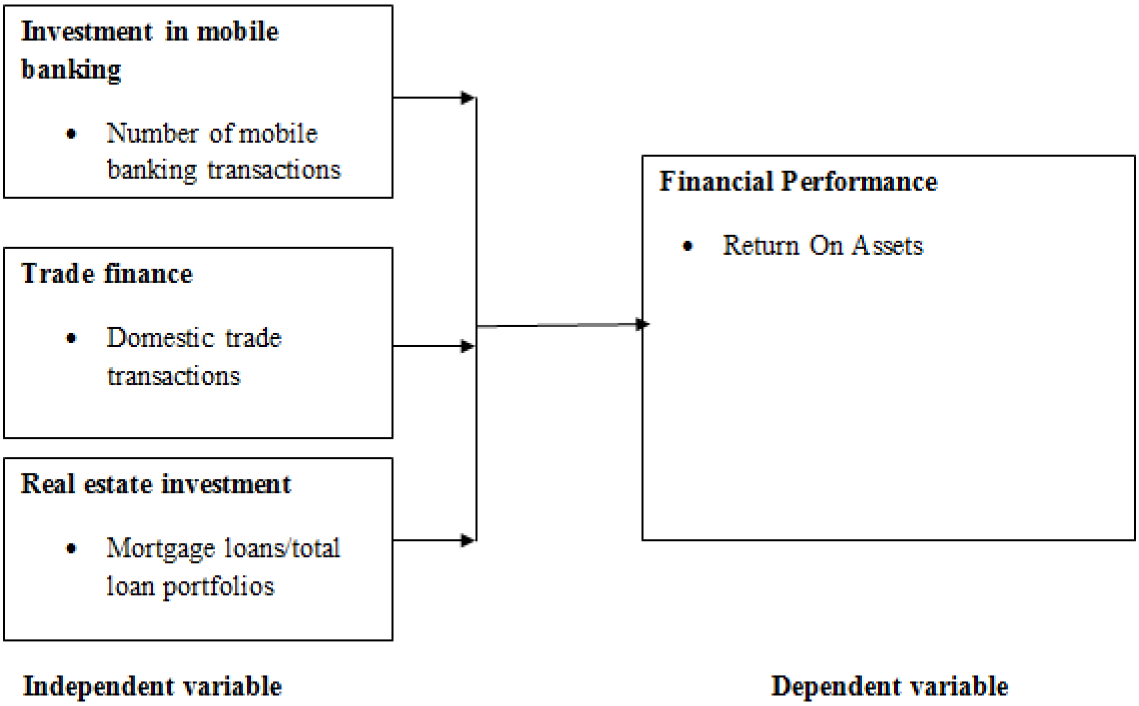

Figure 2.1: Conceptual framework

Critique of the Study

Onduso, (2013) conducted a study on the effect of diversification of revenue sources on financial performance on outreach performance (increased number of SACCOs' members). Despite the fact that this study focused on diversification of revenue sources and how it affects performance of firms, the study was conducted in Tanzania. Similarly, Ongore & Kusa,(2013) conducted a study on diversification of revenue sources and its impact on business performance in Nigeria.

Further, Peng et al (2015) examined the impact of diversification of revenue sources on organizational performance. These studies are similar in that they all analyzed the impact of diversification of revenue sources on organization performance; however, none of them was conducted in Kenya. Therefore, it would be impractical to generalize their findings to the Kenyan context.

Ahoya (2015) examined the influence of diversification of revenue sources on financial performance of Kenya Commercial Bank Ltd. Mutegi (2018) assessed the role of diversification of revenue sources on insurance penetration in Kenya. The two studies are similar in that they both adopted a descriptive research design. However, the two studies differ in that first one focused on commercial banks while the second one focused on insurance firms. Further, none of the two studies focused on SACCOs as was the case in this current study.

Otieno & Moronge, (2014) study examined the relationship between diversification of revenue sources and financial Performance at Barclays Bank of Kenya Limited. Similarly, Waititu (2014) conducted a study on the diversification of revenue sources on the financial performance of commercial banks in Kenya. Both studies are similar in that they both examined how customer focus strategies influence financial performance of banks in Kenya. However, the studies did not focus on SACCOs as was the case in this current study.

Research gap

The study identified several research gaps from empirical literature including contextual, conceptual and methodological gaps. For contextual gap, most studies done on diversification of revenue sources and financial performance were carried out in other countries. For example, Peng et al (2015) examined the relationship between diversification of revenue

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sources and corporate performance of the Nigerian brewing industry. Sorina,(2012) examined the effect of diversification of revenue sources on the performance of SMEs in Ghana. Karlsson and Tavassoli (2015) analyzed the effect of diversification of revenue sources on their future performance, captured by labour productivity in Sweden.

Further, local studies concentrated on other sectors, thus presenting contextual gaps. For example, Pesa and Muturi (2015) assessed the factors affecting deposit mobilization in the banking sector. Onyango's (2016) study sought to determine the effect of diversification of revenue sources on the performance of cut flowers exporting firms in Kenya. Mutegi (2018) assessed the role of diversification of revenue sources on insurance penetration in Kenya. These studies presented contextual gaps since they focused on other sectors such as banking, horticulture, manufacturing and insurance. However, the current study focused on savings and credit cooperative societies.

In addition, several studies revealed conceptual gaps since they did not address the objectives of the current study. For example, Nwokah, Ugoji and Ofoegbu (2009) only focused on one deposit mobilization strategy. Woldemichael (2010) did not focus on the main deposit mobilization strategies including product, marketing, technological and customer focus strategies. The current study addressed this gap by focusing on money transmission**,** foreign direct investments, trade finance and real estate investments and how they influence financial performance of SACCOs.

3. RESEARCH METHODOLOGY

The research design used in this study was descriptive research design.The study targeted SACCOS in Nairobi County. The target population therefore was 36 SACCOS that was drawn from Nairobi County.This study used census sampling since the population also constitute the sample that is 36 SACCOS.The data that was used was dated from year 2014 January to 2018 December. The study used the annual financial reports of the commercial banks in Kenya. This data was authentic since it was secondary data that has been collected by credible agents and published by the Republic of Kenya.The researcher used secondary data in empirical analysis.Secondary data may either be published or unpublished. Usually published data are available in public records and statistics, historical documents, and other sources of published information, technical trade journals among other sources.The data analytical techniques that was used was quantitative techniques in nature. These are correlation analysis and multiple regression analysis. The data was analysed using the help of STATA econometric software.

Specification of the regression model

Where:

$$\log Y = log\beta_0 + \beta_1 LogX_1 + \beta_2 LogX_2 + \beta_3 LogX_3 + \varepsilon$$

Where,

Y= Financial performance

X_1: Investment in mobile banking

X_2: Trade Finance

X_3: Real estate investments

β_0=Intercept term

β_i=coefficients of the independent variables

ε= error term

4. RESULTS

Regression coefficients

Table 4.1 Regression Result table

Variable	Coefficient	Standard error	t-statistic	p-value
Investment in mobile banking	0.1678	0.0413	4.0630	0.000
Trade finance	0.2011	0.0377	5.3342	0.001

Real estate investments	0.5523	0.1572	3.5134	0.003
Constant	1.000	0.3010	3.3222	0.002
F-statistic = 73 **Prob>F = 0.0000**				

The regression model is as follows:

$$\log Y = 1.00\log\beta_0 + 0.1678\log X_1 + 0.2011\log X_2 + 0.5523\log X_4 + \varepsilon$$

Standard Error	0.3010	0.0413	0.0377	0.1572
t-Statistics	3.3222	4.0630	5.3342	3.5134
p-value	0.002	0.000	0.001	0.003

F-statistic = 73

Prob>F = 0.0000

Where:Y = Financial performance, β_0 = Constant Term, β_1 = Beta coefficients, X1 = investment in mobile banking ,X2 = trade finance, X3 = Real estate investments, ε = Error Term

The regression equation above has established that taking all factors into account (investment in mobile banking, trade finance and real estate investments) constant at zero, financial performance of SACCOs in Kenya will be 1.053.The findings presented also show that taking all other independent variables at zero, a unit increase in the investment in mobile banking would lead to a 0.350 increase in the scores of financial performance of SACCOs in Kenya and a unit increase in the scores of trade finance would lead to a 0.770 increase in of financial performance of SACCOs in Kenya.Finally,the findings shows that a unit increases in the scores of real estate investments

would lead to a 0.875 increase in financial performance of SACCOs in Kenya.

5. CONCLUSION

This study concluded that investment in mobile banking significantly and positively influence the financial performance of SACCOs in Kenya. This implies that an increase in financial performance of SACCOs is likely through embracing investment in mobile banking. The investment in mobile banking has enhanced Kenyan SACCOs is industry by making it more productive and effective. Mobile banking gives SACCOs the potential to expand beyond their geographical footprint as well as ability to cross-sell and up-sell products to existing customers. This study also concluded that trade finance significantly and positively influence the financial performance of SACCOs in Kenya. A positive increase of trade finance initiatives within the SACCOs sector increases the financial performance of SACCOs in Kenya. It is therefore concluded in the study that trade finance within the operations of the SACCO is positively significant on their financial performance. This study finally concluded that trade finance significantly and positively influence the financial performance of SACCOs in Kenya. This was confirmed from the correlation analysis as the correlation coefficient was strong and also from both the multiple and linear regressions. The p values also show that real estate investment was significant on financial performance of the SACCOs.

Suggestions for Further Research

One of the suggested areas of further research is the inclusion of listed commercial banks in a similar study. This may lead to a more generalized conclusion on findings and policy recommendation across the industry. Future research could expand this scope to include other parameters that are used to measure financial performance. Other factors such as the stock turnover and how they relate to the overall financial performance of SACCOs can be considered as moderating or controlling variables in future studies. The study on effect of effect of diversification of revenue sources on financial performance should also be done on other sectors like manufacturing for instance to find out if the same results would be achieved.

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