A SURVEY ON THE INVESTMENT PRACTICES AMONG SAVINGS AND CREDIT COOPERATIVE SOCIETIES (SACCOs) IN NAIROBI

BY

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DECLARATION

I, the undersigned, declare that this is my original work and has not been submitted for a degree in this or any other University for examination.

Signed: -- Date: ------ 18/11/08. ------

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This project has been presented for examination with my approval as the appointed University Supervisor.

Signed: -- Date: 20·11·2008 ------

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DEDICATION

To my wife **Margaret** and my children **Roy** and **June**, this project is a true testimony of your encouragement, prayers and love to me.

ACKNOWLEDGEMENT

All praises is due to God the Almighty without whose blessings, this project would never have seen the light of the day. I acknowledge Him in everything I have done; I am doing and will do.

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ABSTRACT

The uncertainty of cash flows, cost of funds and return on investment in ever changing financial markets require financial institutions to develop investment strategies for effective and efficient portfolio management. Savings and credit co-operative societies are financial institutions whose primary functions is similar to other financial institutions and involve generating funds from their members by sell of shares and savings deposits to its members and then lending the funds to members in form of personal loans. This study is inclined to exploring the various techniques that SACCOs employ in portfolio management. It also looks into the prominent constraints that influence investments choices and selection.

The study findings points to a lapse in professional investment practice mainly in the area of asset allocation and selection. Majority of the SACCOs surveyed exhibited a pure passive policy punctuated by sampling and buy-and-hold strategies. It has also been evident that only strategic and integrated asset allocation strategies were followed. In terms of asset selection, SACCOs rely more on historical financial data to project the future share prices. Nevertheless, investor needs and preferences and investment liquidity are the key constraints to investment. It is therefore highly recommended that to optimize value generation, SACCOs may need to adopt some degree of professionalism in investment management.

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CHAPTER ONE

INTRODUCTION

1.0 Research Background

Cooperative movement was initiated in Germany in 1896 and spread all over the world. Today, there is hardly any country where cooperatives do not exist (Gachara, 1990). The cooperative enterprise incorporates a global membership approaching three-quarters of a billion individual members spanning 93 countries and 236 federal member organizations (Oyoo, 2002). Cooperatives cover the full range of business sizes from micro level credit associations to substantial players in the banking, insurance, agricultural marketing and supply sector.

Cooperatives in Africa existed before the era of colonization in form of savings associations offering savings and credit services on a simple rotational order. In Kenya, cooperatives date back to 1908. The then European farmers established the first producer and marketing cooperative at Lumbwa near Kericho. Later the indigenous cooperatives were only authorized in the 1930s through crop ordinances of 1932 and 1945.

Cooperative development was nevertheless very slow due to lack of support by the colonial government (Ouma, 1988). After independence the government of Kenya took a proactive role of promoting cooperative development through registering the first SACCO in 1964 (Obuon, 1988). Consequently, other institutions were established to facilitate their growth and development. These included: cooperative college of Kenya (1967); Kenya National Federation of Cooperatives (KNFC) and cooperative Bank of Kenya (1968). The Kenya Union of Savings and Credit Cooperative (KUSCCO) was established in 1973 as an apex body of SACCOs for advisory and technical services (Ssennyondo, 1988).

According to the Registry of Friendly Societies, the features that distinguish Cooperatives from non-cooperatives are:-

i) Conduct of business must be for the mutual benefit of the members, with the benefits they receive deriving mainly from their participation in the business;

ii) Control of the cooperative must be vested in the members equally;

iii) Interest on capital will not exceed a rate necessary to obtain and retain sufficient capital to carry out the cooperative's objectives

iv) Profits be distributed in relation to the extent members have taken part in the cooperative business; and

v) Membership must not be artificially restricted with the aim of increasing the value of any proprietary rights and interests. This aims at ensuring a genuine community of interest among cooperative's members based on something other than the amount of capital they have placed in the organization.

The above factors forms the bases of the so called cooperative principles (tenets) accepted by cooperatives as their operating guidelines, and are derived from the Rochdale principles. There is no one definitive list of universally accepted principles; therefore, there is no one tight definition of a cooperative (Abigail, 1997).

However, a more precise definition of co-operatives used by the International Co-operative Alliance (ICA) is widely accepted: "A co-operative is an autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly-owned and democratically controlled enterprise" (Sukhwinder, 2005). Co-operatives are based on the values of self-help, self-responsibility, democracy, equality, equity and solidarity.

According to Froman (1935), there are a number of purposes of cooperatives, but the two outstanding ones seem to be: (i) to encourage thrift among the members, and (ii) to provide credit for the members at reasonable rates. Similarly, members are bound to benefit from business training which results from membership in a cooperative movement.

The emergence and rapid development of SACCOs has been a spectacular feature of cooperative movement growth. It has changed the overall pattern of cooperative movement which was largely dominated by agricultural sector. SACCOs are recognized as strong vehicles that can be used to effectively promote economic and social development through financial intermediation.

Prior to deregulation in 1997, SACCOs were constrained to certain investment zones. The existence of stringent regulations not only limited their investment universe but also the flexibility of investment decisions. Gachara (1990) revealed that 42% of their investment is in fixed deposit accounts and below 9% in unquoted stocks of other organizations, giving an astonishing liquidity level of 5times. This seems to explain for their slow growth of surplus, mainly due to the below market lending and fixed deposit rates.

Mwangi (2003) observes that over 91% of corporate savings of SACCOs is allocated to non-liquid assets. These misdirected investments in non-liquid assets compromise their capacity to modify portfolios in the short-run effectively.

Consequently, SACCOs have not fully exploited their investment potentials. For instance, as at December, 2004, SACCOs had mobilized over Ksh. 105 billions, an amount nearly equivalent to total assets of Barclays Bank of Kenya (Ksh. 106 billion), and the most profitable bank with 5.4billion before-tax profit at the end of 2004 (Irungu, 2005). This is a good indication of what SACCOs can do with the assets they hold if their financial issues are run more prudently.

According to Oyoo (2002), overall performance after deregulation of the cooperatives has been declining, with failure to meet two of the World Organization of Credit Cooperative Union (WOCCU) financial ratio targets. Of concern is the low return on assets, an indication of poor resource use and inefficiency. Oyoo attributes this to low returns from real assets that form the bulk of their investment, retrenchment of civil servants and poor treasury management to increase yield on liquid assets.

1.1 The Investment Concept

The Association for Investment Management and Research (AIMR, 1999) defines investment as any medium by which placement of funds generally occurs with the expectation of preserving value and earning a positive return.

Reilly and Keith, (2000) define investment as the current commitment of funds for a period of time in order to derive future payments that will compensate the investor for (i) time value; (ii) expected rate of inflation; and (iii) uncertainty of the future payments. It is thus a process of both value preservation and generation.

Investment managers are in the business of safeguarding and growing their portfolios through conscious and astute investment of shareholders funds. They are professional practitioners whose advice and investment tactics are relevant to the whole business community (Omonyo, 2003).

Today, other things equal, managers of investment funds are most likely to safeguard and increase clients' assets by investing in equities rather than in fixed-income stock. This idea is widely accepted and remains true in the long term, despite even substantial short term fluctuations in equity prices (Essinger, 1993). Essinger notes that, the safety obligation for the hard-earned investor contributions should not overshadow return maximization.

Academicians and practitioners are torn between two broad categories of investment strategies. First are the passive strategists who believe that markets are too efficient to permit much success in either asset selection or market timing. Thus, managers follow a simple buy-and-hold strategy without much portfolio revision. Moses and Cheney (1989) find these strategies useful to managers with limit skills in market forecasts.

On the other hand, active strategies are market focused and target to exploit perceived market imperfections (anomalies). They use analysts' recommendations to choose securities within each asset class.

However, Cohen and Zeikel, (1982) argue for a mix of the two approaches in order to get a better control of risk-return parameter of large portfolios.

This study is geared to establish the predominant investment practices among SACCOs as business organizations. SACCOs, being part of the private sector, have occupied a special position in financial intermediation, especially to the large and growing section of the population unserved by the commercial banks (Muriuki, 2001).

Further, the Kenya's Economic Recovery Strategy (ERS) and the Vision 2030 are targeted to easing unemployment through the growth of Small and Medium enterprises (SMEs). Improving savings mobilization for long-term investments is a major component of the strategies. There is therefore the need to develop SACCOs to be able to fully play their role as private economic enterprises and development agents.

Investments are vital undertakings by cooperatives as they determine future productivity, volume of output, financial liquidity and levels of surplus. SACCOs, as business oriented organizations and operating in a free market economy, are expected to structure their financial and investment policies to aim at raising adequate capital base. This will afford them efficient and effective response to the increasingly divergent needs of members and ensure corporate survival and independence.

Proper investment policies ensure effective treasury management to analyze, select, construct, monitor and modify a diversified portfolio to effectively meet investment objectives and constraints. Profitable SACCOs have higher demands for deposits and consequently higher corporate savings. The attractive yields on corporate savings would persuade members to accept lower dividends and motivate more savings for re-investment (Obuon, 1988).

The cooperative Act (1997) gives SACCO management greater leeway to invest in capital market products (Mwangi, 2003). SACCOs have since expressed interests to expand outreach and investments beyond their traditional common-bond and saving-lending models respectively.

Besides, the recognition among SACCOs, of the need to diversify both income sources and membership to combat inadequate share capital, provides a reasonable motivation to study their consequent investment practices.

1.2 Statement of the problem

The primary objective of a savings and credit cooperative is to provide financial services to members at the most favorable conditions, more effectively and efficiently. Irungu (2005) notes that, few years back SACCOs were seen as the greatest threat to insurers, banks and other financial institutions. However, a closer look at SACCO returns on investment shows that their achievement might have been overstated.

According to WOCCU (2002), the vast majority of assets in Kenyan SACCOs are funded by share capital and do not meet the WOCCU prudential standards of excellence of a minimum of 10% net institutional capital. The extremely low institutional capital puts members savings at great risks incase of increased delinquency and defaults.

Mudibo (2005) identifies the cross-cutting issues affecting SACCOs as; governance, inadequate human resource, weak regulations and supervision, limited products, low marketing and innovation and poor image. Mudibo finds a genuine inadequacy of resources, lack of education and training which force members to exert pressure on the Board members to implement issues in a manner that abuses the spirit of good governance.

SACCOs are in stiff competition with commercial banks in financial intermediation. Lack of diversity in services and products has led most members to seek refuge in commercial banks. Delays in disbursement of approved loans of up to four months and long queues of customers in their offices are just but common indicators of inefficiency (WOCCU, 2002).

In order to maintain both relevance and market, there has been a huge temptation to invest in information technology and to offer the latest hot products such as ATMs and tailored loan products. Unfortunately, the capital required to take this entrepreneurial posture is more than most SACCO managements can afford or are willing to afford.

Investments, if not well designed, may plunge SACCOs into financial distress, thereby putting at risk the members' lifetime savings. Essinger (1993) notes that, by the very nature of their work, investment managers tend to be a cautious and conservative breed. They are thus likely to overlook or ignore really good opportunities to do things better. They need to construct a portfolio of assets whose returns nets off the impacts of inflation and spur value growth.

Nevertheless, the gap between the actual financial intermediation of SACCOs and the ideal states has been disturbing, yet none, and indeed no other study known to the researcher, has examined the investment practices adopted by SACCOs in Kenya. This study expends to fill the gap by seeking to establish the strategic investment decisions of SACCOs that target to optimize shareholders' wealth and sustain competitiveness.

The research questions of this study would be:-
i) What are the pervasive factors (constraints) that influence the investment types and choices of SACCOs?
ii) What strategies do the SACCO managers use to form and manage investment portfolios?
iii) Is there a systematic relationship between cooperative investment choices and managerial factors, such as age, tenure, stock ownership and education level?
iv) Is it possible to establish a causal relationship, in theory at least, between cooperative performance and investment practices?

1.3 Objectives of the study

The objectives of this study are to:
  i)   Investigate the investment policy practices among SACCOs based in Nairobi;
  ii)   Identify key factor that affect the allocation of assets among investment portfolios of SACCOs;

1.4 Importance of the study

  i)   The knowledge about investment practices would give a clear picture to policy makers, notably the treasury and Ministry of Cooperative Development (MoCD), as to the possible policy reforms which would streamline the investment climate to spur value generation among SACCOs.
  ii)   Good management is a prerequisite for any investment undertaking. With a bad management even the best investment opportunity may turn into a liability. The results will expose SACCO management to alternative investment strategies and assist them in making optimal strategic investment decisions, thus reduce the number of stagnant and over-liquid SACCOs.
  iii) The vast majority of assets in Kenyan SACCOs are equity funded. SACCOs have extremely low institutional capital to militate against risks, partly due to improper pricing of services and partly due to lack of diversification of membership. There is need for these societies to go beyond their traditional horizons of operation. Recommendations of this study on such possibilities could prevent the undercapitalization menace of SACCOs.
  iv)   The findings shall create some basic level of awareness to the shareholders and help them in understanding the circumstances under which their SACCOs operate, and hence reduce conflicts.
  v)   Researchers and academicians will find value addition to the existing body of knowledge for further scholarly work.

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

This section is in two parts: Part one, is a review of the theoretical framework on best practices in investment. Part two; we present the empirical literature relevant to investment practices to expose what managers have actually done.

2.1 Theoretical literature review

An investment is the current commitment of money or other resources in the expectation of receiving future benefits. Those who give up immediate possession of savings expect to receive a greater amount than they gave up.

Translating the aspirations and circumstances of diverse households into appropriate investment decision is a daunting task. The task is equally difficult for institutions, most of which have many stakeholders and often regulated by various authorities (Zvi, Kane and Marcus, 2004). They further note that, many investment principles are general and can apply to virtually all circumstances. However, some issues are somewhat unique to specific investors; such as tax brackets, age, risk tolerance, and job prospects, yet they all require an efficient investment.

It then becomes apparent that a well designed and unambiguous investment process could properly deliver appropriate portfolios. While there can be no unique 'correct' investment process, some approaches are better than others. This section reviews the systematic approach suggested by the AIMR.

2.1.1 Investment Process

Investment process specifies how an investor should go about making investment decisions as regards to the type of marketable securities to invest in, how extensive the investment should be and when it has to be made (Sharpe, 2006).

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According to AIMR (1999), this process goes through four key stages: specifying objectives, specifying constraints, formulating policy, and monitoring and updating the portfolio as needed.

2.1.1.1 Setting investment objectives

In specifying objectives, two indicators are central: return requirement and risk profile of an investor. Investors will differ in the choice of investment because they differ in their willingness to trade-off expected return against risk. These are concepts of behavior that are difficult to characterize so neatly in real life, hence are only inferred to form a basis for an investment choice (Ibid). The investor must then reconcile these objectives with what is feasible within the constraints. This means that investment objectives should be stated in terms of risk and returns, and they form a set of guidelines as to the choice of assets.

Usually, investor objectives fall in some risk related categories: capital preservation, capital appreciation, current income, and total return (Omonyo, 2003). These objectives change with age, as argued by Zvi et al (2004) that, attitudes shift away from risk tolerance and towards risk aversion as investors near retirement age, hence preference for safer assets later in life. Sharpe (2006) offers that an elderly retiree may have a relatively low risk tolerance than an investment institution composed of a relatively young workforce. Thus, managers should take cognizance of this in their policy statement. The table below illustrates the theory:

Table 1: Summary of the Life cycle theory on asset allocation

Age	Stocks %	Bonds %	Cash equivalents %
30s	75	15	10
40s	65	20	15
50s	60	25	15
60s	40	40	20

Source: Zvi et al (2004).

2.1.1.2 Investment constraints

Even with a homogenous investor group, whose attitude to risk is identical, different managers might choose institutional portfolios differently owing to differing circumstances of taxes, liquidity requirement or various regulatory restrictions.

Such circumstances constrain choices, and together with investor objectives, they determine appropriate investment policy. The five common investment constraints are: liquidity, horizon, regulations, taxes and unique need and preferences (Reilly and Keith, 1997)

Liquidity refers to both the speed and ease with which an investment asset can be sold without significant price concessions. It is a relationship between time and price dimension of an asset. Zvi et al (2004) argue that liquidity can be measured by bid-ask spread in dealer markets, and that cash and money market instruments such as Certificates of Deposits (CDs), Treasury Bills (TBs) and Commercial Papers (CPs) are most liquid, with a bid-ask spread of 1%. In contrast, real assets in extreme can suffer a 50% liquidity discount.

On the other hand, high liquidity has been blamed for overinvestment problems in firms. Barclay and Smith (2005) have argued that free cash flows have led to value destruction through corporate empire building, consuming perks and pursuing overpriced acquisitions. In view of that, investment managers must consider the urgency of cash needs and establish a prudent level of liquid assets in their portfolios without necessarily tying up capital and incurring the opportunity cost of holding cash.

A planned liquidation date of the investment is equally important. An appropriate investment horizon must relate to the time funds and liabilities fall due. Brigham and Ehrhardt (2004) are in agreement that synchronization of cash flows provides cash when it is needed and thus enables firms to reduce liquidity, decrease bank loans, lower interest expenses and boost profits. It all requires accurate forecasts and arrangements so that cash receipts coincide with cash requirements.

For instance, SACCOs may synchronize their investment horizons with dividend payment dates to avoid the high cost bank loans and loss of value from inefficient disposal of assets. Reilly et al (1997) concur that, there is indeed a relationship between an investor's time horizon, liquidity and ability to handle risks. Long horizon investors generally require less liquidity and can tolerate high risks.

Professional and institutional managers have a fiduciary duty to their shareholders to safeguard and grow investment portfolios through conscious and astute allocation of funds entrusted with them (Omonyo, 2003). More often, this duty may be overlooked, leading to moral hazards and hence the need for official intervention. However, legal and regulatory factors have at times been cause for inefficiency, especially due to their general nature. For instance, SACCOs in Kenya have for long been confined to real estates and fixed bank deposits (Gachara, 1990; Ongore, 2001). Further, penalties upon early withdrawals and/or termination of pensions and insurance schemes make those investments unattractive for investors with substantial liquidity needs. Generally, these policy guidelines amount to constraints on the ability to freely and economically choose investment portfolios.

Tax considerations have a central role in investment decisions as the impact on both asset allocation and diversification (Reilly et al, 1997). They argue that high income investors, owing to their relatively high marginal tax rates, have an incentive for tax exempt assets such as municipal bonds, and that the decision to rebalance or to sell off some assets to buy different others must be balanced against both the resultant tax burden on capital gains and the transaction costs. This inhibits efficient diversification.

But Sharpe (2006) does not believe that such costs should play any impediments given the opportunities of equity/bond swaps. Only a relatively small fee to the swap bank that set up the contract has to be paid to obtain full portfolio balance and/or diversification. Accordingly Zvi et al (2004) advise that, for investors who face significant tax rates, tax shielding and deferrals may be critical in their investment strategy. The appropriate number to consider is, however, the net after-tax return.

Finally, special needs and investor preferences may greatly impede the freedom of asset choice. Cohen et al (1982) observes that, this intangible factor, such as excluding investment in firms producing alcohol, tobacco or pornography have led to social investing which limits the asset universe, again likely to impair diversity of a portfolio.

To this end, fund managers must observe the fiduciary duty of prudence and stick to investment criteria of risk and return, asset diversification and cost conscious investing (AIMR, 1999)

2.1.1.3 Investment policy

This is an invaluable planning tool, especially as regards asset allocation and selection. A policy statement is a breed of investor objectives and constraints. It must reflect an appropriate risk-return profile as well as liquidity, income generation and tax positioning needs of the investor (Zvi et al, 2004). As such it helps in creating realistic investment goals, an objective standard of performance judgment, and guards against unethical lapses by investment managers (Reilly et al, 1997). It allows a better chance of constructing an investment strategy that optimizes investor circumstances: high risk tolerant investors will emphasize equities in their asset allocations while risk averse ones puts more weight on bonds and cash equivalents.

However, Zvi et al (2004) stresses that a balanced portfolio has characteristics of both classes, plus a diversification edge across asset classes, hence well suited to withstand the financial market instabilities. Intuitively, this may work well, than the life cycle strategy, for SACCOs whose shareholders are never cohorts.

2.1.1.4 Monitoring and revising of portfolios

Investor objectives, constraints and market conditions are quite dynamic in nature. This concern calls for managers to continually monitor and update portfolios in an attempt to fine tune them with fundamentals (Ibid). Portfolio revision can be viewed as bringing certain benefits; either it will increase the expected return of the portfolio or it will reduce the standard deviation of the portfolio, or it will do both.

To be weighed against these benefits are transaction costs that are to be incurred for the revision. They include brokerage, price impacts and bid-ask spreads (Sharpe, 2006). Sharpe further argues that the cost of portfolio revision may at times outweigh the foreseen benefits of doing so, thereby constraining the revision.

Moses et al (1989) agree that analysis of historical portfolio performance confirms the success of investment management strategies, manager's skills and may suggest the need for portfolio revision, modification of strategies, or even a change in the portfolio manager. Traditionally, the mean-variance criterion has been used to judge managers on their choice of risky portfolios. An optimal portfolio had to maximize a reward-variability ratio $[E (Rp)/\partial p]$ regardless of the clientele risk profiles. Most professionals, however, are in favor of composite performance measures that are risk-adjusted and able to give excess return per unit risk (Ibid).

Three main statistical measures are; Treynor ratio, Sharpe ratio and Jansen alpha. Jansen and Treynor measures use systematic risk of the portfolio as the appropriate risk measure, and use beta variable assuming a perfectly diversified portfolio, hence evaluate performance only in terms of risk and return. A poorly diversified portfolio would rank high on these two measures! They are arguably suited to mutual funds that strife to perfect diversification (Reilly et al, 1997). On the contrary Sharpe (2006), being aware market inefficiencies, recommends a ratio that captures both risk-return and diversification attributes of a portfolio. Accordingly, the ratio measures reward to total volatility tradeoff, risk being measured by the standard deviation (∂p). Only in the case of perfect diversification would ∂p equate portfolio beta and could be the three measures reconcile.

However, Reilly et al (1997) note that the three measures suffer the weakness of assuming constant portfolio risk over the relevant time period. This is not necessarily so given the changes in investor objectives and portfolio composition overtime.
In modern portfolio theory, superior risk-adjusted returns can be derived through superior timing or superior security selection strategies. This is in support of active strategies and constant portfolio rebalancing.

2.1.2 Investment management strategies

The debate on market efficiency between academicians and practitioners has boiled down to two broad categories of investment strategies: passive strategies and active strategies. Efficient markets suggest passive strategies while inefficient markets prefer active strategies. These strategies are discussed in Moses and Cheney (1989).

2.1.2.1 Passive management strategies

Passive management is based on the belief that security prices are usually at close to 'fair' levels and that it is futile to spend resources searching for mispriced securities, attempting to beat the market. These strategies are characterized by a buy-and-hold tactic. This implies creation of a well-diversified portfolio at predetermined risk levels and holding the portfolio relatively unchanged for longer periods. Cohen et al (1982) find these portfolios to be characterized by low turnover, low unique risks and low transaction and management costs.

According to Moses et al (1989), passive managers do not attempt to outperform the market or to earn a risk-adjusted excess return; the objective is to do as good as the market. The strategy has led to formation of index fund – a portfolio designed to mirror the movement of a selected broad market index (e.g. the NSE 20-share index) by holding commitments in similar proportions as those which comprise the index (ibid). Not many SACCO stakeholders are capable of creating their own efficient portfolios; wouldn't the index fund strategy be a panacea!

Several basic techniques are used to optimize a passive strategy: full replication, sampling, quadratic optimization, and completeness funds and yield tilting. Full replication involves purchase of all securities in the index in proportions to their weight in the index. Though it may guarantee close tracking, transactional and dividend reinvestment costs may render it suboptimal (Reilly, 1997). Sampling save on transaction and reinvestment costs but comes with significant tracking errors. Alternatively, quadratic optimizer uses a computer program, fed with historical price changes and correlations between securities to output a portfolio composition with least

tracking errors. However, owing to steady changes in price and correlation data, the portfolio formed on historical inputs may result in large tracking error.

Completeness funds are created from outside any published index by use of securities that active managers underweight, and thus complete market gaps. The benchmark is customized to incorporate characteristics of such stocks. Similarly, yield tilting is theorized to orient investment to market inefficiency caused mainly by the tax laws.

The highly taxed high-yield stocks are unattractive investment vehicles to high income investors. To be attractive, such stock must promise high returns, hence tax-exempt and/or low-taxed investors skew their portfolios toward them (Litzenberger and Ramaswamy, 1979).

2.1.2.2 Active management strategies

This is a market focused approach to make asset allocation decisions and use analysts' recommendations to choose securities within each asset class. Active portfolio managers attempt to profit from stock selection, market timing or both. In Capital Asset Pricing terms, it is the attempt to achieve investment returns that differ significantly from those implied by the market line (Cohen et al 1982).

According to Morrison (1976), two considerations are necessary for the success of active portfolio management. First, one must have a good idea of how others view alternative investments. Second, one must disagree with the consensus. The task is not to forecast returns accurately but to forecast more accurately than the market. Moreover, the difference in expectation must be of sufficient magnitude to cover transaction costs and to allow for the error factor.

Active managers consider the holding period for portfolio securities to be temporary, changing, replacing or rebalancing immediately the difference in expectation disappears. It thus requires either: (a) concentration in a fairly small number of issues with continuous reassessment of alternatives (selection) or (b) moving in and out of a well-diversified portfolios (timing).

Reilly et al (1997) observe that, actively managed portfolios are overweighted in certain markets or stocks; hence the critical issue of such managers becomes that of selecting an appropriate benchmark. They find the broad market index inappropriate for concentrated portfolios as it does not match average characteristics of the portfolio strategy of the investors. Moreover, overweighting results in low diversification and higher portions of unsystematic risks. Together with transaction costs related to equity turnover, the active manager must earn above the benchmark in order to sufficiently compensate for higher risks and costs.

According to Moses and Cheney (1989), two approaches may be used in asset selection. First, technical approaches which involves an analysis of historical price and volume data to discover patterns and trends that technicians believe they recur. Thus, by identifying an emerging trend or pattern, the analyst hopes to predict accurately future price movements for that particular stock.

Second, the fundamentalists belief that the 'true' value of any financial asset equals the present value of all cash flows that the owner of the asset expects to receive. The true value is defined as that which is justified by financial facts such as asset value; earnings, dividends, firm size and book-market ratios. The analysts use mathematics and quantitative procedures to estimate the true value of an asset independent of the market price.

The magnitude of the difference between true value and the current market price of an asset reinforces the analysts' conviction of a mispriced stock. Stocks that have their true value greater than their current market value are said to be underpriced and conversely (Sharpe, 2006).

On the other hand, market timing is an attempt by active portfolio managers to be in the 'right' security at the right time. Trippi and Harrif (1991) observe that, the motivation for active managers is two fold: First, to tailor the distribution of fund return at some future date so that it can be an entirely different shape from that of the market index. Secondly, it may be to exploit predictable regularities (anomalies) in the market.

Active managers assume that there is some pattern in the way prices of assets change and that the investor can accurately forecast the pattern. For instance, real estates prices tend to reflect the inflation level. Buying a house when inflation is anticipated to rise may be a good timing strategy (Moses et al, 1989). They further assert that perfect market timing occurs when all funds are in stocks prior to a bull market and all funds are invested in TBs prior to a bear market. To be successful at market timing, an investor must correctly forecast market movements over 50% of the times (ibid).

A key tactic in market timing has been sector rotation i.e. overweighting, relative to surrogate portfolio, certain sectors of the economy in response to the expected phase of the business cycle (Omonyo, 2003). Accordingly, Khun (1994) postulates that economic troughs signal chances for financial assets to excel, as it recovers, capital goods excel, at the peak, basic industries excel and during recession, consumer staple sectors excel. 'Sector' can also include different stock attributes such as value stock sector and growth stock sector. Overweighting either of them is again a market timing tactic.

2.1.3 Asset allocation strategies

An investment manager runs a complete portfolio constituting equities, long- and short-term bonds and cash equivalents. According to Zvi et al (2004), the most straight forward way to control the risk of a portfolio is through asset allocation strategy- the fraction of the portfolio invested in TBs and other safer money market securities versus risky assets. Most investment professionals consider asset allocation the most important part of portfolio construction, accounting for over 94% of overall investment returns (Omonyo, 2003, and Zvi et al 2004).

To determine the asset mix that promises superior returns, Reilly and Keith (1997) identify four general strategies to observe: integrated, strategic, tactical and insured asset allocation methods. Integrated strategy separately examines (i) capital market conditions and (ii) the investor objectives and constraints.

The two data sets are optimized through a computer program. Updates on the data changes are regularly noted and a new asset mix is selected through the same procedure. Strategic strategies reflect what policies would portfolio managers adopt in the long-term given the forecasts of expected returns, variances, and covariances of the portfolio. These forecasts are used to generate efficient frontiers, in light of which investors decide on the asset mix (weights) appropriate to their risk and constraint circumstances.

On the other hand tactical asset allocation refers to how wealth is divided among assets at any particular moment given the investor's short-term forecasts i.e. under the current market condition. It thus assumes investor attributes to be constant so that only risk premium estimates would drive asset mix modeling. Accordingly, when the equity risk premium appears to be large (falling market) relative to that of bonds, the proportion of stocks in the overall portfolio rises, and conversely. This is somewhat a contrarian strategy.

Contrary to tactical strategy is the insured asset allocation. It assumes constant market risks and returns. Only investor objectives and constraints change as his wealth position changes. An increase in portfolio value improves investor wealth as well as his risk tolerance. Thus as stock prices increase less of the wealth is allocated to bonds and vice versa.

In equilibrium, although people are happy to buy stocks when the market (index) is bullish, they will need more encouragement to by them when the market is bearish. Thus we would expect higher risk premium at historically low markets and low risk premium at historically high markets. According to Liu, Longstaff and Pan (2003), the longer the horizon the less sensitive the risk premium is to market index. Long horizon investors do not require so big a risk premium after the market has fallen as compared with the short horizon ones. They postulate that the market will clear with the long-term investors tending to be contrarian whereas short-term investors may feel a need to portfolio insure.

2.1.4 Modern investment theory

Haugen (1990) took a fund manager's view to postulate the 'modern investment theory'. He traces the development of investment theory back to Markowitz (1952) work that detailed the portfolio selection process. Markowitz showed how to create a frontier of investment portfolios that would each promise the greatest possible expected rate of return at each given level of risk. His work was later simplified by his student, Sharpe (1963), coming up with the currently known 'single index model'.

Haugen however, specifies the single index to asset selection, while the general model of Markowitz finds unquestionable application in asset allocation. These models have since been packaged as computer software, making it quite possible for investment managers to optimize portfolio construction with high degree of precision. These models are the Capital Asset Pricing Models by Sharpe (1964), Litner (9165), and Mossing (1966) and the Arbitrage Pricing model of Ross (1976).

2.2 Empirical literature review

The investment environment of cooperatives in Kenya has been restrictive since their inception. The 1985, ministry of cooperative development circular, confined cooperative investment to fixed bank deposit and, to some extent, real estates. Financial investments into bonds and shares of private companies were discouraged unless cooperatives were guaranteed certain rights or had high degree of control (Gachara, 1990). Critics of these investment guidelines argued that investments in cooperative banks were against prudential portfolio management. They would lead to excess liquidity, and that conservative and risk-averse investors were not likely to support any investment proposal put to them in the Annual General Meeting, thereby shrinking the investment universe for these organizations.

Gachara (1990) studied investment practices of reserve funds by SACCOs in Nairobi between 1982-'87, a period that the cooperative sector was heavily regulated by the MoCD.

The study analyzed the capital structure, sources of Long-term funds and their application. He revealed that internal funds constituted over 88% of the long-term funds, with share capital occupying 83% of the funds followed by Statutory Reserve Funds (SRF) (3.9%) and Retained Earnings (1.9%). Others that included mainly the bank overdrafts stood at 11.1%.

With regards to growth, the SRF grew at the highest of 31.44%, and that SACCOs tended to borrow in times of financial shortfalls and repay immediately excess funds are available. Accordingly, the major assets held by most SACCOs were bank deposits (42.10%) giving an astonishing liquidity level of 5times more current assets than any debts outstanding. With regards to investment of the SRF, 67 % increased working capital, 20 % into fixed bank deposits and 13 % financed operations. These findings are vital to understanding the capital structure and investment background of SACCOs.

Oyoo (2002) evaluated Sacco's financial performance using the WOCCU financial ratios. The study looked at five years before and five years after deregulation of cooperatives in1997. An overall decline in performance after deregulation was revealed. The table below summarizes the financial findings of the study:

Table 2: Financial performance of SACCOs before and after 1997

Indicator	1992-1996	1997-2001	WOCCU targets
Total members deposits : Total assets	80.67 %	81.54 %	70-89 %
Membership: Total Assets	5.87 %	2.66 %	<20 %
Institutional capital: Total Assets	9.71 %	7.91 %	>10 %
Growth in institutional capital	33.52 %	66.04 %	>inflation
Growth in membership	3.21 %	-1.17 %	>5 %
Liquidity ratio	30.93: 1	24.89: 1	>15: 1
Net profit: Business Assets	3.03 %	1.16 %	Optimal
Basic earning power	2.14 %	0.96 %	Optimal

Source: Oyoo, 2002

Mwangi (2003) conducted a study on SACCO investment attitude to unit trusts. First, the study confirmed the existence of the traditional investment practices among the SACCOs.

Over 67 % of funds were allocated to real estates, fixed deposits (4.4 %), government securities (3.9), quoted and unquoted stock (0.4 % and 23.9 % respectively). The unquoted stocks were linked to cooperative related firms such as cooperative bank, cooperative insurance and KUSCCO limited. Secondly, the predominant factor in asset selection was singled out as expected rate of return, followed by risk and the compliance to regulations.

Among the capital market products, bonds were ranked high followed by quoted stocks and commercial papers. Mwangi attributes the bond preference to both their stable incomes and the introduction of secondary market for corporate and government bonds at the Nairobi Stock Exchange (NSE) market. He further reveals that most of the SACCO income is derived from interest on members' loans, dividends on shares of other organizations, deposit interests, TBs, and fixed assets. Thus SACCOs were found to employ a return maximization and diversification criteria in selecting portfolios.

It is however regrettably noted that, stocks constituted a paltry 8.4% while over 91% of corporate savings was allocated to non-liquid assets such as real estates and unquoted stocks. However, over 49 % of the sample did not respond to asset allocation/selection criteria, a situation which significantly reduces the credibility and general applicability of his findings. The non-response is attributed to management lack of sufficient information on the operations of Capital Markets. Nevertheless, whatever category of SACCO clientele in terms of risk profile, the above revelations fall shot of popular advice as exemplified by the table below:

Table 3: Risk category and asset allocation for Merrill Lynch clients

Group attributes	Stocks	Bonds	Cash equivalents
Income oriented	30	60	10
Growth oriented	60	30	10
Moderate risk	50	40	10
Aggressive risk	60	40	-

Source: Omonyo (2003)

In addition, Corrado & Bradford, (2002) applaud the 60-40 asset mix as a generally plausible asset allocation strategy. This may serve well for SACCOs that may never succeed in profiling their members' risk tolerance.

The popularity of the more volatile stocks, relative to bonds, can be explained by two main factors. First, taxation of dividends, interest and rent incomes at the investors marginal tax rate inevitably influences asset allocation. Dammon, Spatt and Zhang (2004), show that there is a strong locational preference for holding taxable bonds in the tax-deferred account and equity in the taxable account.

This preference reflects the higher tax burden on taxable bonds relative to equity. When held in the taxable account, equity generates less ordinary income than taxable bonds, provides the investor with a valuable tax-timing option to realize capital losses and defer capital gains, and allows the investor to avoid payment of the tax on capital gains altogether at the time of death.

Second, stocks have been shown to weather inflation impacts in the long-term (Reilly et al, 1997). They have argued that, an asset allocation decision for a taxable portfolio that does not include a substantial commitment to common stock makes it difficult for the portfolio to maintain real value over time. This view is shared by Cheney et al (1989) that, although seemingly risky, investors seeking capital gains, income or even capital preservation over long-term, should include a sizeable allocation to equities in their portfolios; the otherwise is inefficient allocation of resources.

Tables 5 and 6 below attest to these postulates.

Table 5: Effects of taxes and inflation on investment returns, 1969-1994

Compounded annual returns 1969-1994	Before taxes and inflation	After taxes	After taxes and inflation
Common stocks	10.1 %	7.0 %	1.2 %
Government bonds	8.3	5.7	0.0
TBs	7.0	4.1	-1.5
Municipal bonds	6.5	6.5	0.8

Source: Reilly et al (1997)

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Municipal bonds	6.5	6.5	0.8

Source: Reilly et al (1997)

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Thus, by sticking with a long-term investment policy and riding out difficult times, attractive long-term rates of return can be earned.

Liu et al (2003) observe that, some kind of asset allocation strategies essentially throw away value. To them, a timing strategy of someone who has no forecasting ability and the plunge in and out of equities loses the sort of diversification benefits you would enjoy from a smoother policy. Accordingly, stop-loss strategies are also inefficient as investors liquidate immediately on bad weather yet the market would normalize through other routes.

These observations seem to give credit to passive strategists, who may have lacked excellent market forecasting (timing) abilities as opposed to active portfolio management. In deed, studies by Hodges and Brealy (1973) and Treynor and Black (1973) looked at the relationship between fund performance and the forecasting ability as measured by correlation between forecasts and outcomes. They show that very significant returns can be obtained with remarkably low levels of forecasting ability as measured by correlation coefficient (R^2). It turns out that, with an R^2 of 0.01 or 0.02 respectable returns of 2 or 3% are attainable.

However, though stocks would outperform TBs over a long-term policy, they would do worse than TBs when held for shorter periods. Stocks are riskier than bonds or TBs for quite an extended period of time as revealed below:

Table6: Historical average annual returns and returns variability, 1926-'95

Asset class	Geometric mean %	Arithmetic mean %	Std deviation %
Large company stocks	10.2	12.2	20.3
Small company stocks	12.2	17.4	34.6
L.T corporate bond	5.4	5.7	8.4
L.T government bond	4.8	5.2	8.8
M.T government bond	5.1	5.2	5.7
US TBs	3.7	3.7	3.3
Inflation	3.1	3.2	4.6

Source: Reilly et al (1997). NB: L.T – Long term and M.T – Medium term

An important consideration in designing a portfolio is to establish the correlation among the constituent securities in a portfolio. This enables managers to diversify away all or considerable amounts of unsystematic risk.

CHAPTER THREE

RESEARCH METHODOLOGY

3.0 Introduction

This study was modelled on descriptive research concerned with describing the investment characteristics of SACCOs in Kenya. This part describes the procedures that the researcher used for collection and analysis of data in a manner that aimed at combining relevance to the research purpose with economy in procedure. It therefore gives the conceptual structure within which the research was conducted.

3.1 Population

The target population included all the SACCOs registered under the Cooperative Societies Act and were on the Register of the Provincial Cooperative Officer, Nairobi Province as at 31st Dec. 2007. Out of these, it was only active SACCOs (whose annual reports are regular) since the deregulation of cooperatives in1997 that qualified for consideration.

The country boasts of over 3000 registered SACCOs (GoK, 2004; Mudibo, 2005), where Nairobi province, being the hub of cooperatives, houses over 30% of them (Gachara, 1990). This gives an estimated population of 1000 SACCOs. A sample drawn from Nairobi Province was therefore a representative of all SACCOs in the country.

3.2 The Sample

From the sampling frame, three strata that are individually more homogenous than the total population were formed on the basis of capital base. A sample of 60 SACCOs was picked using a mix of stratified and systematic random sampling methods. This sample size was both economical and sufficient for most statistical tests and inference.

Besides, a comparative analysis to establish if there exist cross-stratum differences was possible. Since each stratum was more homogenous than the total population, we were able to get more precise estimates for each stratum and hence a better estimate of the entire population became tenable.

3.3 Data collection

The target respondents of this study were the investment managers of respective SACCOs or their equivalent. The main data for this study was primary in nature and thus, data collection was by use of both closed- and open-ended questionnaires (see appendix 2), that was either a drop-and-pick or interviewer administered or both depending on the circumstances. On the basis of the answers provided, further clarification was always arranged through focused interviews

3.4 Data Analysis

Once the responses were received, the questionnaires were edited for completeness and consistency before processing. Responses in the questionnaires were tabulated, coded and processed by use of SPSS and Excel spread sheets. Frequency tables, charts, percentages and means were mainly used to analyse the data.

These tools were selected for their clarity, preciseness, ease of understanding and interpretation. They were efficient in contrasting fund sizes and the amounts allocated to each asset class over time.

Descriptive statistics especially the mean was used to determine the most frequent response on the factor under study. The cross tabulation was used to analyse the consistency, and hence the main asset allocation strategy over the study period. Frequency tables and percentages were employed to summarize the demographic profiles of the respondents. Responses across strata were used to show similarities and differences.

CHAPTER FOUR

DATA ANALYSIS AND FINDINGS

4.0 Introduction

In this section we analyze the data collected using the SPSS and Excel programs. Whereas excel was used to draw the graphs, SPSS was majorly used to compute the cross tabulations, percentages, frequencies and Friedman rank test. Out of the 60 questionnaires distributed, 45 questionnaires were returned. This was an equivalent of 75 per cent response rate. This was felt to be sufficient for the analysis and hence drawing valid inferences from the collected data.

The SACCOs were categorized into small-sized (0 – 150,000,000), medium-sized (151,000,000 – 300,000,000) and large-sized (301,000,000 and above) based on an arbitrary class interval of share capitals. Classification was meant to establish if there could be any significant difference in the investment factors and strategies analyzed.

4.1 Distribution of respondents by job title

The following table gives frequency distribution of respondents based on job title. 55.6 per cent of the total respondents interviewed were assistant accountants mainly due to their availability. Whereas 33.3 per cent of the total respondents interviewed were accountants, financial officers were only 11.1 per cent. It is worth noting that most respondents were accounts' clerk because they have regular access to most accounting data.

Table 4.0 Distribution of respondents by job title

Job Title	Frequency	Percent	Valid Percent	Cumulative Percent
Accountant	15	33.3	33.3	33.3
Asst. accounts' clerk	25	55.6	55.6	88.9
Financial officer	5	11.1	11.1	100.0
Total	45	100.0	100.0	

Source: Research data
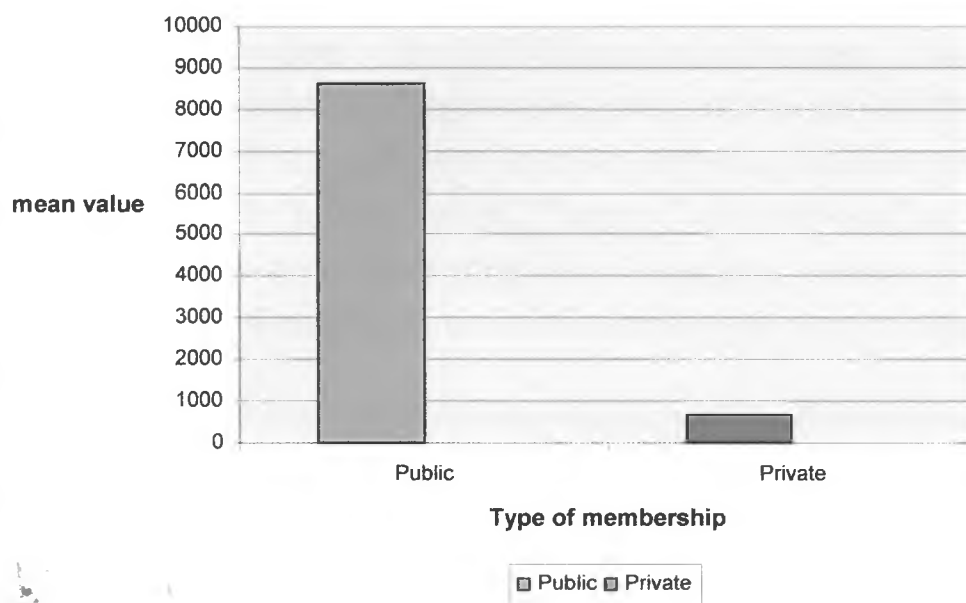
Graph 4.0

Table 4.2 Cross tabulation between Share capital in category and type of membership

Share capital in category	Type of membership		Total
	Public	**Private**	
Small	50.0%	20.0%	33.3%
Medium	.0%	20.0%	11.1%
Large	50.0%	60.0%	55.6%
Total	100.0%	100.0%	100.0%

Source: Research data

4.2 Membership as at Dec. 2007 by type of SACCO

The table below indicates the total number of respondents, the average and the total number of members in the SACCOs categorized by type of ownership. Although there was a smaller number of respondents from public owned SACCOs compared to private, the mean of 8625 and the total number of 172495 members for public owned SACCOs were above the private owned. Therefore it means that on average, public owned SACCOs register a higher number of members compared to private ones. The membership entry conditions are felt to explain the disparity depicted below.

Table 4.1 Mean distribution of membership as at Dec. 2007 by ownership

Statistics	Public	Private
N	20	25
Mean	8624.75	686.6
Sum	172495	17165

Source: Research data

Membership was sought alongside capital size in order to determine clusters and later compare investment differences across the divide. Table 4.2 represents cross tabulation that compares the percentage distribution of share capital and type of ownership. According to the clusters established, publicly owned SACCOs reported the highest membership but failed to beat privately owned SACCOs (with lowest membership) in share capital (contrast graph 4.0 and table 4.2).

4.3 Investment and asset allocation analysis.

In a bid to establish the investment class (es) that are more popular with SACCOs, respondents were asked to indicate (in KShs.) their respective investment values in given investment areas. As such, it was established that illiquid assets ranked highly at about 77.0 per cent of the total investment value, a situation that confirms literature review (Gachara, 1990; Oyoo, 2002 and Mwangi, 2003) and hence conservative nature of SACCOs. This is illustrated by the table below.

Table 4.3: Preferable investment areas

Asset class	Investment Value	Proportions %
Land	2,560,078,780.00	29.2
Vehicles	2,214,784,670.00	25.3
Housing	1,934,406,640.00	22.1
Loans to members	1,068,641,425.00	12.2
Fixed deposits	894,722,160.00	10.2
Unquoted shares	42,557,541.50	0.5
Gov't securities -	39,562,425.00	0.5
Quoted shares in NSE	13,823,195.00	0.2
Value of corporate Bonds		0.0
Total	**8,768,576,836.50**	**100.0**

Source: Research data

4.4 Analysis of factors considered before investment into asset class

Investment decisions are largely influenced by some constraints. In accordance to Reilly and Keith (1997), a list of five key investment constraints were listed and respondents asked to rank them in order of their importance. Based on a Likert scale of 1-5 (where 1 = most important 2 = important 3= not certain 4= not important and 5 = most unimportant). The scale for most important and important was considered to suggest a positive response to a given factor.

The table 4.4 below presents investment behavior across categories of SACCOs. For the small SACCOs, government regulations play the most important role (66.7 per cent) in selecting an investment as opposed to liquidity (100 per cent) for the medium SACCOs.

In addition to the above factors, investor needs and preferences are considered equally important among large SACCOs as illustrated below.

Table 4.4: Investment factors stratified by SACCO size

Investment Constraints	SACCO Size	Most important	Important	Total %
Taxes	Small	33.3	0	33.3
	Medium	0	0	0
	Large	20	20	40
Liquidity	Small	33.3	0	33.3
	Medium	100	0	100
	Large	40	20	60
Govt. regulations	Small	66.7	33.3	100
	Medium	0	100	100
	Large	40	20	60
Investor needs and preferences	Small	33.3	0	33.3
	Medium	0	100	100
	Large	40	20	60
Investment period	Small	0	33.3	33.3
	Medium	0	0	0
	Large	0	0	0

Source: Research data

These findings can be pictorially illustrated using a comparative bar graph shown below.
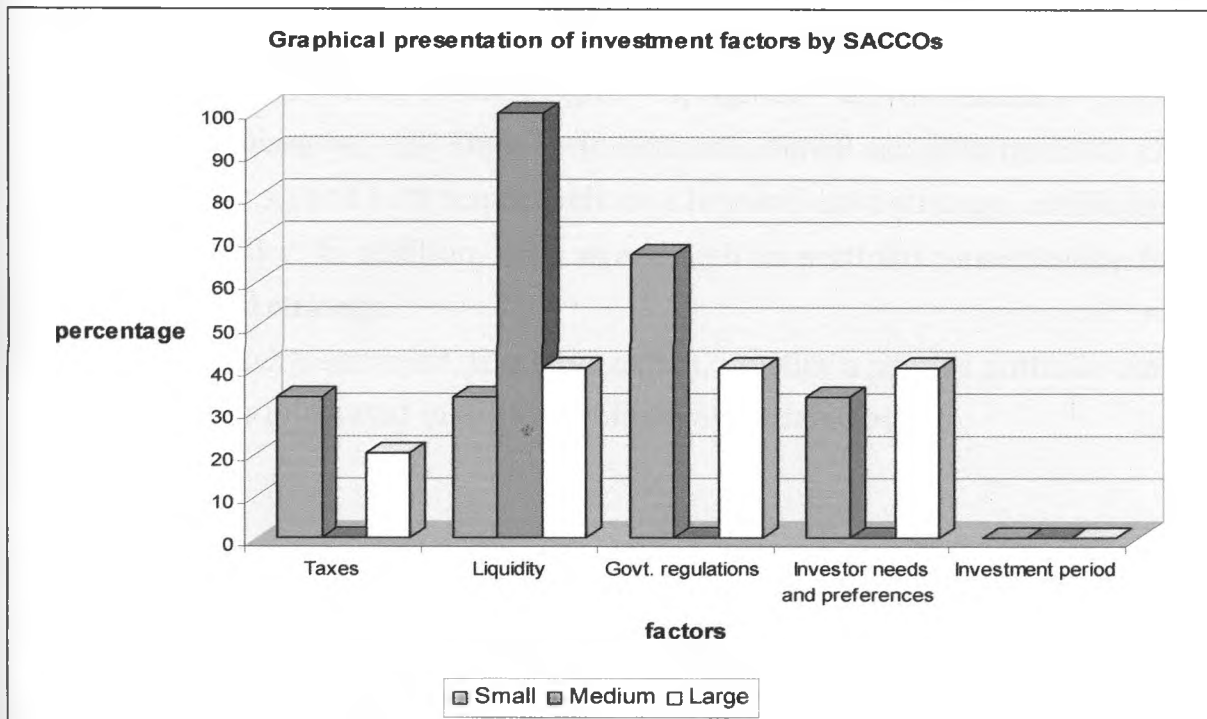
Graph 4.1

In overall, based on the Friedman rank test, SACCOs surveyed indicated that investor needs and preferences and Liquidity were more pervasive factors in asset allocation. From the responses, a mean of 2.22 and 2.33 for the two factors respectively, was derived as illustrated by table 4.4. This seems to be consistent with the literature as observed by (Mudibo, 2005).

Table 4.4: Mean Values of Investment constraints stratified by Share capital

Investment constraints	Category of SACCO			Overall
	Small	Medium	Large	
Taxes	3.33	4.00	3.00	3.22
Liquidity	3.33	1.00	2.00	2.33
Govt. regulations	2.33	3.00	3.20	2.89
Investor needs and preferences	2.33	2.00	2.20	2.22
Investment period	3.67	5.00	4.60	4.33

Source: Research data

4.5 Analysis of portfolio management styles

The respondents were asked to indicate the extent to which they considered the various aspects of investment management, being applicable to their styles. This was based on a Likert scale of 1-5 (where strongly Agree – 1, Agrees – 2, Not Certain – 3, Disagree – 4 and Strongly Disagree – 5). From their responses, Small and Medium SACCOs scored a mean rank of 1.33 and 1.00 respectively on a buy-and-hold strategy, exhibiting a Passive investment policy. In addition, large scored high on portfolio concentration followed by a buy-and-hold strategy.

In overall, SACCOs surveyed, to a large extent, practice a passive portfolio management policies. This is illustrated in the fifth column of the table below.

Table 4.5: Friedman rank test on investment practices

Statements	Category of SACCOs			Overall	
	Small	Medium	Large	Mean	Std. Deviation
We assume that the NSE market is efficient enough	2.00	2.00	1.25	1.63	0.49
We follow a simple buy-and-hold strategy of our investment assets	1.33	1.00	2.00	1.63	1.00
We invest in securities whose maturity matches our investment horizon	2.00	4.00	2.25	2.38	1.43
We build our portfolios based on the NSE-20 share index	2.33	2.00	2.25	2.25	1.41
We select our investment assets based on their intrinsic values	2.33	2.00	3.00	2.63	1.89
We usually buy cheap and sell dear	3.33	1.00	3.25	3.00	1.68
We position our portfolios to take advantage of the market's next move	3.00	2.00	3.50	3.13	1.38
We build our portfolios so that their returns match our liabilities	2.67	3.00	3.00	2.88	1.56
Our portfolios are concentrated in few sectors of the economy	2.67	2.00	1.00	1.75	1.32

Source: Research data

4.6 Analysis of investment strategies

Respondents were again asked to indicate the extent to which they considered various aspects of investment strategies to apply to their styles. Also based on a likert scale of 1-5 (where strongly Agree – 1, Agrees – 2, Not Certain – 3, Disagree – 4 and Strongly Disagree – 5). From their responses, Small SACCOs determine long term policy asset weights in their portfolio (mean rank of 1.33) and believe that whatever a security return has been in the recent past, it will eventually revert to its long term average value (mean ran of 1.67). These two scores indicate a strategic investment management strategy and a use of technical analysis to ascertain the fair value of stocks respectively.

On the other hand, Medium-sized use integrated strategies (mean rank of 1.00) besides technical analysis (mean rank of 1.00) to maximize returns. A combination of strategic (mean rank of 1.50) and integrated strategies (mean 1.25) plays a big role in the large SACCOs.

In overall, the sample surveyed exhibited an application of both integrated and strategic asset allocation tactics. They also scored high (at 1.75) on the use of technical analysis in assets selection. The table below illustrates these findings.

Table 4.6: Friedman rank test on investment strategies

Statements	Category of SACCOs			Overall
	Small	Medium	Large	
We examine separately the capital market conditions and our shareholders objectives and constraints in establishing asset mix	2.00	1.00	1.50	1.63
We continuously revise our portfolio in light of all changes that occur in the shareholder objectives and constraints	3.33	3.00	1.25	2.25
We periodically rebalance our asset allocation to adjust the portfolio to the specified asset weights	3.33	2.00	2.00	2.50
We usually determine long term policy asset weights in our portfolio	1.33	2.00	3.25	2.38
We constantly adjust our asset class mix in the portfolio in an attempt to take advantage of changing market conditions	3.33	3.00	3.75	3.50
In constructing our asset mix, the shareholders risk tolerance and investment constraints are assumed to be constant over time	3.67	2.00	2.00	2.63
We believe that whatever a security return has been in the recent past, it will eventually revert to its long term average value	1.67	1.00	2.00	1.75
We buy assets currently out of favour on a relative basis, at least, and sell those with the highest market value	3.67	1.00	2.00	2.50
We buy believing that expected market returns and risks are constant over time but the investor's objectives and constraints change as their wealth position change	3.00	3.00	2.25	2.63

Source: Research data

Based on portfolio concentration in few sectors of the economy (table 4.5 above), we can reasonably suggest that most of the SACCO portfolios are formed out of sampling certain sectors especially those that they affiliate to.

Both the table and the graph below illustrate that most SACCOs consider investing in KUSCCO, Co-operative Insurance Company (CIC) and Co-op. bank.

Table 4.7: Frequency distribution of SACCO holdings

Holdings	Freq.	% Response
Co-op bank	40	25
CIC	35	21.9
Blue-Shield	15	9.4
Equity	15	9.4
KUSCCO	30	18.8
KCB	10	6.3
Barclays	5	3.1
RBA	5	3.1
Family	5	3.1
Total	160	100

Source: Research data

Graph 4.2

39
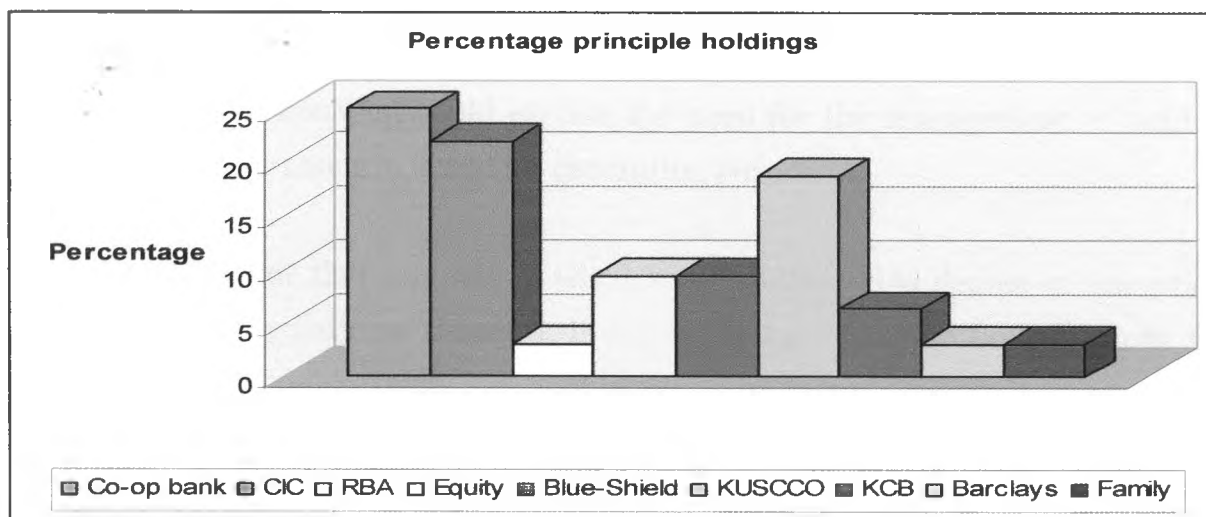
CHAPTER FIVE

CONCLUSION AND RECOMMENDATIONS

5.0 Summary of Findings

The objectives of this study were twofold: to establish the predominant portfolio management and asset allocation strategies. It also sought to determine the key investment constraint among SACCOs in Nairobi. From the findings, it has not been clearly established that there exists a significant difference in investment behavior among different sizes of SACCOs. However, a general picture about their investments can be safely concluded from the analysis so far done.

It is evident, from the sampled SACCOs, that investor needs and preferences are given first priority in choosing investments. This could be thought to result out of pressure from members mainly during their AGMs. In addition, investment Liquidity ranked closely, a situation that could explain the need for the management to hold a larger portion of their assets in liquid for precaution purposes.

The other factor that was felt to wield some considerable degree of importance was government regulations. However, it did not feature much in both medium and large SACCOs. This could explain a case of laxity in the part of the regulator and hence likely to lead to inept investment decisions and choices.

In terms of asset allocation, majority of the SACCOs could be said to follow a simple buy-and-hold strategies as they have all indicated their great confidence in the efficiency of NSE. This is basically a passive investment management strategy. It has been revealed that most portfolios are formed out of market sampling within affiliated sectors. While this indicates a conservative nature of SACCOs, it should be noted that it denies investor efficiency in asset diversification. This may not be a good investment practice given the concentration of risks within limited asset class.

To optimize their passive investment strategies, it has been established that majority of the managers employ both strategic and integrated asset allocation tactics. These are felt to be efficient in capturing the dynamic nature of the investor's risk profiles and financial market instabilities. However, asset selection criteria have predominantly been revealed as technical analysis.

5.1 Recommendations

From the findings of the study, there are several aspects of investments that need to be addressed if SACCOs are to realize their full intermediation potentials. Firstly, investments need to address the issue of risks. This could be achieved probably through asset diversification. From the analysis SACCO investments were confined within their traditional illiquid assets. Such assets do not afford the flexibility necessary for immediate response to market signals. On the other hand, confining investment to affiliate firms is equally risky and denies other sectors in the economy to intermediate with SACCOs.

Secondly, there is need for the regulator to exert influence in order to streamline SACCO investment environment and lay a level playing ground for all financial institutions. This way, both the shareholders and the society at large are bound to reap the benefits of efficient competition among the financial institutions.

Thirdly, SACCO management may need to consider their investment period so as to avert the risk of financial distress that may arise out of poor synchronization of cash flows. Investment pay-offs that match cash-out flows would ensure only necessary liquidity is maintained so that over- or underinvestment does not inflict them.

Fourthly, a blend of both active and passive strategies is felt to generate more value as it will combine advantages from both sides. Besides, there is no empirical evidence so far that puts one strategy superior to the other!

Lastly, investment in quoted stocks has been noted to be rather poor and does not auger well with the popular advice from both academicians and professionals. Stocks have been shown to weather inflation impacts in the long-term and a valuable tax-timing option. It is therefore felt necessary that a sizeable allocation to equities in SACCO portfolio may result in efficient resource allocation.

5.2 Limitations of the study

1. The research was conducted within Nairobi city and therefore may not have captured the mood of SACCOs in the up-country. Besides, the response rate was 75 percent with a clear 25 percent not responded.
2. The main respondents to this study were accounts' clerks whose feelings may be skewed to their own understanding of policies in place.
3. Time was a limitation to the study in that a bigger sample could not be studied.

5.3 Areas for future research

This study was not conclusive as it was only inclined to investment practices among SACCOs. Other areas of concern that are felt could add value include the following;

A study on the relationship between investment policies and managerial factors such as age, education and stock ownership would help to link respective managerial aspects to certain policies. Secondly, a research on challenges of value maximization among SACCOs would the necessary solutions to arrest incidences of disintegration.

Besides, there is a stiff competition raging among financial institutions, it is therefore necessary to look at strategies used by SACCOs to ward-off competition from other players in financial intermediation. Moreover, the perception of SACCO members to investment policies is equally important and may need to be established. This would establish whether such policies actually reflect their aspirations.

Finally, the conservative nature of SACCO traditional investment has repeatedly been noted in several studies. A study to expound on this rigidity would be necessary.

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APPENDIX 1: Letter to the Respondent

UNIVERSITY OF NAIROBI,
SCHOOL OF BUSINESS,
KABETE CAMPUS,
P.O. Box 23030, KABETE,
NAIROBI.

Dated...........................

Dear Sir/ Madam,

RE: A SURVEY ON THE INVESTMENT PRACTICES BY SAVINGS AND CREDIT COOPERATIVE SOCIETIES (SACCOs) IN NAIROBI

I am a postgraduate student undertaking a Master of Business Administration Degree at the School of Business, University of Nairobi. I am currently carrying out a research on investment practices by SACCOs in Nairobi.

I kindly request you to provide the required information by responding to the questions in the questionnaire. The information required is purely for academic purposes and will be treated in the strictest confidentiality possible.

The results of the report will be used solely for academic purposes and a copy of the same will be availed to you upon request. I will appreciate your co-operation in this academic exercise.

Thanking you in advance.

Yours faithfully,

George, K. Ileve

APPENDIX 2: Questionnaire for SACCO Managers

Background information

This questionnaire is designed to gather information for a research which seeks to establish the investment practices employed by SACCOs in their efforts to maximize shareholders' wealth and also to investigate the challenges they face in trying to achieve this goal. The study is being carried out as partial fulfillment of the requirements for degree of Master of Business Administration (M.B.A), School of Business; University of Nairobi.

Part A. General Information

Demographic information

1. Please indicate your job title---
2. Gender: Male--------- [   ]   Female---------- [   ]
3. Age Bracket (please tick as applicable)
   a. (a) Less than twenty six years   [   ]
   b. (b) 26-35 yeas   [   ]
   c. (c) 36-45 years   [   ]
   d. (d) 46-55 years   [   ]
   e. (e) 56 years and above
4. How many years have you worked in your organization?
   (a) Less than one year   [   ]
   (b) 1-5 years   [   ]
   (c) 6-9 years   [   ]
   (d) 10 years and above   [   ]

Information on Organization

5. Name of SACCO (optional) --

6. Year of incorporation/registration--

7.   Type of members---

8. Membership as at 31st Dec., 2007---

9. Share capital as at 31st Dec., 2007---

PART B: Investment and asset allocation

1. Please state the existing investments values and proportion as at 31st Dec. 2007 in the spaces provided.

Asset class	Value (Ksh '000')	Proportion %
Land		
Housing		
Fixed deposits		
Government securities		
Corporate Bonds		
Quoted shares in NSE		
Unquoted shares		
Others (Specify)		

2. Please rank in order of importance (using 1 being most important and last being least important) the factors that you consider when selecting the investments above.

	Factors	Ranking
a	Taxes	
b	Liquidity (the speed & ease with which an investment can be liquidated)	
c	Govt. regulations	
d	Investor needs and preferences	
e	Investment period	
f	Others (specify)...	

In a scale of 1 – 5 where (Strongly Agree – 1, Agrees – 2, Not Certain – 3, Disagree – 4 and Strongly Disagree – 5), please show how you agree or disagree with the following statements in 3 and 4.

3.

Statement	Strongly Agree	Agree	Not Certain	Disagree	Strongly Disagree
We assume that the NSE market is efficient enough					
We follow a simple buy-and-hold strategy of our investment assets					
We invest in securities whose maturity matches our investment horizon					
We build our portfolios based on the NSE-20 share index					
We select our investment assets based on their intrinsic values					
We usually buy cheap and sell dear					
We position our portfolios to take advantage of the market's next move					
We build our portfolios so that their returns match our liabilities					
Our portfolios are concentrated in few sectors of the economy					

4. Asset mix refers to the composition and weight of each class of assets in the investment portfolio.

Statement	Strongly Agree	Agree	Not Certain	Disagree	Strongly Disagree
We examine separately the capital market conditions and our shareholders objectives and constraints in establishing asset mix					
We continuously revise our portfolio in light of all changes					

that occur in the shareholder objectives and constraints					
We periodically rebalance our asset allocation to adjust the portfolio to the specified asset weights					
We usually determine long term policy asset weights in our portfolio					
We constantly adjust our asset class mix in the portfolio in an attempt to take advantage of changing market conditions					
In constructing our asset mix, the shareholders risk tolerance and investment constraints are assumed to be constant over time					
We believe that whatever a security return has been in the recent past, it will eventually revert to its long term average value					
We buy assets currently out of favour on a relative basis, at least, and sell those with the highest market value					
We buy believe that expected market returns and risks are constant over time but the investor's objectives and constraints change as their wealth position change					

5. Please state any five principal holdings (*where they place their investments*)

Company/Firm Name (e.g. ICEA, Unit Trust, Safaricom etc)	% Holdings
1.	
2.	
3.	
4.	
5.	

Thank you for your cooperation