DIVERSIFICATION STRATEGY AND FINANCIAL PERFORMANCE OF KENYA NATIONAL POLICE DEPOSIT TAKING SACCO

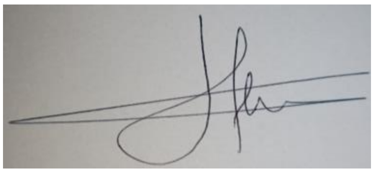
KINYAGU JOHN KINUTHIA

A RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION, FACULTY OF BUSINESS AND MANAGEMENT SCIENCES, UNIVERSITY OF NAIROBI

2021

DECLARATION

This research project is my original work and has not been submitted to any other university for award of a degree.

Signature……………………………………….Date …15/11/2021………………

JOHN KINUTHIA KINYAGU

D61/11861/2018

This research project was submitted for examination with my authority as the university supervisor.

Signature…  Date 15/11/2021

DR. MERCY MUNJURI

SENIOR LECTURER

FACULTY OF BUSINESS AND MANAGEMENT SCIENCES

UNIVERSITY OF NAIROBI

ACKNOWLEDGEMENTS

I am deeply grateful to the Almighty God for his grace and providence which has enable me start and complete this MBA program and research project.

Special thanks go to my supervisor Dr. Mercy Munjuri and my moderator Prof. Evans Aosa for their immense support and guidance throughout my research process. Their contribution is extremely valued.

To all the respondents considered, your effort and cooperation in availing the valuable information required in the study is highly appreciated.

I am forever grateful to my precious family for their love, support and understanding especially during numerous occasions I had to work late to complete this research project.

Thank you all!

God bless you all

DEDICATION

This work is dedicated to the almighty God who has blessed me and guided my work and footsteps throughout my life. To my caring and priceless mum and late dad for educating me and nurturing my dream. To my loving wife Jane, daughter Shirleen and son Alvin for their moral support.

TABLE OF CONTENTS

ABBREVIATIONS AND ACRONYMS

ATMs: Automatic Teller Machines

CBK: Central Bank of Kenya

DT: Deposit Taking

FOSA: Front Office Service Activities

KUSCCO: Kenya Union of Savings and Credit Co-operatives

MPT: Modern Portfolio Theory

NIM: Net Interest Margin

RBA: Retirement Benefits Authority

RBT: Resource Based Theory

ROA: Return on Assets

ROE: Return on Equity

SACCOs: Savings and Credit Co-operatives

SASRA: Sacco Societies Regulatory Authority

SCA: Sustainable Competitive Advantage

USA: United States of America

ABSTRACT

Diversification strategy remains a critical corporate strategy in the business world today for purposes of building a sustainable competitive advantage, growth of market share, spreading business risks, resource utilization efficiency, promote and promoting profitability and the overall financial performance. The purpose of the study was to determine the influence of diversification strategy on the financial performance of Kenya National Police Deposit Taking SACCO. This study was anchored on three theories including Ansoff Product Matrix on the four main growth strategies by Igor Ansoff in 1957, the Modern Portfolio Theory (MPT) by Henry Markowitz (1952) which emphasizes the need for firms to invest in a range of portfolios with different correlations as a way of spreading risks and the Resource Based Theory (RBT) by Birger Wernerfelt (1984) which allows firms to leverage upon their rare and inimitable inward capabilities to gain competitive advantage. This research adopted a case study research design and involved collection of primary data gathered using face to face or virtual interviews conducted to all nine functional managers and three senior managers for the three divisions of the SACCO. The collected data was analyzed through content analysis approach. The research findings revealed that the SACCO has adopted four main diversifications strategies including membership diversification involving opening of the common bond to allow recruitment of members outside the original sources; product and service diversification characterized with introduction of innovative products and services customized to meet the needs of members; geographical diversification or robust branch network with eight physical branches and a virtual branch supported by technology; and investment portfolio diversification where investments are spread across a range of investment classes as a way of managing risks and enhancing profitability. As revenue from diversification increases, the gross revenue have also significantly increased thus diversification strategy has positively affected financial performance of the SACCO. The study made four recommendations including membership recruitment and retention from all corporate segments across the country; continued branch network enhancement; introduction of innovative products and services for the members and enhanced investment portfolio diversification.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Diversification remains an essential corporate strategy embraced globally by firms for purposes of survival and growth (Cernas, 2011). The strategy has over the years evolved to be a key strategy for the survival of firms in an intention to outpace competitors (Haug & Ultich, 2013). It enhances business expansion (Su & Tsang, 2015), economies of scale (Sindhu et al., 2014), profitability (Yigit & Tur, 2012; Karimi, 2013), and fosters resource utilization efficiency (Emel & Yildirim, 2016; Hasby et al., 2017). Whether in related or unrelated form, diversification is a strategy employed by firms to improve financial performance (Makau & Ambose, 2018; Castaldi & Giarratana, 2018). Perez (2015) emphasizes the need for organizations to have several diversified investment portfolios for income growth as different portfolios achieve different performance when subjected to diverse economic conditions. As a result, diversified portfolio insure firms against harsh market conditions and frequent economic variations. However, the available empirical studies on diversification correlation with financial performance of firms have generated conflicting findings. Some studies indicates that diversification enhances financial performance (Odhiambo, 2013; Karimi, 2013; Mulei & Kosgei, 2010; Kimeu, 2014). Other studies concludes that diversification negatively affects financial performance (Phung & Mishra, 2016) while others depicts no relationship (Shyu & Chen, 2009).

This study has been anchored on three theories or models. Firstly, the Ansoff Product Matrix by Igor Ansoff in 1957 whereby diversification is considered one of the four main growth strategies. The other growth strategies include market penetration, product development and market development (Hussain et al., 2013). Secondly, the Modern Portfolio Theory (MPT) by Henry Markowitz (1952) which guides in the formulation of the most efficient and diversified investment portfolio with minimal risk. MPT assists firms in reference to the expected risk and returns for a given investment. The theory recommends that firms should consider investment in a range of portfolios with different correlations as opposed to reliance on a single portfolio in order to enjoy diversification benefits through risk reduction by way of spreading risk amongst portfolios. Thirdly, the Resource Based Theory (RBT) by Birger Wernerfelt (1984), which allows firms to leverage upon their rare as well as inimitable inward capabilities to gain competitive advantage over other firms. The theory indicates that all firms have enormous untapped resources in their possession thus making them superior over their competitors and ultimately enhances financial performance if properly combined (Oladimeji & Udosen, 2019).

The stability of SACCOs is necessary for economic growth and resilience in the midst of financial shocks (Chambo et.al, 2013). SACCOs success just like other businesses is assessed based on its asset and profit quality. Profitability and asset quality are critical factors for the growth and survival of SACCOs. Compared with other economies in East Africa, the SACCO sector in Kenya has continuously been recognized for its extensive diversification and size (Kithinji, 2010; Gaitho, 2013). SACCOs are capable of issuing loans at lower interest rates compared with other financial institutions. Furthermore, they are capable of reaching clients in regions considered unattractive by banks including rural or poor areas thus endearing customers of SACCOs in many countries (Munyiri, 2006). Despite the impressive contribution of SACCOs, there remains numerous grey areas. For instance, diversification strategy and its implication on financial performance particularly for SACCOs has not been explored adequately. Most of the research has been on commercial banks, investment firms and pension firms, which has still yielded mixed findings. These gaps motivated the need to undertake this research.

1.1.1 Diversification Strategy

In the past two decades, diversification remains one of the most prominent strategies embraced by corporates globally. The strategy emerged prominently in the USA and Europe during 1960s and 80s. These periods were characterized by expansion of firms via mergers and acquisitions (Favourate & Eukeria, 2014).

Ansoff (2003) defines diversification as a strategy, which facilitates a given firm within its current market to develop new products or launch current products in new markets. The strategy arose due to globalization, intense competition and liberalization in the corporate sector and assists in spreading risks among various businesses through combination of a variety of investments (Mohindru & Chander, 2010). It entails spreading an investment portfolio into a range of asset classes or markets such as fixed income, equities, cash equivalents and alternatives (Derek, 2015). Reilly & Brown (2004) further reiterates that diversification involves spreading investment over a wide range of assets as way of removing unsystematic risk. Spreading investment portfolio into diverse assets assists in lowering the overall portfolio risk (Arora & Jain, 2013). Put in simpler terms, it ensures that all eggs are not put in the same basket in accordance with the Markowitz portfolio theory (Marling & Emanuelson, 2012).

Risk, according to diversification strategy, is generally categorized into two types namely systematic and unsystematic risk. All asset classes in the market are affected by systematic risk while unsystematic risk is specific to the asset class and submarket. Unsystematic risk or diversifiable risk is connected with random factors which by use of diversification strategy can be eliminated (Welner & Thomas, 2004). The rationale is to reduce the unsystematic portfolio risk through selection of products and services with minimal correlation (Hu, 2012). Diversification reduces the portfolio variance in case the products are not of the same line (Orina, 2011). A well-diversified portfolio mix generates higher returns with minimal risk compared with any individual investment hence positively effects financial performance and stability. However, different researchers and scholars still hold mixed arguments on the relationship between diversification strategy and business enterprise financial performance.

1.1.2 Financial Performance

According to Boru (2011) performance is defined as fulfillment of a goal or a shared purpose. It involves achievement of a certain task measured against given standards. Financial performance is the profitability level of a given investment. Organizational performance indicates accomplishment level of the strategic objectives of the firm. (Murimiri, 2009). Moullin (2002), further defines performance giving emphasis on how organizations are managed and the value delivered to the respective stakeholders.

Financial performance is the outcome of policies, strategies, technology, systems and processes of a firm expressed or measured in monetary value and arises from the diverse business activities in a given firm (Thiagarajan, 2011). According to Stoner (2003) financial performance is the capabilities to perform profitably, efficiently and effectively, being able to withstand all the hard economic times, environmental threats while utilizing the available resources and existing opportunities to the maximum with minimal cost. The management is guided by the financial performance of a firm in deciding the policies and strategies to be adapted to enhance sustainability of the organization (Almazari, 2011).

The balances scorecard was established by Kaplan & Norton (2001) for purposes of financial performance measurement in a certain firm. The balance scorecard describes cause and effect relationship of a strategy and additionally develops a structure for the strategic objectives organization into the financial perspective aligned together with the firm's vision and mission. The essential components include customer satisfaction index, financials, internal business processes as well as learning and growth. Ratio analysis is another key financial performance measure that is categorized based on the following financial performance aspects profitability, efficiency, liquidity, leverage or debt management (Mwaura, 2005). Kent (1994) identifies several indicators or ratios of financial performance among them Return on Assets (ROA), revenue/profit growth and Return on Equity (ROE). ROA is viewed as the prominent and accurate financial performance measure (Kamwaro, 2008).

1.1.3 SACCOs in Kenya

Savings and Credit Co-operatives (SACCOs) forms part of the larger cooperative movement that encompasses of user owned financial institutions offering savings and credit services to their members (Tache, 2006). Cooperatives comprises autonomous association of individuals joined together voluntarily with the aim of meeting shared socio-economic as well as cultural needs and aspirations via a jointly owned and democratically controlled organization (SASRA, 2020). Member of SACCOs comprises net savers and net borrowers who usually pay an initial entrance fee, purchase shares and continuously save monthly deposits. Only members can transact with SACCOs unlike commercial banks, which deals with the public. Generally, members of credit unions have a common bond acting as the main catchment area although recently the trend has been to open the common bond for purposes of growth (Saunders & Cornett, 2011).

The modern co-operative concept emerged at Rochdale village of Manchester region in England at around 1844. Since then the movement has developed globally as a unique and distinct social-economic movement (Tache, 2006). In Kenya, cooperative movement can be traced back in 1908 at Kipkelion area of Kericho County in Rift Valley region. Registration was done under the Companies Ordinance and was aimed at providing agricultural and dairy support for the white settlers (Kobia, 2011). Prior 1930, growth of the cooperative movement was hampered as a result of discouragement emanating from colonialists who considered it rare finding smart people in Africa who could command trust and keep business accounts for the members (Oyoo, 2002; Ongore, 2001). Involvement in co-operatives by government begun in 1931 with the enactment of the first co-operative statute or ordinance. The Government continued promoting the movement after independence in 1963, for purposes of fostering modern economic development particularly in land acquisition, business and agribusiness (Mudibo, 2006).

Kenya's SACCO industry has since independence evolved within the financial sector and is currently considered among the biggest in Africa with 5.7 percent of total assets to GDP ratio, followed by Rwanda and Ethiopia, with 3.0 percent and 0.7 percent, respectively. Growth of the SACCO industry has leveraged on rapid adoption of technology and innovations in financial products and services provision coupled with opening of the common membership bond. In addition, enhanced legal and regulatory environment have helped the SACCO industry to grow and be accessed by 28.4 percent of the adult population as at December 2019, the highest in Africa (Financial Sector Regulators, 2020). The SACCO business operations in the country cut across various sectors and regulated largely under the SACCO Societies Act and the Co-operative Societies Act.

According to SASRA (2020), the SACCO sector, represented by the 172 DT-SACCOs with valid deposit-taking licenses as at December 2019, continued to record impressive growths in all the key performance parameters such as total assets, total deposits and gross loans during the year 2019. The total assets portfolio crossed the half-trillion mark to reach Kshs 556.71 Billion in 2019 representing a 12.41% increase from Kshs 495.25 Billion recorded in 2018. The gross loans portfolio grew by 12.09% to reach Kshs 419.55 Billion in 2019 from Kshs 374.29 Billion recorded in 2018 while the net loans and other credit advances increased by 11.46% to reach Kshs 400.16 Billion in 2019 from Kshs 359.02 Billion recorded in 2018. The total deposits grew by 11.27% in 2019 to reach Kshs 380.44 Billion from Kshs 341.91 Billion reported in 2018.

1.1.4 Kenya National Police DT SACCO

Kenya National Police DT SACCO has been in existence for over 45 years mobilizing savings and providing affordable credit facilities to its members. The SACCO is licensed to operate by SASRA which is the Regulatory Authority for SACCO Societies in Kenya. In the past, the SACCO drew its members from the Kenya Police Service, the SACCO employees, Ruaraka Housing Estate Ltd and Utumishi Investment Ltd but opened its common bond in 2014 to admit other members.

Over the years, the SACCO has experienced enormous growth with membership growing from 690 in 1972 to 63,009 in 2020. In the same year, the SACCO had an asset base and loan portfolio of about Ksh 39.1 billion and Ksh 32.6 billion respectively. Currently, the SACCO has nine branches: eight physical branches (Nairobi, Mombasa, Meru, Eldoret, Nyeri, Kisii, Kakamega and Nakuru) and a virtual branch. The SACCO offers a range of savings and credit products, tailor-made to suit the needs and expectations of members. The SACCO has continued to embrace technology in provision of services, which has led to operational efficiency and enhanced customer experience.

1.2 Research Problem

Diversification strategy continues to play a crucial role in the business world today (Elango & Ma, 2003). The strategy is a stimulus for gaining competitive advantage and a way of spreading risk across several investments or businesses in order to spur profitability, promote financial performance, enhance market operations, create synergy and reduce bankruptcy risk (Oladele, 2012). Furthermore, diversification as a corporate strategy assist in promoting debt capacity, asset deployment and facilitates firms to employ their skills, competencies and expertise to come up with new products and services (Pandya & Rao, 2011; Ajayi & Madhumati, 2012; Funchai & Junior, 2013). A well-diversified entity also enjoy competitive advantage (Dosi & Teece, 1993). As a result, diversification and financial performance relationship of firms has been the focus of a wide range of studies although many researchers disagree on role of diversification strategy on financial performance (Hitt et.al, 1997).

Financial institutions have globally underwent massive transformation efforts as a means of coping with the continually changing business environment. Growing global and domestic competition, drastically changing market trends, economic downturn and volatile financial markets have collectively created pressure on firms to develop practical responses for survival and success (Omondi & Muturi, 2013). To achieve their objectives outlined in their strategic plans, SACCOs have employed diverse business strategies for survival in a competitive and highly dynamic industry. Such a strategy include diversification of products and services as well as entrance of new markets targeting new customer base with the aim of dismantling the common bond and ultimately expand the national coverage (Machoki, 2014).

Multiple studies on diversification strategy and its linkage on financial performance of organizations include Santarelli & Tran (2016) who researched on profitability and diversification on firms in Vietnam. The study established existence of curvilinear effect of diversification on profitability of a firm but there is an associated reduction in financial performance. Krivokapic et al. (2017) studied a sample of 23 industries by use of Hausman and Entropy test to ascertain the linkage between diversification strategy and financial performance of insurance firms in Siberia. The research established that well diversified insurance firms outsmarted undiversified ones. Kamwaro (2008) carried out a causal research design by use of the least squares method and multiple linear regression to ascertain the effect of portfolio selection on investment firms in Kenya. The research concluded that investment in equity, real estate, bonds including size of the firm positively affected unit trusts financial performance. Based on a research done by Makokha et.al (2016) on diversification strategy effect on Kenyan banks financial performance argued that within banks, diversification is identified mainly on assets, loans, deposits and geographical location portfolios. The study further identified a positive linear relationship. Kipleting (2016) further studied portfolio diversification effect on the Kenyan banks financial performance and established lack of significant relationship between diversification strategy and firms financial performance.

The above empirical evidence on diversification strategy and its implication on the financial performance of business enterprises have yielded mixed, contradictory and inconclusive results. Furthermore, limited research on the subject have been done amongst SACCOs thus remains an area that is not adequately explored. This research seeks to answer the research question, what is the diversification strategy and its influence on the financial performance of Kenya National Police Deposit Taking SACCO?

1.3 Research Objective

The research objective for this study is to establish diversification strategy and its influence on the financial performance of Kenya National Police Deposit Taking SACCO.

1.4 Value of the Study

This research will essentially broaden the current theories or body of knowledge by reviewing and enriching the available literature on diversification strategy and financial performance for SACCOs. The resultant research findings will contribute to theory by validating diversification strategy as an optimal means of promoting organizations financial performance. It will assist in design of a suitable model on diversification strategy linkage with financial performance amongst SACCOs. This model will be crucial for SACCOs formulating corporate strategies for their survival and growth.

The results of this research shall be essential to the management, government agencies and policy makers controlling and regulating the SACCO sector in Kenya. Insights on diversification strategy and its implication on the financial performance of SACCOs shall be provided thus enabling them to develop and implement policies and procedures to guide diversification process in the best interest of SACCOs and their members. It will also guide the SACCO management on the necessary considerations to make during asset allocation.

Finally, this study will contribute to the study of strategic management practice as well as cooperative management by providing insights on the role of diversification strategy on the financial performance. It will provide the base for conducting future research as future researchers, academicians and scholars will refer to this study. This research will also suggest areas of further study to be investigated in the future.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter presents literature reviewed from multiple researchers and scholars in the subject of diversification strategy and financial performance of firms. It discusses theoretical foundation, diversification strategy, financial performance indicators, empirical review and research gaps.

2.2 Theoretical Foundation

This study has been anchored particularly on three theories comprising Iansoff Matrix, Modern Portfolio Theory (MPT) and the Resource Based Theory (RBT) discussed as follows.

2.2.1 Iansoff Matrix

H. Igor Ansoff established the Matrix in 1957. The matrix provides a structured avenue for the assessment of potential growth strategies in existing or new markets, with existing or new products. The four strategies include (a) Market Penetration centered on growth of sales of current products within the current market, (b) Product Development centered on introduction of products that are new to the current market, (c) Market Development concerned with entrance of new market applying current products, and finally (d) Diversification concerned with entrance of a new market through launch of new products. In reference to risk, Market penetration is considered to have the lowest risk while diversification is the riskiest. However, it has been argued that diversification into multiple unrelated markets lowers the overall risk portfolio. The matrix has been useful for firms intending to identify and explore potential growth strategies (Ansoff , 1957,1965, 1987). Major criticisms against Ansoff Matrix include the diffusion of innovation phenomenon that implies differences in how consumers adopt new products (Rogers, 1985).

2.2.2 Modern Portfolio Theory (MPT)

MPT theory originated from Markowitzs (1952) and is anchored on the mean-variance portfolio analysis. He assumed that investors are cautious while investing and would like to take the least risk as possible to earn the highest return as possible, optimizing return to the risk ratio. Markowitz indicated that distinct correlations between assets could be employed in minimizing risks in a portfolio or in obtaining additional return with minimized risk. This theory suggests that investors realize better portfolio performance by allocating their investments into diverse financial securities classes and other segments that reacts differently. MPT aims at reducing the total portfolio return variance through combination of various assets with returns that are negatively correlated (Markowitz, 1959).

This theory includes numerous explicit and implicit assumptions concerning investors and markets (Reilly & Brown, 2009; Markowitz, 1952). These assumptions include: 1.) Unlimited capital can be borrowed or lend by investors as a risk free rate, 2.) Existence of rational investors seeking to minimize risk and maximize returns, 3.) Investors accept higher risk if guaranteed of higher returns, 4.) Investors attain essential investment information for decision making on a timely basis, 5.) Existence of perfectly efficient markets, 6.) There are no transactional costs or taxes in the market, 7.) There is possibility of selecting securities whose performance is free from other investments in the portfolio. These assumptions have been are widely criticized and challenged as they are not aligned with the real world in many aspects.

MPT seeks to optimize risk and return relationship through composition of assets portfolios pegged on their risks and returns as well as correlation or covariance with other assets. An efficient investment portfolio is diversified through diversification (Markowitz, 1959). The major practical application of MPT is its ability to minimize volatility in a portfolio comprising of one category of stocks (O'Neill, 2000). Preceding invention of MPT, portfolios were selected randomly with little attention on risk (Hagstrom, 2001). This theory is significant to this research due to the applicability of diversification as an essential corporate strategy and catalyst of financial performance of firms. The theory acknowledges diversification as important for risk mitigation, growth of returns and achievement of an efficient investment portfolio.

2.2.3 The Resource-Based View (RBV)

Edith Penrose introduced this theory in 1959. The core idea of the theory is that in case an organization intends to attain Sustainable Competitive Advantage (SCA), there is need for acquisition and control of valuable (V), rare (R), inimitable (I) as well as non-substitutable (N) internal resources coupled with capabilities. There must also be an organization (O) capable of resource absorption and utilization (Barney, 1994 & 2002). Barney & Hesterly (2012) proposes four categories of resources including physical, human, financial and organizational. This theory is unique and distinct from the earlier notions of competitive advantage advocated by Porter (1985) which emphasized that competitive advantage was realized through external means or industry level factors such as products, customer base or location.

This theory relies on two key assumptions on the means of achieving firm's SCA. First, the resource heterogeneity assumption implying that some firms possesses unique and distinct resources thus are more skilled in accomplishment of certain activities (Peteraf & Barney, 2003). Secondly, due to the resource immobility assumption or the difficulty of trading resources amongst firms differences in resources may persist. Over time, the benefits attributable to the heterogeneous resources thus persists (Barney & Hesterly, 2012).

This theory has been applied in this research due to its wide application by firms in developing strategies geared towards enhancing financial performance. RBV is an action strategy designed for purposes of positioning a firm as a foundation for a multi-business while emphasizing the ability of the firm to explore and exploit the synergies between resources and as a result attain higher financial performance. Hence, diversification based on RBV looks at resource allocation and competency sharing across diverse business lines thus enhancing financial performance through cost reduction or edging out competitors (Porter, 1980). Exploitation of these synergies through sharing of resources, competencies and functions leads to creation of SCA and hence profitability associated with cost reduction. Thus, RBV indicates existence of a positive diversification and financial performance linkage in an organization.

2.3 Types of Diversification Strategy

Ansoff (2009) classified diversification strategies into four types. Firstly, Horizontal Diversification is the development of new products which are attractive to the current customers of a firm (Klein & Lien, 2009). It occurs as a result of firm's entry into a new related or unrelated business line within the same production stage as that of its existing operations (Ansoff, 1988). The new business line could complement the current product lines, a by-product of the current products or even a different product aimed at enhancing the competitive advantage for the firm Johnson et al (2002). The risk is minimized, as the firm already understands the current customers.

Secondly, vertical integration is a strategy involving acquisition or control of firms supplying the firm with customers or inputs for its outputs (Pearce & Robinson, 2010). The strategy involving movement towards the sources of raw materials in the production cycle is referred as backward vertical integration and this provides the firm with more control over the procured supplies quality and a source of the raw materials that is more dependable. Forward integration involves movement of the firm towards the subsequent stages of the production cycle and guarantee an outlet for the final products of the firm. The business also gains enhanced control over how products are disposed and differentiated from those of competitors (Barney, 2007). Based on Pearce & Robinson (2010), vertical integration strategy assist in eliminating the profits of the middleman and ultimately lower production costs and make the firm to be more competitive in regard to the cost leadership.

Thirdly, Concentric diversification involving development of new and correlated products and services in the new market. This strategy entails entrance to a new business line guided by the firm's core competencies associated with their current products and services (Ansoff, 1965).

Fourthly, Conglomerate (heterogeneous) diversification whereby a firm seeks new business opportunities with no linkage with the existing market. It involves addition of new products which are significantly distinct or unrelated to the existing products or services of the firm. This products are largely offered to new customers who are not interested in the current offerings (Thompson & Strickland, 2006). Other authors proposes two broad categories: related and non-related diversification.

Perez (2015) observes diversification for financial institutions can be measured through examination of returns on loans, cash equivalent, financial assets and other investments, which in turn can be used in measuring their overall financial performance. Bismark & Chengyi (2015) argue that the largest revenue stream for banks including SACCOs is loan portfolio. Morsman (2003) and Lawrence (2013) further notes that loans constitutes the major asset class and the predominant revenue stream. As a result, according to Dang (2011) the main risk faced by financial institutions are losses emanating from non-performing loans. Cash and cash equivalents constitutes cash including other liquid and short term investments that are easily convertible into cash (Harford & Haushalter, 2000). Perez (2015) observes that bank assets include loans, cash and cash equivalents, financial assets, other assets and premises such as property, plant and equipment. Diversification for financial institutions can be measured through examination of loans, financial assets, cash equivalents and other investments.

2.4 Financial Performance Indicators

Alexandru et al. (2008) and Murthy & Sree (2003), asserts that profit remains an essential objective of firms. Strategies and activities within the firm aims at realizing this ultimate objective. To measure profitability there exists a variety of financial ratios that can be employed including Return on Equity (ROE), Net Interest Margin (NIM) and Return on Asset (ROA).

ROE is defined as the expected investor’s return from their current investment. Higher ROE is associated with higher potential of the firm to generate profit. ROE is computed by dividing the Net Income after Taxes by Total Equity and reflects the generated return from the shareholders’ funds. ROE reflects the effectiveness in utilization of shareholders’ capital (Khrawish, 2011). Willie & Hopkins, (1997) indicates that the ultimate and most preferred measure of financial institution’s profitability or strength is its ROE.

ROA is defined as a financial ratio indicating profitability level for a given institution and is measured by dividing Income with the total assets (Khrawish, 2011). It assesses the potential of the firm to create income through utilization of the firm’s assets. It depicts the resource utilization efficiency of the firm in creating income (Khrawish, 2011). According to Wen (2010), a higher ROA imply that the firm has a higher efficiency in its resource employment. Kosmidou et.al (2007) notes that the ROA has emerged as the most popular measure of profitability. ROA avails important information in terms of profitability.

NIM is normally depicted as the earning on loans including other assets minus paid interest on funds borrowed divided by the average assets involved in generating income expressed as a percentage. NIM is the net interest income divided by total earnings assets (Gul et al., 2011). It indicates the difference between the interest income earned from loans and the cost of funds borrowed. As the NIM increases, profitability and stability of the financial institution also increases thus an essential profitability measure. A higher NIM might, however, indicate higher risk of lending practices characterized with huge provisioning of loan losses (Khrawish, 2011).

2.5 Empirical Studies and Research Gaps

Various studies on diversification and financial performance have been conducted locally and internationally. The available empirical review on the linkage between diversification strategy and financial performance indicates mixed findings and conclusions. Gibson (2000) conducted a study on the importance of strategic asset allocation on United Kingdom pension fund performance. The study observed that 96% of the total monthly portfolio returns variation is associated with the normal asset class holdings across funds. More importantly, over half of the portfolio returns variability for the fund is explained by the normal asset class holdings.

Kahloul & Hallara (2010) targeting sixty nine large firms in France between 1995 to 2005, researched on diversification risk and performance linkage. The research approach adopted was multivariate and univariate analysis. Sixty nine organizations were selected based on industrial activity, total period and size. The collected data was cross sectional and time series in nature thus, regression analysis was applied in the panel data analysis. The findings invalidated existence of a relationship between performance and diversification strategy. Total risk was also found to be linearly unrelated with diversification. Ownership structure is, however, potentially capable of intervening on the relationship between performance and diversification.

Oyewobi et al. (2013) established the effects of diversification and performance of firms within the construction sector in South Africa. The applied research design was case study research design and data was collected by use of interviews targeting five-year period. The dependent variable was performance and was computed by use of ROE, ROA and Profit Margin (PM). Geographic Diversification (GD) and Product/ Service Diversification (PD) constituted the predictor variables. Age, size, capital structure and technical capability of firms were the intervening variables. The study concluded that construction firms recorded higher profit margin. The study, however, did not specify the criteria applied in identification and separation of large construction companies from newly upgraded companies.

Oyedijo (2012) studied the effects of product-market diversification strategy on growth and financial performance of identified Nigerian firms. Descriptive research design was employed using independent sample test, correlational and multiple regression analysis. Based on regression analysis diversification strategy significantly affected financial performance whereas unrelated diversification insignificantly and negatively influenced growth and performance. However, the researcher recommended that more time scope was required to investigate the existing difference in performance prior to diversification and after diversification minimum being seven years.

Makokha et al (2016a) conducted a descriptive study on how portfolio diversification strategy affected financial performance of Kenyan banks. Portfolio diversification measurement was via Likert Scale with the questions covering only product diversification including loans and savings. The study established that most of the banks that had diversified their investments was able to increase profits and overall performance over prior years. This research resolved that financial institutions need to invest in a set of negatively correlated assets since this maximizes returns (revenue) and minimizes risks (losses).

Shikwe (2016) studied asset allocation relationship with investment returns of insurance companies in Kenya. Secondary data specifically on asset allocation and quarterly returns was gathered from IRA. The research observed that performance has a linear correlation with returns of the numerous asset classes. The linear correlation was strongest between fund performance and return of government securities and quoted equity. 30.8% of the fund performance variability is as a result of differences in policy amongst various funds. 69% is associated with other factors including whether the management embraces an active insurance fund management style, securities selection, timing of investments and manager’s asset class selection.

Mutega (2016) studied asset diversification effects on the financial performance of Kenyan banks. The research design applied was descriptive research design and secondary data was largely gathered from the annual reports of commercial banks in Kenya. 5 year time scope from 2011 to 2015 was used and data analyzed through descriptive means and inferential statistics. A coefficient of determination (R2) of 0.646 was obtained from the regression analysis implying that 64.6% of the variations of commercial banks financial performance was attributable to other investments, financial assets, cash and cash equivalent, and loans. The study revealed that diversification into financial assets had positive significant relationship with commercial banks financial performance. It emerged that unit change in financial assets would change banks financial performance by 0.00162 units.

Omondi (2013) studied the relationship between financial performance and asset allocation of pension funds in Kenya. He selected descriptive research design and gathered secondary data, specifically, on asset allocation and quarterly returns from RBA. Returns of various asset classes and fund performance was established to be linearly correlated. The correlation between fund performance and returns in government securities and fixed deposit was the strongest. 28% of the fund performance variability was observed to be because of differences in policy amongst the various funds. 72% was because of other factors such as the timing of investments, securities selection, manager’s selection and whether the manager adopts an active fund management style.

Kiplagat (2014) looked at the effects of asset allocation on the financial performance of Kenyan pension funds. RBA availed the required secondary data. The weights of asset classes and fund performance were observed to be linearly correlated. The correlation between fund performance and asset weights of quoted shares, property, government securities and cash deposit. The research, additionally, observed that 58% of the fund performance variability is associated with differences of policy in allocation of assets. 42% is as a result of other factors including timing of investments, manager's selection, whether the manager adopts an active fund management style and securities selection.

Philita (2018) studied effects of diversification on financial performance of Kenyan commercial banks. The research solely relied on secondary data. The data and other relevant information were derived from the annual published statements of accounts and CBK reports for banks between 2013 and 2017. The study found that diversification had implication on financial performance of commercial banks which means that when banks portfolio become more diversified the financial performance increases. Portfolio diversification and commercial banks performance was established to be strongly and positively correlated.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter outlines the research methodology applied in undertaking this study. The key sections covered include the research design, data collection and data analysis techniques employed.

3.2 Research Design

Churchill & Lacobucci (2009) describes research design as a plan expressing the approach or strategy used in collecting adequate evidence in order to resolve the research problem. Orodho (2003) further defines research design as the scheme, plan or outline employed in answering the research problems. It offers the blueprint or framework for the data collection, measurement and analysis (Kothari, 2003).

This research adopted a case study research design involving a detailed and intensive analysis of a particular event, organization, situation, social unit or phenomenon to allow for wider generalization (Miles et al., 2014). Based on scope, a case study research design involves an in-depth inquiry of a contemporary phenomenon within its real-life context (Yin, 2018).

3.3 Data Collection

This study involved collection of primary data gathered using face to face or virtual interviews conducted to all nine functional managers and three senior managers for the three divisions of the SACCO. These managers were considered key informants for the study owing to their immense involvement during strategic plan and policy formulation, implementation and review for the organization. An interview guide guided interviews and appointments were booked with the respondents before the due dates for the interviews to ensure availability. These interviews were conducted and the findings written down by the researcher.

3.4 Data Analysis

This research largely involved collection of qualitative data analyzed through content analysis approach. Content analysis is defined as any technique or approach of making inferences via objective and systematic identification of specified characteristics of messages (Nachmias & Nachmias, 1996). Kothari (2004), define content analysis as the analysis of documentary and verbal material contents analysis. It is a qualitative analysis involving general import of message of the existing documents and measure pervasiveness.

CHAPTER FOUR

DATA ANALYSIS, FINDINGS AND DISCUSSION

4.1 Introduction

The purpose of this study was to establish diversification strategy and influence on the financial performance of Kenya National Police DT SACCO. To achieve this objective, the researcher collected primary data gathered using face to face or virtual interviews conducted to all nine functional managers and three senior managers for the three divisions of the SACCO.

This chapter presents the research findings and discussions of the respondents' perception of diversification strategy in terms of its forms, risks, benefits and effects to the SACCO. The chapter further provides findings on the various diversification strategies explored by the SACCO and their influence on financial performance. Finally, the chapter presents a brief discussion of the research findings.

4.2 Diversification Strategy

Kenya Police SACCO Society is a key strategic player in the SACCO financial services sector. The SACCO has persistently pursued its object of mobilizing savings and providing affordable credit facilities to its members. Over the years, performance of the SACCO has been impressive with membership growing from 690 at inception in 1972 to over 63,000 in 2020. In 2020, the SACCO realized 12% growth rate in asset base and loan portfolio to about Ksh 39.1 billion and Ksh 32.6 billion respectively.

The incredible performance of the SACCO is attributable to a number of factors including sound strategic planning. The SACCO has a strategy running 2021 – 2021 and accordingly the SACCO applies a couple of strategies including diversification in the interest of ensuring financial sustainability and growth. This strategy is manifested with membership diversification, product and service diversification, broad branch network and investment diversification.

4.2.1 Types of Diversification Strategy

The study sought to establish from the respondents the various types or forms of diversification strategy explored by the SACCO. Four types of diversification were identified and ranked in a five point Likert scale as follows 1 - Strongly Disagree , 2 - Disagree, 3- Neutral, 4- Agree and 5-Strongly Agree. The respondents rated all the types of diversification and a mean score computed depending on the selection.

The four types of diversification identified included Horizontal diversification - development of new products which are attractive to the current customers; Vertical integration - acquisition or control of firms supplying the firm with customers or inputs for its outputs; Concentric diversification - development of new and correlated products and services in the new market; and Conglomerate (heterogeneous) diversification whereby a firm seeks new business opportunities with no linkage with the existing market. Horizontal diversification was ranked first with a score of 4.92 due to the diversity of savings and credit products and services offered by the SACCO; Vertical integration was ranked second at 3.67 as the SACCO continuously undertakes continuous stakeholder mapping and engagement for purposes of building the necessary partnership and support; Concentric diversification was ranked third at a score of 3.5 since the SACCO has opened the common bond and is continuously marketing its products and services in the expanded target market although more needs to be done as the bulk of the products and services patronage is still largely from members of the National Police Service; Conglomerate diversification was ranked last at 2.83 as the SACCO just like other SACCOs largely depends on loans and advances in generating revenue.

4.2.2 Drivers & Benefits of Diversification Strategy

Respondents were asked to indicate the drivers and benefits of the adoption of diversification to the SACCO. Drivers and benefits were said to be correlated. A numbers of factors were identified and ranked using a five point Likert scale. The key factors identified include risk reduction, profitability & financial performance, financial sustainability, business expansion & growth, enhanced resource utilization efficiency, increased market share & competitive advantage and economies of scale.

The above factors were ranked as follows. Risk reduction (4.92), enhanced profitability and financial performance (4.83), financial sustainability (4.75), business expansion and growth (4.67), fosters resource utilization efficiency (4.58), increased market share and competitive advantage (4.42) and enhanced economies of scale (4.25). The above findings imply that the main driver or benefit of diversification for the SACCO as well as majority of SACCOs is reduction of business risks, enhanced profitability and financial performance as well as financial sustainability reasons among other factors.

4.3 Diversification Strategy & Financial Performance

4.3.1 Membership Diversification & Financial Performance

Originally, the SACCO drew its members from the Kenya Police Service, the SACCO employees, Ruaraka Housing Estate Ltd and Utumishi Investment Ltd but in 2014 the SACCO strategically opened its common bond in 2014 to admit other quality members especially from corporate bodies. To ensure membership recruitment and retention, the SACCO conducts member perception and satisfaction surveys as well as membership education drives and marketing activities or sessions in various parts of the country since membership is spread throughout the country. The SACCO also participate in corporate social investment such as donations to Police College-Kiganjo, GSU Training School, Police Football Team and Utumishi Boys Academy. The SACCO has also heavily invested in technology as a way of facilitating provision of quality and diversified services to members. As a result, the SACCO membership has grown from 690 in 1972 to over 63,000 in 2020.

4.3.2 Product and Service Diversification & Financial Performance

Over the last decade, the SACCO has launched numerous innovative products and services that never existed initially. These products and services are tailor-made depending on the members' needs and aspirations as a way of ensuring growth of its market share and enhancing financial performance. Most of these latest products are supported by technology.

The recent new products introduced include Premier Loan (84 Months), FOSA Ultra (12 months) and two mortgage products (Home Purchase and House Construction) aimed at enabling members own their own homes, business or wezesha loan aimed at supporting businesses/asset financing/housing development and various mobile loans such as Q-Cash which can be accessed by members instantly at the comfort of their homes. Collateral based lending has been introduced to complement guarantor-ship model of lending. The SACCO is also developing a product for the retirees as a way of motivating them to continue as Active members even after retirement. There are also plans to develop an insurance product or SACCO assurance services enabled through an insurance agency as a way of offering insurance services to the members. Benchmarking on custodial services is also underway and once launched will facilitate storage of security documents. The current loan and savings products are also reviewed periodically as way of aligning them to the changing environment. Members are also enabled to submit loan forms electronically via email and the SACCO is also working at availing majority of loans online.

The respondents observed that growth in the uptake or performance of various loan products of the SACCO has been impressive. As at the end of Aug 2021, the total loan disbursements was Kes.22,346,108,045 compared with Kes.31,057,060,841 in 2020, Kes.30,192,404,738 in 2019, Kes.22,202,037,996 in 2018, Kes.18,537,476,975 in 2017 and Kes.12,026,556,081 in 2016. Premier Loan with a repayment period of 84 months and interest of 15% p.a was leading at 44.828% of the total loan disbursements, Mega Loan with a repayment period of 72 months and 14.7% p.a interest rate was second at 18.825% of the total loan disbursements while Fosa Ultra which is a form of salary advance with a 12 months repayment period and 4% per month was third at 11.833% of the total loan disbursement. The performance of the other loan products was Normal Loan 6.032%, Super Loan 6.928%, Q-Cash 4.611%, FOSA Golden 2.337%, FOSA Flex, 1.049%, Emergency Loan 0.765%, Biashara Loan, Business Loan/micro credit 0.712%, Refinancing Loan 0.608%, Muslim Normal 0.466%, M-Sasa 0.448%, Staff Mortgage 0.190%, School Fees Loan 0.165%, Members Home Loan 0.140%, Muslim Emergency 0.034%, Staff Car Loan 0.026% and Asset Financing Loan 0.002%.

Compared with the previous year 2020, we noted tremendous improvement in the uptake of Premier Loan which was launched in 2020 at the expense of Mega Loan, Normal Loan and Super Loan due to the extended repayment period. In 2020, the ratio for Premier Loan was 5% of the total loan disbursement, Mega Loan 38%, FOSA Ultra 2%, Normal Loan 10% and Super Loan 15%. Furthermore, annual loan disbursement has grown at a rate of 158% from Kes 12,026,556,081 in 2016 to Kes 31,057,060,841 in 2020. This is enabled through introduction of various loan products.

The study also revealed that the SACCO currently offers Visa branded ATM Services supported by Cooperative bank, mobile banking services branded ‘MTAWI’ for purposes of enabling members transact by use of their mobile phones and bankers cheque services offered through partnership with Cooperative bank. Agency banking services, internet banking and SACCO Assurance services are in the pipeline. Additionally, the SACCO offers one of the most competitive savings products such as term deposit products with interest of up to 12% p.a.

4.3.3 Branch Network Diversification & Financial Performance

The Society has a robust branch network established through an extensive feasibility study undertaken at the highest level of expertise and supervision by Management and the Board of Directors. This guarantee viability of the respective catchment areas before injection of funds. To enhance access to its services, the SACCO has eight physical branches (Nairobi, Nakuru, Eldoret, Kisii, Kakamega, Mombasa, Nyeri & Meru) and a virtual branch (mobile banking services) supported by technology. The SACCO indicates that its future relies on technology and thus the Society intends to continue investing and embracing technology in provision of services for purposes of operational efficiency and enhanced customer experience.

As at the end of Aug 2021, the total loan disbursement was Kes 22,346,108,036/- and Virtual Platform was leading at 20% of the total loan disbursement, Nairobi which is the headquarters of the SACCO was second with 18% of the total loan disbursement, Nakuru which is the youngest branch launched in 2019 was third with 13% of the total loan disbursement. Other four physical branches including Kakamega 10%, Kisii 8%, Nyeri 7% and Meru 6% have also been launched in the last 5 years. In total the five youngest physical branches contributed about 44% of the total disbursements as at the end of Aug 2021. Eldoret and Mombasa which are older than the above branches were number 5&7 in terms of loan disbursements respectively at 10% and 8% accordingly.

The strategic direction of the SACCO is to continuously invest in technology as a way of availing its products and services to the members as opposed to brick and mortar.

Physical branches will only be explored only in case of extreme necessity but this will also be subjected to market and feasibility study for purposes ensuring viability.

4.3.4 Investment Portfolio Diversification & Financial Performance

The investment portfolio allocation for SACCOS is heavily guided by the prudential guidelines issued by SASRA from time to time. According to the guideline the maximum ratio for land & buildings to total assets is 5%, financial investments to core capital is 40%, financial investments to total deposits is 5% while non earnings assets to total assets is 10%. The current investment portfolio for Kenya National Police DT SACCO comprises loans & advances, term deposits, money market, treasury bills, equities and property.

As at the end of 2020, the above investment portfolio was Kes 37,158,926,000/-. Loans and advances took the largest share at Kes 32.6 Billion equating to about 87.8 % of the SACCO's Investments. Term deposits including call and fixed deposits at Cooperative bank and KUSCCO Ltd were second at Kes. 2.1 Billion or 5.7% of the entire investment portfolio. Equities were Kes. 1.1 Billion or 3% and involves quoted and unquoted shares at Cooperative bank, Safaricom, Kenya Mortgage Refinance Company and KUSCCO. The SACCO have also recently diversified into Money Market at CIC – Kes 319.3 Million or 0.9% and Treasury Bills Kes 248.7 Million or 0.7% of the entire investment portfolio designed as a way of building a long term savings for the financial sustainability of the SACCO. Property namely land and buildings was about Kes 740 Million or 2% of the portfolio.

The above findings indicates that although the SACCOs investment portfolio is still largely under loans and advances, significant effort has been put in place in building a well-diversified investment portfolio. Major growth has been noticed under term deposits, money market and treasury bills whose risk is relatively moderate as opposed to high risk investment classes such as stocks.

The study also sought to determine the contribution of each of the above investment classes to the gross revenue. The respondent availed financial information for the last five years from 2016 to 2020. The gross revenue was Kes 6,057,730,000 in 2020, Kes 5,885,240,000 in 2019, Kes 4,575,684,000 in 2018, Kes 3,855,895,000 in 2017, Kes

3,125,566,000 in 2016. Interest income makes the largest contribution to the gross revenue. As at the end of 2020, interest income was 89.40% of the gross revenue, interest on short term deposits 1.40%, interest on money market 0.30%, dividends on shares 2.20%, rental income 0.20%, fees &commissions 4.50% and other income 2.00%. This findings indicates that non-interest income accounts about 10.6% of the gross revenue. However, we noticed reduction in contribution of interest income to the total revenue from 93.2% in 2018 to 89.4% in 2020 largely due to the increased investment in other revenue streams such as short term deposits and money market.

The study further analyzed the effect of investment portfolio diversification on the financial performance based on the information availed by the respondents. This was done though computation of the percentage revenue growth rate and the percentage contribution of non-interest income to the gross revenue annually from 2016 to 2020. Revenue from non interest streams was Kes 130,245,000 in 2016, Kes 310,708,000 in 2017, Kes 139,479,000 in 2018, Kes 195,405,000 in 2019 and Kes 370,031,000 in 2020.

The study findings indicates that in the year 2017 non-interest revenue grew at a rate of 139% to Kes 310.7M and constitutes 8% of the SACCO's revenue which was an increment compared with the previous year 4%. In 2018, non-interest income reduced by -55% to Kes 139.4M and subsequently its contribution to the total revenue reduced to 3%. In 2019 non-interest income grew at a rate of 40% to Kes 195.4M and as a result its contribution to total revenue stood at 3%. In 2020 non-interest income grew at a rate of 89% to 370M and consequently its contribution to the total revenue increased from 3% in 2019 to 6%. The above findings generally depicts an upward trend in the revenue generated from investment diversification. It also demonstrates that the revenue earned from non-interest income constitutes a significant portion of the SACCO's revenue and has the potential to grow the overall revenue if more allocation is done to this alternative revenue streams. The findings further supports conclusion that investment diversification has a significant positive effect on the SACCO's financial performance.

4.3.5 Diversification Risk Profile

The study sought to establish the SACCO's risk profile perception based on the business environment that the SACCO operates in. The limits as set in the applicable legal and regulatory environment provides some guide in terms of how the SACCO sector perceive risks. The prudential guidelines issued by SASRA are meant to guarantee security and safety of depositors' funds.

Majority of the rspondents observed that the SACCO just like other SACCOs is cosidered a conservative investor (75% of the respondents), 17% of the respondents rated the SACCO as moderate investor while 8% of the respondents rated the SACCO as an aggressive investor. The results are due to SACCOs low risk tolerance thus may not be able to exploit contemporaly business opportunities that comes with very high risk. This is largely because SACCOs deal with members funds that needs to be strictly safeguarded or preserved and should be made readily available should members want to withdraw. There is also a strict legal and regulatory guidelines. These guidelines sets the limits for the business. These low risk tolerance nature of SACCOs explains why the SACCO has recently concentrated on low risk investment classes such as money market, term deposits, treasury bills as opposed to stocks and other invetments that comes with a higher risk.

4.4 Perceived Effect of Diversification Strategy on Financial Performance

The researcher sought to establish the respondents' perception on diversification strategy and its effect on financial performance. 92% of the respondents confirmed that they are sure that diversification strategy positively affects financial performance of the SACCO. 8% of the respondent were not sure of the specific effect of diversification on the financial performance of the organization. This indicates that majority of the respondents were in agreement that diversification strategy positively influences financial performance and only a small portion of the respondents were not sure of the effect of the strategy.

The respondents further emphasized the role of diversification strategy in building a sustainable competitive advantage and an expansive market share. Through diversification strategy the business is protected against adverse effects associated with economic shocks or risks, the revenue derived from the new business lines contribute to the overall gross revenue thus enhances profitability, resources are efficiently or optimally utilized as any idle resources may be employed in supporting new business lines or units thus reduces wastage. For instance, the current ICT infrastructure supports all the branches in provision of all financial services and is capable of supporting additional branches or new business lines. A robust branch network also enhances connectivity and ensures convenience of members while transacting with the organization. Automation of business processes also assists in reducing operational costs. Thus, SACCOs should explore diversification strategy as a way of enhancing financial performance

4.5 Discussion of Findings

The study reviewed that the current impressive SACCO's financial performance in the current competitive business environment is attributable to a number of factors including adoption of prudent growth strategies such as business diversification. As Johnson & Whittington (2008) emphasize, the current business environment is characterized by new entrants into already diminishing market thus need for businesses develop appropriate strategies in the interest of preserving its market share and grow its income streams. Such strategies include diversification involving venturing into a different business line. At Kenya National Police DT SACCO, diversification strategy is characterized with membership diversification, product and service diversification, robust branch network and investment diversification.

In 2014, the SACCO strategically opened its common bond to admit other quality members especially from corporate bodies. Originally, the SACCO drew its members from the Kenya Police Service, the SACCO employees, Ruaraka Housing Estate Ltd and Utumishi Investment Ltd. Furthermore, the SACCO as part of its products and service diversification strategy has launched numerous innovative savings and credit products and services that never existed before. These products and services are tailor-made to suit members' needs in the interest of growing its market share and enhancing financial performance. This findings are in agreement with Patricia (2004) who observed that related corporate diversification occurs when a firm engage in more than one product or single market and if less than 70% of the revenue earned comes from one product market.

The SACCO has adopted geographical diversification strategy which involves organizational spread of a firm beyond its local borders or company head office to another region either internally (within the country) or externally (beyond the country's borders) (Ibrahim et al., 2009; Oyewobi et al., 2013). There is a robust branch network established through an extensive feasibility study since a branch comes with both benefits and costs. In total, the five youngest physical branches contributed about 44% of the total disbursements as at the end of Aug 2021. Enabled by technology, the SACCO also has a virtual branch that is currently leading in terms of financial performance ahead of the physical branches.

Investment portfolio diversification strategy is also pursued by the SACCO. This strategy involves spreading an investment portfolio into a range of asset classes or markets such as fixed income, equities, cash equivalents and alternatives (Derek, 2015). The SACCO's investment portfolio comprises loans & advances, term deposits, money market, treasury bills, equity and property. Interest income makes the largest contribution to the total revenue at 89.4% in 2020 while other non-interest income is about 10.6%. However, we noticed reduction in contribution of interest income to the total revenue from 93.2% in 2018 to 89.4% in 2020 largely due to the increased investment in other revenue streams such as short term deposits and money market.

The study findings depicts an upward trend in the revenue generated from investment diversification strategy. It also demonstrates that the revenue earned from non-interest income constitutes a significant portion of the SACCO's revenue and has the potential to grow the overall revenue if more allocation is done to this alternative revenue streams. This implies that diversification strategy has a significant positive effect on the SACCO's financial performance. This agree with the the findings of the study by Philita (2018) who found that diversification has a positive effect on financial performance of commercial banks.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents a summary of the study findings, conclusions and recommendations on diversification strategy and financial performance of Kenya National Police DT SACCO. The chapter also offers the limitations and a suggestion of areas of further research that may assist in bridging any research gaps which may not have been adequately addressed due to the limited scope of this study.

5.2 Summary

The study reviewed that the SACCO has adopted a number of diversification strategies in the interest of its financial sustainability and growth within the current competitive business environment. This diversification strategy is characterized with membership diversification, product and service diversification, geographical diversification and investment portfolio diversification.

The SACCO in 2014 strategically opened its common bond to admit other quality members especially from corporate bodies. Originally, the SACCO drew its members from the Kenya Police Service, the SACCO employees, Ruaraka Housing Estate Ltd and Utumishi Investment Ltd. To ensure membership recruitment and retention, the SACCO conducts member perception and satisfaction surveys as well as membership education drives and marketing activities or sessions in various parts of the country. The SACCO also participate in several corporate social investment programs and has also heavily invested in technology as a way of facilitating provision of quality and diversified services to members.

As part of its products and service diversification strategy the SACCO has launched numerous innovative products and services that never existed initially. These products and services are tailor-made to suit members' needs in the interest of growing its market share and enhancing financial performance. Most of these latest products are supported by technology. Collateral based lending has been introduced to complement guarantor-ship model of lending. The current loans and savings products are also reviewed periodically as way of aligning them to the changing environment. Members are also allowed and enabled to submit loan forms electronically via email and the SACCO is also working at availing majority of loans online.

Under its geographical diversification strategy, the SACCO has developed a robust branch network established through an extensive feasibility study. The five youngest physical branches contributed about 44% of the total disbursements as at the end of Aug 2021. The virtual branch leads in terms of financial performance ahead of the physical branches. The future of the SACCO depends on its ability to embrace technology in provision of its products and services as opposed to brick and mortar which should only be considered in case it is extremely necessary guided by market and feasibility study for purposes of ensuring viability.

The SACCO's investment portfolio diversification strategy comprises of a range of investment or asset classes namely loans & advances, term deposits, money market, treasury bills, equity and property. Allocation is guidance by the returns and risk appetite of the SACCO as well as the applicable prudential guidelines issued by the regulator. Loans and advances account about 87.8 % of the SACCO's Investments as at 2020. Term deposits were second at 5.7% of the entire investment portfolio while Equities accounted 3%. The SACCO have also recently diversified into Money Market at CIC – 0.9% and Treasury Bills at 0.7% of the investment portfolio. Interest income makes the largest contribution to the total revenue at 89.4% in 2020 while other non-interest income is about 10.6%. The study findings depicts an upward trend in the revenue generated from investment diversification. It also demonstrates that the revenue earned from non-interest income constitutes a significant portion of the SACCO's revenue and has the potential to grow the overall revenue if more allocation is done to this alternative revenue streams. This implies that investment diversification has a significant positive effect on the SACCO's financial performance.

5.3 Conclusion

Kenya National Police DT SACCO has adopted four key diversification strategies. Firstly, membership diversification which involves opening of its common bond to admit members from other segments especially from corporate bodies. Originally, the SACCO drew its members from the Kenya Police Service, the SACCO employees, Ruaraka Housing Estate Ltd and Utumishi Investment Ltd. This is through continuous membership education drives and marketing activities or sessions in various parts of the country.

Secondly, products and service diversification strategy involving introduction of numerous innovative products and services that never existed previously. These products and services are tailor-made to suit members' needs. Most of these latest products are supported by technology. Collateral based lending has been introduced to complement guarantor-ship model of lending.

Thirdly, geographical diversification strategy whereby the SACCO has developed a robust branch network established through an extensive feasibility study. The virtual branch leads in terms of financial performance ahead of the physical branches. The future of the SACCO depends on its ability to embrace technology in provision of its products and services as opposed to brick and mortar.

Fourthly, the SACCO has embraced investment portfolio diversification strategy comprising of a range of investment or asset classes namely loans & advances, term deposits, money market, treasury bills, equity and property. Allocation is guidance by the returns and risk appetite of the SACCO as well as the applicable prudential guidelines issued by the regulator.

The study findings depict an upward trend in the revenue generated from diversification strategy. The five youngest physical branches contribute about 44% of the total disbursements. Revenue earned from non-interest income constitutes a significant portion of the SACCO's revenue and has the potential to grow the overall revenue if more allocation is done to this alternative revenue streams. This implies that diversification has a significant positive effect on the SACCO's financial performance.

5.4 Recommendations for Policy and Practice

Diversification strategy continues to play a crucial role in the corporate world today. The strategy is a stimulus for gaining market share and competitive advantage, risk reduction, profitability & financial performance, financial sustainability, business expansion & growth, resource utilization efficiency and economies of scale. As per the study findings, diversification has a significant positive effect on the SACCO's financial performance. As a result, this study proposes the following recommendations.

5.4.1 Membership recruitment and retention from all corporate segments across the country

Although the SACCO opened the common bond in 2014, the SACCO's membership is still largely derived from the National Police Service which creates the risk of excessive over dependency in one sector. There is need for targeted marketing activities aimed at recruitment of quality members especially from police at AP camps, security agencies, security firms, SMEs, counties, parastatals, civil servants, National Government Administration Officers (NGAO). The SACCO can start with recruitment of members from key strategic business partners.

5.4.2 Enhanced branch network supported by technology

The SACCO currently has eight physical branches including Nairobi, Nakuru, Eldoret, Kisii, Kakamega, Mombasa, Nyeri and Meru including an extra virtual branch (mobile banking services) supported by technology which is currently leading in terms of performance. For purposes of enhancing connectivity across the country, the SACCO should continuously explore other potential areas guided by extensive market and feasibility study to ensure viability of the branches. The SACCO should also continue investing and embracing technology in provision of its services for purposes of operational efficiency and enhanced customer experience. This is where the future lies.

5.4.3 Develop innovative products and services for the members

Guided by a robust market research, membership perception and satisfaction surveys, the SACCO should continue design and introduction of new innovative products and services that are tailor-made to suit members' needs and aspirations. Such products may include products related to insurance, housing, health care, agriculture, custodial services and education. The SACCO should also consider collateral based lending to complement the conventional guarantor-ship model. The current products and services should also be reviewed periodically and should be supported by technology.

5.4.4 Investment portfolio diversification

Diversify investment risks and enhance profitability by continuously growing alternative revenue streams such as investments in treasury bills, term deposits, money market, equities and property. While doing this, ensure investments are negatively correlated and are also spread in different stable companies. This strategy should also not compromise compliance with the relevant guidelines issued by the regulator.

5.5 Limitations of the Study

This research focused on diversification strategy and financial performance of Kenya National Police DT SACCO. The findings may not entirely be applicable to other SACCOs and other financial institutions. Such firms may have different outcomes on diversification strategy. This study findings may also not be relevant for the entire SACCO's lifespan as circumstances and business environment may change from time to time. Furthermore, this study has largely covered a duration of the last five years thus may not reflect the position prior this duration.

5.6 Suggestions for Further Research

A study should be carried out to establish the effect of diversification strategy on the financial performance of organizations in other sectors in Kenya. This will assist in developing a broad picture of the influence of diversification strategy on the financial performance. There is also need to replicate this study after some time since business environment is dynamic thus may erode the current findings.

REFERENCES

Almazari, A. A. (2011). Financial performance evaluation of some selected Jordanian commercial banks. *International Research Journal of Finance and Economics*, 68, 50-63.

Ansoff, H. I., (2003). A Model for Diversification. Burbank, Lockheed Aircraft Corporation.

Ansoff, H. I. (1957). Strategies for diversification. *Harvard Business Review* 35(5): 113– 124.

Ansoff (2009). New Company Strategy. Southwestern University of Finance and Economics Press.

Ansoff, H. (1965). Corporate Strategy, New York: McGraw-Hill.

Barney, J.B, & Hesterly, W. (2012). *Strategic management and competitive advantage: Concepts and cases* (4th ed.). New Jersey: Pearson.

Barney, J. B. 1986a. Organization culture: Can it be a source of sustained competitive advantage? *Academy of Management Review*, 11: 656-665.

Barney, J. B. 1997. Gaining and sustaining competitive advantages. Reading, MA: Addison-Wesley.

Barney, J.B. (1991). Firm Resources and Sustained Competitive Advantage, *Journal of Management* 17 (1): 99-120

Barney, J.B. (2002). *Gaining and Sustaining Competitive Advantage, 2nd ed.* Reading, Mass: Addison-Wesley

Bismark, A., & Chengyi, P. (2015). The Impact of Delinquent Loans on Financial Performance of Banks in Ghana. *British Journal of Economics, Management & Trade*, 9(2), 1-8.

Castaldi, C., & Giarratana, M.S. (2018). Diversification strategy, branding and performance of professional service firm. *Journal of Service Research*, 21 (3), 353–354.

Cernas O. D. A. (2011). *Examining Curvilinearity and Moderation in the Relationship between the Degree of Relatedness of Individual Diversification Actions and Firm Performance*. Doctor of Philosophy, University Of North Texas.

Chandler Jr., A.D. (1962) Strategy and Structure. Chapter in the History of the Industrial Enterprise. MIT Press, Cambridge.

Chandler, A. D. Jr. (2010). Strategy and Structure: Chapters in the History of the American Industrial Enterprise. Cambridge, MA: MIT Press.

Churchill, G. A. and Iacobucci, D. (2009). *Marketing Research: Methodological Foundations*, Tenth edition. Mason, OH: South-Western Cengage Learning

Churchill, C., & Frankiwiez, C. (2011). *Making microfinance work: managing product diversification.* International Training Centre of the International Labour Organisations Publication.

Dang, U. (2011). The CAMEL Rating System in Banking Supervision: a Case Study of Arcada University of Applied Sciences, International Business.

Derek, C. (2015). *What is Asset Allocation & Stock Investment Diversification – Definition & Strategy*. Retrieved from http://www.moneycrashers.com/what-is-diversification- definition-asset-stock-investment/. Accessed on 9th August 2021.

Dosi, G., & Teece, D.J. (1993). Organisational competences and the boundaries of the organization market and organization. *Journal of Management*, 2 (23), 21–60.

Emel, Y.,& Yildirim, B.O. (2016). Industrial diversification and performance in an emerging market. Panoeconomicus, 63 (4), 441–454

Hasby, H., Buyung, S., & Hasbudin, S. (2017). The effect of organization size and diversification on capital structure and organization value (study in manufacturing sector in Indonesia Stock Exchange). *The International Journal of Engineering and Science,* 6 (6), 50–61.

Haug, J., & Ultich, P. (2013). Diversification and competitive advantage: A risk-based explanation. Academy of Management Annual Meeting Proceedings, 2013 (1), 13418-13418

Hitt, M. A, Hoskinsson, R. E & Kim, H (1997). International Diversification; effects on innovation and firm Performance in product-diversified firms, *The Academy of Management Journal.* 6, 15-20.

Johnson, Gery, Kevan Scholes (2002). Exploring Corporate Strategy Text and Cases, Edinburg: Pearson Education Press.

Junior, J. N., & Funchai, B. (2013). The effect of corporate diversification on the capital structure of Brazilian organizations. Revisca Contabilidade & Financas, 24 (62), 154–161. 21.

Kamwaro, E. K. (2008). The impact of investment portfolio choice on financial performance of investment companies in Kenya. Unpublished MBA Project, University of Nairobi.

Kaplan, T and Norton, D. (2001), Balanced Score Card; Translating Strategy into Action. Harvard Business School Press, Boston Kaplan, R. & Norton, D. (1992). The Balanced Scorecard. Harvard Business School.

Karimi, D.G. (2013). Relationship between investment portfolio choice and profitability of investment companies listed in the Nairobi securities exchange. Unpublished MBA thesis, Kenyatta University.

Kiplagat, M. K. (2014). *The effect of asset allocation on the financial performance of pension funds in Kenya*. Unpublished MBA thesis, University of Nairobi.

Kipleting (2016) on the effect of investment diversification on the financial performance of commercial banks in Kenya. Unpublished MBA Thesis, University of Nairobi.

Khrawish, H.A. (2011) Determinants of Commercial Banks Performance: Evidence from Jordan. *International Research Journal of Finance and Economics*, 81, 19-45.

Kithinji, A.M. (2010). Credit Risk Management and Profitability of Commercial Banks in Kenya, School of Business, University of Nairobi, Nairobi.

Kothari, C. R (2010) Research Methodology: Methods and Techniques, second revised Edition, New Age International (P) Ltd Publishers New Delhi.

Krivokapic, R., Nladimir, V., & Stojic, D. (2017). Effects of corporate diversification on organization's performance: Evidence from the Serbian insurance industry. *Economic Research Journals*, 30 (1), 1224–1236.

Lin, X.; Zhang, Y. 2009. Bank ownership reform and bank performance in China, *Journal of Banking and Finance* 33(1): 20–29.

Lloyd, P. W., & Jahera, S. J. (1994).Firm Diversification Effects on Performance as Measured by Tobin's q. *Journal of Managerial and Decision Economics,* 15, 259-266.

Makau, M.M., & Ambrose, J. (2018). The impact of portfolio diversification on financial performance of investment firms listed in Nairobi Security Exchange Commission, Kenya: Empirical review. *International Journal of Management and Commerce Innovation,* 5 (2), 177–187.

Makokha, A. N., Namusonge, G. S., & Sakwa, M. (2016). Effect of Portfolio Diversification on Commercial Banks Financial Performance in Kenya. *International Journal of Business and Management Invention*, 15 (9), 05-08

Markowitz, H. (1952). Portfolio Selection. *The Journal of Finance* 7(1), pp. 77-91.

Markowitz, H. (1959). Portfolio selection: Efficient diversification of investments (p. 345). New York, NY: John Wiley & Sons, Inc

Murimiri, S.W. (2009) "Competitive Business Strategy and Firms Performance of the Commercial Banks in Kenya". Unpublished MBA project, University of Nairobi, Nairobi, Kenya

Mutega, G. M. (2015). The Effect of Asset Diversification on the Financial Performance of Commercial Banks in Kenya. Unpublished Research Project. University of Nairobi., 1-58.

Murthy, Y., Sree, R. (2003). A Study on Financial Ratios of major Commercial Banks. Research Studies, College of Banking & Financial Studies, Sultanate of Oman.

Frankfort-Nachmias, C. and Nachmias, D. (1996). Research Methods in the Social Sciences. Fifth Edition, Arnold, London.

Nyathira, C.N. (2012). *Financial Innovation and its effect on Financial Performance of Commercial Banks in Kenya*. Unpublished MBA project, University of Nairobi

Odhiambo, J. (2013). Portfolio diversification and financial performance of deposit taking savings and credit cooperative societies in Kenya. Unpublished MBA Project, University of Nairobi.

Oladele, O.P. (2012). Product diversification and performance of manufacturing organizations in Nigeria. *European Journal of Business Management*, 10 (1), 226–233.

Oladimeji, M. S. & Udosen, I. (2019). The Effect of Diversification Strategy on Organizational Performance. *Journal of Competitiveness*, 11(4), 120–131.

Omondi, M. M., & Muturi, W. (2013). Factors Affecting the Financial Performance of Listed Companies at the Nairobi Securities Exchange in Kenya. Research Journal of Finance and Accounting, 4(15).

Omondi, E.A.(2013).The relationship between asset allocation and performance of pension funds in Kenya, Unpublished MBA Project, University of Nairobi.

Ongore, V.O. (2011) The relationship between ownership structure and firm performance: An empirical analysis of listed companies in Kenya. *African Journal of Business Management*, 5(6), 2120-2128

Orina, S. O. (2011). *Advanced Financial Management.* Mustard seed Publications Nairobi, Kenya

Oyedijo, A. (2012). Effects of Product – Market Diversification Strategy on Corporate Financial Performance and Growth: An Empirical Study of Some Companies in Nigeria. *American International Journal of Contemporary Research*, 2(3), 199-210.

Oyewobi, L. O., Windapo, A. O., & Cattell, K. (2013). Impact of Business Diversification on South African Construction Companies' Corporate Performance. *Journal of Financial Management of Property and Construction*, 18(2), 110-127.

Penrose, E.T. (1959). The Theory of the Growth of the Firm. New York

Phung, Duc Nam, and Anil V. Mishra. 2016. Corporation Diversification and Firm Performance: Evidence from Vietnamese Listed Firms. Australian Economic Papers 55: 386–408.

Porter, M. E. (1980). Competitive strategy techniques for analyzing industry and competitors. The Free Press, New York.

Porter, M.E. (1985). *Competitive Advantage*. New York. The Free Press. New York

Reilly, F. K. and Brown, C. K. (1997). Investment analysis and portfolio management. Sixth Edition. Fort Worth: The Dryden Press.

Santarelli, E., & Tran, H. (2015). Diversification strategies and firm performance in Vietnam. *Economics of Transition*, 24 (1), 31–68.

Saunders, A. and Cornett, M.M. (2011) Financial Institution Management—A Risk Management Approach. 7th Edition, McGraw Hill Irwin, New York.

Sindhu, M., Haz, E., Ali, S., & Ali, M. (2014). Impact of diversification on the organizations performance: An evidence from Pakistan. *European Journal of Business Management*, 6 (4), 106–111.

Stoner, T. H. (2003). *A Financial Model for Evaluating Projects with Performance Contracts Report to the Brazilian Energy Efficiency Financial Task Force*. Econergy International, Boulder, Colorado

Su, W., & Tsang, E.W.K. (2013). Product diversification and financial performance: the moderating role of secondary shareholders. Academy of Management Journal, 3 (2), 1128–1148.

Thompson A.A, Stickland, A. J Gamble, J.E and Jain, A.K (2006*). Crafting and Executing strategies: The Quest for Competitive Advantage*, 12th Ed. New Delhi: Tata. McGraw-Hill publishing Co. Ltd

Vijayakumar, A. (2012). Evaluating Performance of Banks through CAMEL Model. A Case Study of State Banks of India and Its Associates. *International Interdisciplinary Research Journal*, 2 (6), 104 – 12

Waithaka, N. (2013). The Effect of Basel II Requirements of Kenyan Commercial Banks lending. Unpublished Msc. Finance Project, University of Nairobi.

Wenerfelt, B. (1984). A Resource-Based View of the Firm. *Strategic Management Journal* 5(2), 171-180

Yigit, I., & Tur, S. (2012) Relationship between diversification strategy, application and organisational performance according to Heifindahl index criteria. Procedia. Journal of Social and Behavioural Sciences, 3 (6), 118–127.

Zhou, J.H. and Ji, H.L. (2015) An Empirical Study on Diversified Management and Business Performance of Enterprises. Reform and Open, No. 22, 25-26, 28.

Gort, M. (1962) Diversification and Integration in American. Princeton University Press, Princeton, New Jersey.

Song, T.B., Lan, H.L. and Zeng, P. (2010) Regional Diversification or Product Diversification: Strategic Choice of Dominant Enterprises under the Constraints of Institutional Environment. Journal of Guangzhou University: Social Science Edition, No. 3, 45-52.

APPENDICES

APPENDIX 1: INTERVIEW GUIDE

Section A: Diversification Strategy

1) What is your understanding of diversification?
2) What types or forms of diversification strategies has the SACCO adopted?
3) What has driven the SACCO into adopting the diversification strategies mentioned above?
4) What products and services has the SACCO diversified into and how has technology contributed?
5) What are the major investment or asset classes of the SACCO?
6) How many branches does the SACCO have?
7) How does the SACCO deal with risks associated with diversification strategy?

Section B - Financial Performance

1) What is the overall financial performance of Kenya National Police DT SACCO Society compared with the prudential guidelines and the overall industry performance?
2) What is the financial performance of each product or service of the SACCO?
3) What is the financial performance of each investment or asset class?
4) What is the financial performance of the various branches of the SACCO?

Section C: Perceived relationship between diversification strategy and financial performance.

1) How do you rate the relationship between diversification strategy and financial performance?

2) In what ways do you think diversification strategy has influenced the financial performance of the SACCO?