

**DETERMINANTS OF THE GROWTH OF INDIVIDUAL
PENSION SCHEMES IN KENYA**

BY

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REG. NO.: D61/60117/2010

**A RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILLMENT OF
THE REQUIREMENTS FOR THE AWARD OF THE DEGREE OF MASTER
OF BUSINESS ADMINISTRATION, SCHOOL OF BUSINESS, UNIVERSITY
OF NAIROBI**

NOVEMBER, 2012

DECLARATION

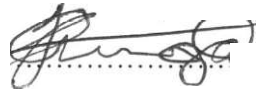
I, the undersigned, declare that this management research project is my original work and that it has not been presented for any other degree/diploma in any other university

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This research project has been submitted for examination with my approval as the University Supervisor.



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AC KNOWLEDGMENT

I thank the Almighty God for his gift of life, kindness, mercies and grace from which I got my courage and strength throughout my studies.

Special thanks to my supervisor Dr. Josphat Lishenga for his invaluable guidance, criticism, suggestions, contribution and commitment throughout the study. His immense knowledge enabled me to successfully complete this research project.

In addition, I thank the management of individual Pension Schemes in Kenya who accept my request of data collection from them.

My appreciation goes to all lecturers of the University of Nairobi for impacting knowledge in me. Finally, I owe my gratitude to all MBA colleagues and Library staff who in one way or another offered the much needed help.

To all I say thank you and God bless you abundantly.

DEDICATION

This Proposal is dedicated to my family for their endless love, tolerance, encouragement and support. I also dedicate the same to my colleagues, my supervisor, Josephine Ikundo in the work place for accommodating my request of leaving a bit early than the rest of my colleagues in the evening to concentrate on my project.

ABSTRACT

Individual pension schemes are the principal sources of retirement income for millions of people in Kenya. Pension schemes are also important contributors to the gross domestic product (GDP) of countries. This study focuses on pension funds in Kenya. Retirement income accounts for 68% of the total income of retirees in Kenya, while pension assets account for 30% of Kenya's GDP. It is therefore important that pension schemes be managed effectively to ensure their growth. The general objective of the study was to investigate the factors influencing the growth of individual pension schemes in Kenya. More specifically, the study explored the effect of fund governance, regulations, investment strategy and fund ethics on the growth of pension schemes. The study adopted the descriptive research design. The target population for this study comprised of 22 individual pension schemes in Kenya (RBA Directory, 2012) out of which all are privately owned and compete for customers in the market. Then statistical package for social sciences (SPSS) Version 17.0 was used for the purpose of data analysis.

The findings of the study revealed that fund governance exert a significant relationship on the growth of the pension schemes. This means that pension fund governance lead to improved growth of the individual pension schemes. The result further shows that reducing the benefits processing period, providing relevant education to the trustees, maintaining an appropriate internal control system, communicating regularly with members, defining the roles of the trustees clearly, regulating the fees charged by the service providers, controlling default risk on the

part of the sponsor and implementing investment strategies that are major factors that influence the growth of individual pension schemes in Kenya. Fund regulation was also found to exert a significant relationship on the growth of individual pension schemes. This implies that the implementation of the following regulations improve the performance of individual pension schemes: monitoring of performance of the service providers; regulation of compliance costs; limiting the size of the pension fund board; conducting regulatory meetings; the separation of fund ownership from the sponsor's business; and the investment policy.

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ACRONYMS AND ABBREVIATIONS

CEO	Chief Executive Officer
CSPS	Civil Servants Pension Schemes
DB	Defined Benefits
DC	Defined Contributions
GDP	Gross Domestic Product
IPP	Individual Personal Plan
IRS	Individual Retirement Schemes
NSSF	National Social Security Fund
OECD	Organisation for Economic Co-operation & Development
ORS	Occupational Retirement Schemes
PAYG	Pay -As-You-Go
RBA	Retirements Benefits Authority
USA	United States of America

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

1.1.1 The Growth of Pension Schemes

Traditionally, pension systems were operated on a Pay As You Go (PAYG) basis which meant that workers did not have to contribute to their pensions but would be guaranteed pension benefits on retirement (Financial Times, 2003). This system was sustainable in the last four decades since the number of workers far outweighed the number of retirees (Pecchenino and Pollard, 2005). As the population ages, life expectancy increased and the cost of living rose. However, the PAYG system became unsustainable and prone to political manipulation, and the benefits paid to retirees decreased.

Describing the pension crisis in developed countries, Bettendorf and Heijda (2006) note that the percentage of the elderly population (65 years and over) over the working age (15 - 64 years) was 12% in 1950, 21% in 2000 and predicted it to increase to 44% in 2050, thus threatening the sustainability of the PAYG system.

According to Sinn (2004), the PAYG system contributes to intergenerational inequity since it merely transfers wealth from today's workers to today's retirees. In this way, according to Weikard (2004), the PAYG pension system subjects the present workers to the responsibility of paying pensions (taxes to support current retirees) while at the same time taking responsibility for the future generations (current child care). This creates a cycle that does not guarantee returns to the ageing population. In addition,

the system can only be operated by governments since private enterprises cannot be trusted to be in operation when the population gets to retirement age (Sinn, 2004).

According to OECD (2000), the ratio of total OECD pension fund assets to GDP increased from 81.9% to 84.1% in 2004. In monetary value, pension fund assets grew from US\$ 5.9 trillion in 1994 to US\$ 15.6 trillion in 2004, representing a compound growth rate of 10.2% per annum. According to Corbo and Schmidt-Hebbel (2004), the ratio of the pension fund assets to the GDP grew by 46% in the Chilean economy over the period 1981 to 2001. In Kenya, pension fund assets account for 30% of the GDP (Odundo, 2008).

According to Wyatt (2007), the growth of pension fund assets amounted to 100% of the GDP in Australia, 80% in Canada, 10% in France, 12% in German, 36% in Hong Kong, 50% in Ireland, 75% in Japan, 130% in Netherlands, 147% in Switzerland, 98% in the United Kingdom and 108% in the United States of America in 2006.

The growth of Pension funds exerts both quantitative and qualitative effects on financial markets (Davis, 2006). Quantitative effects relate to asset allocation decisions while qualitative effects relate to corporate governance decisions. Pension funds increase offshore investments, which grow international financial markets thus contributing to greater stability of the economies as a result of increased capital flows (Davis, 2006). In addition, pension funds increase equity market capitalization and bond market capitalization (Impavido et.al, 2003).

Raddatz and Schmukler (2008) suggest that since pension funds face regulatory requirements and are required to allocate more funds to domestic investments, they are the most important institutional investors within a country. Furthermore the

pooling of pension fund assets boosts the stock market and increases the stock market's liquidity (Catalan, 2004). As holders of large amount of bank deposits, government paper and short-term assets, pension funds are important institutions that control the flow of funds in the financial markets (Raddatz and Schmukler 2008).

In developing countries such as Kenya, market for individual pension schemes is at development stage (RBA, 2002). This indicates that the growth of individual pension is relatively low in developing countries and therefore it needs to be studied thoroughly as it develops. Members to these funds need a lot of transparency, which was found lacking in the public pension schemes (RBA News, 2002). Certainly, membership of such schemes has offered considerable financial advantages over reliance on the basic state pension which, as a result of indexation to prices rather than average earnings, has continued to decline in value (Taylor, 2000). Since 1988, it has become possible for employees to choose to exclude themselves from their employer's pension scheme and to opt for a personal pension plan based on regular defined contributions to an invested accumulating fund from a life annuity which would be purchased on retirement.

1.1.2 Factors that Influence the Growth of Pension Schemes

The growth of pension schemes has been influenced by several factors. As per the previous studies done on management of pension funds the following are the main factors that influence the growth of pension schemes. These include regulation, investment strategy, fund governance, operational efficiency and fund ethics.

Regulation has been a big influential factor in the management of pension industry. According to Yermo and Tinga (2007) licensing is defined as the process by which an authority grants permission to a pension entity to operate and/or to have the right to

benefit from specific tax treatment. It includes a range of actions, involving the assessment of compliance with specific requirements, prior to granting permission to operate or granting tax benefits, or it may be the status of compliance with such requirements. Regulations stabilize financial systems which provide a favorable environment for efficient resource allocation which therefore promotes economic growth. Furthermore experience show that if left for themselves, financial systems are prone to bouts of instability and contagion (Dan w. punchniak, 2010)

Investment strategy is another factor that influences the growth of pension schemes. Stanko (2002) defines investment strategy as the assortment of investments made by pension funds. The investment strategy determines the investment mix of the total funds of a pension fund that aims at having a careful balance between investment risks and returns (Stanko 2002; Eichholtz and Margaritova ,2009). The investment strategy is therefore a plan that guides the choice of the investments that pension funds make. According to (Eaton and Nofsinger, 2001 there is a positive relationship between risk and returns. That means a pension funds will take more risk for better returns. It is therefore suggested that pension funds adopt appropriate investment strategies that provide higher returns on investments with moderate risk (Eaton and Nofsinger, 2001)

Although corporate governance has attracted much attention in the recent past, focus has not shifted to pension fund governance and credibility of the pension systems as important determinants of pension funds (Besley and Prat, 2005; Carmichael and Palacios ,2003; Ambatchsheer, 2001). In empirical models, pension fund governance is measured by the use of board composition and financial expertise of trustees variables (Hsin and Mitchell, 1997; Mitchell and Yang, 2005), plan management practices based on expense ratios (Mitchell and Yang, 2005; Bikker and Dreu 2009),

as well as decisions on whether funds outsource their services (Bikker and Dreu, 2009).

Additionally, Mitchell and Yang (2005) show that governance variables of a pension fund may also include board (trustee) composition (proportion of active and retired trustees). Governance of a pension fund is also determined by the pension fund sponsor, be it a public enterprise, private enterprise or a financial institution for an individual retirement fund (Bikker and Dreu, 2009).

Another factor which affects the growth of pension schemes is operational efficiency. Operational efficiency is defined as the ability of a pension fund to meet non financial objectives (Canadian Treasury Board, 2009). The operational variables include; strategic management of administration and investment costs, timely processing of pension benefits, improvement in the internal control systems, efficiency in the conduct of trustee meetings, timely reporting to members, and decrease in compliance costs.

Fund ethics another factor that influences the growth of pension schemes. Ethics refers to benchmarks of conduct that indicate how individuals should behave based on moral duties and virtues, which themselves are derived from principles of right and wrong (Hugman, 2008; Baron, 2008). Empirical studies (Roe, 2006; Merton and Bodie, 2005; Clark 2007) report a link between pension fund trustees upholding ethical behaviour and the achievement of long-term objectives set in the trust deed. According to Clark (2007), ethical behaviour should ensure that pension funds are managed diligently, pension laws are followed and all disputes are sorted out without fear or favour and there is explicit communication to all the interested parties. Save-

Soderbergh (2009) suggests that ethics contributes to long-term sustainability of individual pension funds and ensures a highly regarded decision-making framework

1.1.3 Pension Industry in Kenya

Pension fund in Kenya were first put in place after independence in 1963. The first post independent pension fund body, the National Social Security Fund (NSSF), was established in 1965 (RBA, 2000). Prior to reforms, the pension fund system provided for benefits once a worker retired on attaining the mandatory retirement age of 55 (RBA, 2006). The guarantee was fixed as the worker's full basic salary throughout his life or that of the widow as the law did not envisage a situation where the wife would support the husband. This law was embodied in the NSSF Act and the Pensions Act (Cap 189).

The pension fund system in Kenya has been supervised by the independent Retirement Benefits Authority (RBA) since 2000, which oversees the 1997 RBA Act that brought about regulation, protection and structure to the pension fund industry. The pension fund structure in Kenya involves the members, the sponsor, board of trustees, the fund administrator, the custodian, the fund manager and the auditors. The RBA continues working to develop the industry and advise the government on pension policy reforms.

Kenya's pension fund system embraces four components namely the NSSF, Civil Servants Pension Scheme (CSPS), Occupational Retirement Schemes (ORS) and Individual Retirement Schemes. Overall the system is estimated to cover 15% of the labour force and to have accumulated assets of 18% of the GDP (Kakwani *et al.* 2006). The pension fund system covers an estimated 2 million workers leaving an

estimated 5 million workers uninsured under any retirement scheme, of which at least 10% are at or near the retirement age (Kakwani *et al.* 2006).

Individual pension schemes or Individual retirement schemes (IRS) are run by financial institutions mainly insurance companies which provide an avenue for saving where employers do not have their own schemes, and for workers who wish to make additional voluntary contributions (RBA, 2009). By the close of 2009, RBA had registered 21 IRS that covered an estimated 2% of the working population. RBA (2009) points out the gap filled by the IRS where the number of employees is so small forming an ORS would not be financially viable.

1.2 Statement of the Problem

Private pension schemes were set up by institutional providers to target individual members not necessarily tied to an employer or any formal setting. The existence of occupational pension schemes and civil servants pension schemes in Kenya only covers workers who work for companies and the government of Kenya respectively. This category of pension schemes are entities that are open to the entire public regardless of employment affiliations providing an invaluable window of opportunity for workers in the informal sector to save for their retirement in a manner commensurate to their ability to make contributions. IRS also covers anybody who is employed by a company and wish to make an additional savings for retirement.

Individual Retirement Benefits schemes (IRBS) in Kenya are at the developmental stages. Before the retirement benefits sector reform, only four individual retirement benefits scheme existed all of which were operated by Insurance Companies. Overall the pension subsector is estimated to cover 15% of the labour force and to have

accumulated assets of 18% of the GDP (RBA, 2010). The pension fund system covers an estimated 2 million workers leaving an estimated 5 million workers uninsured under any retirement scheme, of which at least 10% are at or near the retirement age (Hannah, 2000). The coverage of the workforce in Kenya covered under Individual Retirement Benefits Schemes is disappointingly low (RBA, 2011). The total number of members in individual pension schemes is a dismal 8800 individual's majority 70 percent of whom are company employed. Sixteen percent are members engaged in self-employment professional occupations. The asset holding of the individual retirement schemes account for less than one percent of the total sub-sector assets.

Despite the critical role played by private pension schemes, the growth of pension scheme in Kenya is inundated by multiple and diverse problems (Hannah, 2000). By 2007, twelve individual retirement schemes had been registered with the Authority and four were in the process of getting registered.

Locally study done on pension schemes has not focus on factors affecting the growth of individual pension schemes in Kenya. For instance, Muli (2008) carried out a study on challenges faced by insurance firms in the management of pension funds in Kenya. This has only outlined the challenges and not addressing the factors affecting the growth of pension schemes in Kenya. Makori (2010) on the other hand did a survey on asset liability management among defined benefits pension schemes. Another related study was done by Macharia (2011) which covered risk management strategies and returns by pension funds in Kenya. The study mainly focused on strategies put by pension schemes to minimize risks and maximize the returns. Gicharu (2011) carried out a study on corporate governance practices and firm financial performance; the case of pension schemes in Kenya. The study only outlined the relationship between

corporate governance practices and the financial performance. This study therefore, will seek to fill the existing knowledge gap. What are the factors affecting the growth of individual pension schemes in Kenya.

1.3 Objective of the Study

To establish the factors affecting the growth of individual pension schemes in Kenya

1.4 Value of the Study

It is anticipated that the findings of this study will be important to;

The study will be significant to individual pension schemes providers. The study will provide insight on factor affecting the growth of the individual pension schemes and recommend various reforms that need to be undertaken to promote efficiency and growth of the pension systems. The Retirement benefit Authority in Kenya will gain an insight from the study on factors that hinders the growth of individual pension schemes and seeks ways that will promote growth of the individual pension schemes.

The government and policy maker will gain insight on factors hindering growth of individual pension schemes and institute effective reforms that will enhance the growth of individual pension schemes in the country. The government will gain insight of importance of individual pension schemes in the economy and formulate and implement reforms that will influence growth of this category of pension schemes. The policy maker will know how well to incorporate the sector effectively to ensure its full participation. On the other hand the academicians will be furnished with relevant information regarding pension schemes. The study will also contribute to the general body of knowledge and form a basis for further research.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter reviews literature on the factors affecting the growth pension funds. It further covers the review of both the theory and empirical evidence on previous research studies on management of pension funds.

2.2 Theoretical Review on Pension Funds

Pension funds like other organisations, can be viewed as open systems since they collect and accumulate contributions from employees (members) and their sponsors (employers who establish the pension fund), invest the contributions and hold the proceeds in stewardship for the benefit of the members upon retirement (Davis, 2005). Davis (2005) thus suggests that pension funds have definite inputs that they convert to outputs. Following this systems theory approach (inputs - conversion - outputs), efficiency in the present study is conceptualised as the pension fund's ability to maximise financial outputs (pension fund value and retirement benefits) financial resources (contributions, investment funds, other inputs) available to it. According to Chansarn (2005), a financially efficient system ensures distribution of limited funds to the most beneficial uses in the most effective manner.

The systems approach is also evident in the OECD's (2004) description of efficiency. The latter defines efficiency as controlling spending, accomplishing more with lesser financial resources, commissioning long term investments to save financial resources in the long term and using budgets prudently.

With reference to the systems approach, pension fund efficiency in this study is defined as the ability of a pension fund to maximise its financial outputs (retirement benefits and asset values), operate at minimal costs, pay retirement benefits on time and generally optimise gains to members.

2.2.1 Regulation

Regulation has been a big influential factor in the management of pension industry. According to Yermo and Tinga (2007) licensing is defined as the process by which an authority grants permission to a pension entity to operate and/or to have the right to benefit from specific tax treatment. It includes a range of actions, involving the assessment of compliance with specific requirements, prior to granting permission to operate or granting tax benefits, or it may be the status of compliance with such requirements

The major reason why many developing countries fail to optimize pension fund efficiency is the existence of many laws that pension funds are obliged to subscribe to (World Bank, 2004). The multiplicity of fragmented laws increases compliance costs and therefore calls for a unified pension law within a country or block of countries (World Bank, 2004). Yet the case can also be made that the benefits of economies of scale are more theoretical than real. They may only be marginally achieved if different, specialized authorities are simply re-arranged into one institution, while at the same time there is no substantial or cohesive re-organization of the new agency (Cihak and Podpiera, 2006). Asher and Nandy (2006b) found that the lack of coordination of the six pension laws in India have resulted in haphazard action and an increase in pension fund costs that reduces the pension benefits.

Concerns have also been raised that a single, integrated, financial agency might be too big to function efficiently, leading to what has been termed a 'bureaucratic leviathan'. In contrast to the closeness of the specialized agency and its supervised industry, under the framework of integrated supervision, such a mega supervisor might be divorced from the markets it oversees (Madero and Lumpkin, 2007), thus leading to slow responsiveness to new market developments. In addition, due to less competition between supervisory agencies, the integrated agency might become too powerful to function efficiently. In addition to the four examples outlined; the specialized pension supervisory model is found in other countries, including India, Italy, Kenya and Mexico.

Madero and Lumpkin (2007) also points out that pension asset increased significantly in all the OECD countries as a result of implementation of quantitative asset restriction and the prudent person laws. The quantitative asset restriction legislated on the maximum percentages that could be invested in specific classes of assets, while the prudent person rule legislated on a code of governance (Hu *et al* 2007A). Moreover, Hu *et al.* (2007) showed that in China, pension regulations on investments and governance resulted in more robust risk control mechanisms, better investor protection, more transparent information disclosure and subsequent stability of the pension funds.

Eijffinger and Shi (2007) attribute pension crises in the European Union to regulatory failure. The pension crises have made pension funds inefficient and unable to deliver on their promises to the stakeholders and so pension laws should be created in licensing, governance, asset restrictions, financial information disclosures and guarantees (Eijffinger and Shi, 2007). Shah (2005) found that legislation on

governance, design, financial reporting and service providers improve efficiency where as the regulations on tax on pension benefits taxation, premature withdrawals of benefits and investment restrictions reduces pension fund efficiency.

Pension fund regulations affect funding costs that in effect have a strong influence on the investment and contribution strategies of pension funds (Blome *et al.* 2007). Blome *et al.* (2007) conclude that funding regulations that require full funding ignore the market-based solvency rules thus limiting creativity on the part of the pension fund managers who eventually fail to maximize pension fund returns.

Pension funds in the United Kingdom are more operationally efficient compared to their OECD counterparts in Kenya as a result of adopting a risk based supervision approach that focuses more on the ability of the pension funds to abide by the taist documents and monitor their activities (Blome *et al.* 2007). Far-sighted and proactive regulations should therefore be made to ensure that pension funds do not renege on their promises (Odundo, 2008).

2.2.2 Investment Strategy

Stanko (2002) defines investment strategy as the assortment of investments made by pension funds. The investment strategy determines the investment mix of the total funds of a pension fund that aims at having a careful balance between investment risks and returns (Stanko, 2002; Eichholtz and Margaritova, 2009). The investment strategy is therefore a plan that guides the choice of the investments that pension funds make. According to Eaton and Nofsinger, 2001 there is a positive relationship between risk and returns. That means a pension funds will take more risk for better returns. It is therefore suggested that pension funds adopt appropriate investment

strategies that provide higher returns on investments with moderate risk (Eaton and Nofsinger, 2001)

This positive relationship between risk and returns causes a dilemma since to get more returns, pension funds have to take more risk (Eaton and Nofsinger, 2001). It is therefore suggested that pension funds adopt appropriate investment strategies that provide higher returns on investments with moderate risk (Eaton and Nofsinger, 2001).

According to OECD (2006), the investment strategy varies depending on the type of pension fund. In the case of a DB, the goal of the investment strategy is to generate the highest possible returns consistent with the liabilities and liquidity needs of the pension fund. In a DC pension fund, the main goal of the investment strategy is to generate gains that accrue to individual member account balances in light of the investment goals. The investment strategy thus contributes to the returns obtained on investments, which directly impacts on the financial efficiency of the pension fund (OECD, 2006).

The appropriate investment strategy should be anchored on four pillars namely: the prudent person rule (ensuring that all investments made are in the best interests of members), diversification (ensuring that pension investments are not concentrated in a specific asset), maturity matching (ensuring that investments mature as liabilities become due) and it should have a clear statement of investment policies (Kyiv, 2003).

Despite the higher returns expected from equities, poor global market performance since 2005 has led many institutional investors to shift their investment mix to incorporate more fixed interest securities at the expense of equity investments (OECD, 2009b). This was done to mitigate the effects of the low returns noted on

equity. Strategic decision-making is therefore related to the investment strategy (Campbell and Viceira, 2002) since strategic decision-making is the process of setting the parameters of institutional performance, matching its objectives and goals to long-term investment strategies informed by experience and expectations. According to Campbell and Viceira, (2002), strategic investment decision-making results in higher returns that contribute to increased efficiency.

A good investment strategy results in more returns and lesser risks for the individual pension funds (Kyiv, 2003). To achieve pension fund efficiency, pension funds must devise sound investment strategies and apply them consistently (Kyiv, 2003). The investment strategy leads to the attainment of the pension fund's short-term (less than 3 years), intermediate (3 to 10 years) and long-term (more than 10 years) goals (OECD 2009b). The investment strategy determines the short-term and long-term sustainability of a pension fund (OECD 2009b; Maurer, Schlag and Stamos, 2007). In other words, an investment strategy that money is available to pay benefits and other costs as they fall due (Bikker et al. 2009). The investment strategy thus provides an appropriate mix between the long-term and short-term financial instruments where the investments are made in consideration of the expected maturity of liabilities (Bikker et al. 2009).

An investment strategy ensures that pension funds do not act haphazardly in times of stock market volatility (Springer and Cheng, 2006). The strategy ensures that the management is aware of the strategy relating to buying and holding of investments such that assets are purchased when prices are low and short-term ones are disposed of when prices are high (Kake, 2006).

The investment strategy contributes to better re-investment plans (Eaton and Nofsinger, 2001). According to Eaton and Nofsinger (2001), the reinvestment plans involve ploughing back the earnings to the same high yielding assets to take advantage of compounding effect. In addition, the investment strategy should result in savings in the form of taxation on the investment returns generated since it focuses on the more tax efficient investments (Kakes, 2006).

Furthermore, restricting investment opportunities tends to depress financial performance making the pension funds less profitable (Olivia and Mitchell 2008). According to Elton, Gruber and Blake (2006), inadequate investment strategy leads to less wealth. Poor investment strategies led to a 53% less benefits to pensioners in the US compared to a market portfolio over a 20-year period (Elton et al. 2006).

Vittas et al. (2008) attribute the poor past record of investment performance in public pension funds in Sweden, Jordan and Mauritius to poor investment strategies that resulted in excessive investment in government bonds and failed to take advantage of the higher returns that the equity market offered. Poor investment strategies led to achievement of returns that were less than the inflationary rates in Ghana, Kenya, Nigeria, Tanzania, Uganda and Zambia's provident funds. In contrast the use of proper investment strategy resulted in better performance of the CALPERS (pension fund covering local government workers in California) and TSP (pension fund covering federal government workers in the U.S) (Vittas et al. 2008). Supporting the above literature review, Hebb (2006), Baldursdottir (2000) and Iwaisako, Mitchell and Piggott (2005) all agree that sound investment decisions maximize pension fund efficiency.

Another critical issue in investment strategy is the aspect of risk. Key amongst these risks is default risk from members, stock market risk, operational risks and liquidity risks. This risk element limits pension funds from investing their entire pension finances in very high return assets forcing them to invest in inefficient portfolios that blend high return with low return security (Dobronogov and Murthi, 2005).

2.2.3 Fund Ethics

Ethics refers to benchmarks of conduct that indicate how individuals should behave based on moral duties and virtues, which themselves are derived from principles of right and wrong (Hugman, 2008; Baron, 2008).

According to the Social Investors Forum (2007), cited in Clark and Urwin (2009), an ethics framework should view trustees as being individually and collectively subject to the common law, statutes and fiduciary responsibilities to the members of the pension fund. Trustees are therefore inherently bound by some degree of ethos to which they should adhere to in decision-making (Clark and Urwin, 2009). Ethical investing involves assessing extra financial risks in investments and in particular those related to environmental, social and corporate governance variables (Yenno, 2008b; FOE, 2009; OECD, 2009c). Firms, including pension funds are increasingly screened for unethical investing.

Gifford (2004), Walsh et al. (2007), and Yermo (2008b), differentiate between negative and positive screening with regard to pension fund investments. Gifford (2004) defines negative screening as "the practice of avoiding or divesting the shares of companies with poor social, environmental and ethical performance." The OECD (2007a) cites negative screens as alcohol, tobacco, gambling, nuclear power, firearms, irresponsible foreign operations, abortion and pornography. Positive screening on the

other hand involves actively investing in companies that have good social, environmental and ethical performance (OECD, 2007a). Examples of positive screens are investing in companies that mind long-term sustainability, environment protection and involvement in corporate social responsibility aspects (Walsh et al. 2007).

Walsh et al. (2007) found that one-third of pension funds in Australia restrict investments in tobacco industries. In Sweden many pension funds prohibit investments in alcoholic companies, tobacco companies, enterprises that engage in child labour and companies that degrade the environment (Soderbergh, 2009). The Norwegian Government Pension Fund prohibits investment in companies which are involved in serious human rights violations (murder, torture and forced labour) and corruption (SaveSoderbergh, 2009). In the USA, pension funds demanded that their investments be withdrawn from South African companies in the campaign against apartheid (Sparkes, 2002).

Failure to abide by the acceptable ethical standards in pension funds result in sub optimal decision-making that compromises their financial results and trust bestowed to them (Clark and Urwin, 2008; OECD, 2007c). Proper ethical behaviour in pension fund management minimises compliance costs and ensures that the risks taken by the trustees are acceptable and within the appropriate thresholds as prescribed in the investment policy thus improving efficiency (Gifford, 2004).

Inadequacies in the application of ethical behaviour results in poor pension fund returns (Raiffa, 2002; Antolin and Stewart, 2009). Ethical behaviour in the pension fund industry however contributes to maximisation of the beneficiary's welfare, reduced chances of litigation, improved governance and better investment performance, which increases efficiency (OECD, 2009b).

Appropriate ethical behaviour enhances objective application of skills and expertise in ways that build a collective sense of commitment and responsibility and provides a way of dealing with rival interests in pension funds, which consequently increase efficiency (Hirschhorn, 2004; SaveSoderbergh, 2009; O'Neill, 2007). Moreover, ethical practices influence the 125 pension funds investment strategy since pension funds conduct negative screening to divest their shares in companies viewed to be unethical (Chapman, 2006; Walsh et al. 2007; FOE, 2009).

2.2.4 Fund Governance

Catalan (2004) suggests that pension funds contribute to the growth of the financial markets through the corporate governance channel. Pension funds lobby for enactment of pro-investor laws, increase intensity of their monitoring activities thus exposing corporate crimes and are capable of initiating legal claims against managers when crimes are detected. Strengthening pension funds can therefore shape corporate governance principles applicable to the corporations as to where they invest their money. In Latin American countries pension reforms contributed to the growth of capital markets and resulted in these economies opening their markets to trade and foreign investments and reducing their national budget deficits (Andrade et. al., 2007).

In empirical models, pension fund governance is measured by the use of board composition and financial expertise of trustees variables (Hsin and Mitchell, 1997; Mitchell and Yang, 2005), plan management practices based on expense ratios (Mitchell and Yang, 2005; Bikker and Dreu, 2009), as well as decisions on whether funds outsource their services (Bikker and Dreu, 2009).

The CEO's influence on decision making in the board is very important since all other board members are subordinate in authority to the CEO (Teisseire, 2009). Although fund sponsors have substantial freedom in setting up pension funds, they must take responsibility for offering participants investment options with appropriate risk and return features, and monitoring the investment vehicles to make sure they continue to be appropriate (Mitchell and Tang, 2008). These roles of the sponsor should be taken up by the pension fund under the leadership of the CEO.

The influence of CEO differs in defined benefit (DB) versus defined contribution (DC) pension funds. According to Robinson (2007), the CEO in a defined benefit fund plays a critical role as he/she appoints more trustees in the board as opposed to the member nominated ones. It is therefore expected that the CEOs take charge of the operations of the defined benefit pension fund since they are ultimately responsible for the payment of the fixed terminal benefits to the employees.

Despite the above mentioned leadership responsibility of the CEO, there is a school of thought that advises against CEOs powerful control, citing instances where the CEOs of the pension fund may award themselves excessive benefits from their defined benefit pension funds (Colvin 2001, Bebchuk and Fried, 2004; Hodgson 2004). Firms sometimes grant CEOs pensions that provide annuities of up to 60% of their average final salaries plus bonus from their defined benefit pension funds (Sundaram and Rermark, 2006).

Ambachtsheer, Capelle and Lum, 2008 and Impavido, 2005 provided evidence that pension boards that are led by the CEO have weak oversight functions that lead to difficulties in sorting out the competing financial interests of different stakeholder groups. They argue that the CEO chairmanship to the board brings about dysfunction

as a result of lack of delegation, board micro-management and the inability of the other members to question the views of the CEO. They recommend that the CEO should leave the pension fund to a professional board of trustees independent of the company's board of directors but to follow its operations and major decisions closely.

Casanova (2001) therefore advocates for "constraint policies" that restrict the CEO. These policies should clearly prescribe the activities and transactions that the CEO is prohibited from undertaking, and that the CEO should not operate outside the written pension fund policies; the CEO will not fail to protect pension assets, information and files from damage; the CEO will not establish current compensation and benefits (including pension) that deviate materially from the geographic or professional markets for the skills employed; and the CEO will not engage in investment activities that violate the asset-mix as approved by the pension board of trustees.

Inherent conflict of interest between the trustees and sponsors arise because sponsors have extensive discretionary powers in making decisions and at the same time the trustees are employees of the sponsor (Moriarty and Zadorozny, 2008). Such decisions include: determining the level of sponsor contributions to the pension fund, retirement age of the members and the organisational use of the workforce (Moriarty and Zadorozny, 2008). In addition, Moriarty and Zadorozny (2008) identify "two hat" decisions (situations that put the decision maker in a dilemma) that result in inherent conflict of interest on the part of the sponsor. These decisions include: the level of funding (the adequate asset: liability ratio since the sponsor determines the contribution rates), types of investments to make and the appointment of service providers. The inherent conflict of interests will always exist as it cannot be eliminated but should be managed (Moriarty and Zadorozny, 2008).

According to Robinson (2007), the risks to pension funds in terms of conflict of interest are greatest in defined benefit schemes where the sponsor nominates a larger percentage of trustees than the members and specifies the benefits payable on retirement. In this situation, the sponsor is able to influence resource allocation decisions, which leads to conflict of interest in appointing service providers, determining a trustee's remuneration, the CEO's accountability for an underperforming pension fund and making of inefficient decisions to avoid hurting the sponsor company (Robinson, 2007).

Having a pension governance policy minimizes potential agency problems or conflict of interest between fund members, the fund administration and the service providers that can adversely affect the security of pension savings (Stewart, 2009). The absence of conflict of interest improves the performance of the fund, creates trust amongst the stakeholders and is vital for the sustained operation and efficiency of the pension fund (Stewart, 2009). According to Robinson (2007), conflict of interest is a breach of the fiduciary duty bestowed on the trustees by the pension fund members, which results in inefficiency and misconduct in pension fund administration.

2.2.5 Operational Efficiency

Summarizing the problems created by the PAYG system in Sweden, Sunden (2000) reveals a decrease in real pensionable wage as the flat pension guaranteed by the state was not indexed to inflation; an unsystematic and inequitable distribution of contributions through taxes and benefits since contributors contribute for longer periods than they earn the benefits; and labour distortions which increases pension expenditure.

Pecchenino and Pollard (2005) reported that the PAYG system had significant public expenditure in the G7 countries and with the increase in the number of retirees however, the system will wane in the long-term leaving behind frustrated retirees and huge budget deficits (Pocchenino and Pollard, 2005). In Uganda, the PAYG system caused increased budget constraints, the local government and the army could not afford the pension benefits and wages could not be increased without raising pensions disproportionately (Herbertsson, 2001).

To address the global pension crisis, OECD (2009a) advocates for reforms in the pension systems to make them fully funded and hence make the PAYG funds extinct. The OECD argues that by funding the pension systems, workers will be saving for their own retirement incomes and will therefore eliminate intergenerational inequity, reduce old-age dependency ratios and remove excessive pension expenditure on the part of the World governments. OECD therefore suggests contributory pension systems that increase the replacement rate (ratio of retirement income to pre-retirement income). To achieve this objective, pension funds must be operationally and financially efficient.

2.3 Empirical Review

Stanko (2002) evaluated the financial performance of pension funds in Poland by comparing their results with other investment opportunities over the period 1999 - 2002. They found that pension fund returns were maximised through active management of the investment portfolio. Charles, McGuigan and Kretlow (2006) report that investors can maximise returns if they put their funds in a single high yielding investment they would however, be exposed to greater risk of loss in case of

poor market performance. According to Asebedo and Grable (2004), investment diversification leads to average performance but minimises losses during periods of poor stock market performance.

Markese (2000) investigated the relationship between the investment strategy and financial performance of pension funds and found that pension funds that invest more in equity stocks perform better than those that invest more in bonds and other fixed securities. The OECD (2009b) concurs that pension funds with clear statement of investment principles perform better than those without. Stanko (2002) evaluated the financial performance of pension funds in Poland by comparing their results with other investment opportunities over the period 1999 - 2002. They found that pension fund returns were maximised through active management of the investment portfolio. Charles, McGuigan and Kretlow (2006) report that investors can maximise returns if they put their funds in a single high yielding investment they would however, be exposed to greater risk of loss in case of poor market performance. According to Asebedo and Grable (2004:18), investment diversification leads to average performance but minimizes losses during periods of poor stock market performance. Through proper investment strategy risk is avoided and timing is enhanced (Hebb 2006).

Clark (2006, 2007) has also surveyed the ability of pension fund trustees in the UK. In the 2006 paper looking at trustee competence (Clark (2006)), trustees'ability in solving problems relevant to their investment responsibilities is examined. The results show that trustees are more cautious with other people's money than their own, which may be an impact of the predominance of the prudent person rule in UK common law. The fact that trustees are not professionals has also led to concerns that trustees may lack the understanding to judge advice they receive from experts. Clark (2007) notes a

growing tension between representation and expertise in several fields, using UK pension fund governance and the USA mutual fund industries as examples. The evidence suggests that very few trustees have the competence and consistency of judgment to challenge the experts who are responsible for executing complex financial decisions. There is a clear association between trustee boards 'understanding across key topics and their confidence levels in managing their schemes.

The importance of guidance is evident, and The Pensions regulator continues to use education as the means to change behavior across schemes. Trustees are required to comply with trustee knowledge and understanding (TKU) requirements and develop further their knowledge to ensure they are confident in dealing with the more complex aspects of running their schemes.

Cocco and Volpin (2005), looking at DB plans in the UK, found that pension plans of indebted companies with more 'insiders' (i.e. also executive directors of the sponsoring company) on the trustee board invested more in equities, contributed less to the pension fund and had a higher dividend payout ratio. The conclusion drawn is that when finances get tough, conflicts of interest may arise and impartial trustees are needed on the board to make governance work. However, other explanations could be found - such as trustees who are also directors of the sponsoring company potentially having greater investment knowledge which would allow them to maximize returns and therefore lower funding demands for the sponsor. Two recent studies have specifically focused on the issue of the differences between the levels of DB and DC governance in the United Kingdom. A recent NAPF survey concluded that trustees were not doing enough to explain that there may well be better ways for members to deploy their funds (NAPF (2007b)). A Cass Business School report on reluctant investors (Byrne, Harrison, Blake (2007)) points out that, with the exception of senior

executives, it is unusual for employers to pay for face-to-face regulated investment advice (due to cost). In its DC consultation work (Pensions Regulator (2007c)) The Pensions Regulator has concluded that two of the areas where there are opportunities for improvements are with member understanding and member choices, and the Regulator has stated that it will issue guidance for trustees with the aim of raising standards in those areas. The guidance will be targeted primarily at trustees, encouraging them to take a more pro-active role in member education.

Empirical findings with regard to the relationship between size and the operational efficiency of pension funds are inconclusive. A positive relationship between financial performance and operational efficiency is reported in Cicotello and Grant (1996), Droms and Walker (2001) and Grinblatt and Titmat (1994). It was also reported that larger pension funds can achieve numerous benefits brought about by economies of scale in administration (Mahon and Donohoe, 2006; Bikker and Dreu, 2009). Furthermore, Brown and Davis (2009) found that collaboration of pension funds in Australia led to better performance since the larger funds were able to exercise a significant influence on the industry.

Empirical studies fund ethics (Roe 2006; Merton and Bodie, 2005; Clark, 2007) report a link between pension fund trustees upholding ethical behaviour and the achievement of long-term objectives set in the trust deed. Ambachtsheer et al. (2007b) however found that unethical behavior in pension funds in decisions relating to investments, benefit promises and fund performance does exist.

From the above evidence it proves that the study on the factors affecting the growth of individual pension schemes in Kenya has not been done thus this study will address the matter in an efficient and effective manner.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter describes the methods, techniques and procedures that were used to answer the research problem. It gives a description of the research design, population, sampling techniques and data collection procedures that were used. It also describes the data analysis techniques used in the study.

3.2 Research Design

The study adopted the descriptive research design. Descriptive research involves gathering data that describe events and then organizes, tabulates, depicts, and describes the data collection (Glass & Hopkins, 1984). It is a process of collecting data from the members of a population in order to determine the current status of the sample under study with respect to one or more variables. Descriptive type of design best suited the study because the researcher tried to find out what is going on in individual pensions schemes in Kenya. It is therefore describes the predictors of growth of IRS.

The study was a survey since the researcher had no control on factors affecting the growth of IRS. The major emphasis of a descriptive study is to determine the frequency of occurrence or the extent to which variables are related (Kothari, 2005). The main variables looked at among the following are, fund governance, fund regulations, operational efficiency, investment strategy and fund ethics. This design was suitable because the study required an accurate assessment of factors affecting the growth of individual pension funds in Kenya.

3.3 Population of Study

Population in statistics is the specific population about which information is desired. According to Field (2005), a population is a well-defined or set of people, services, elements, events, group of things or households that are being investigated. This definition ensures that population of interest is homogeneous. The category of private pension plan providers offers savings products for retirement makes it homogeneous. IRS is a large collection of objects which in this case was the focus of the scientific query. The target population for this study comprised of 22 individual pension schemes in Kenya (RBA Directory, 2012) out of which all are privately owned and compete for customers in the market. The researcher therefore made generalizations and conclusions based on its findings on all IRS in Kenya.

3.4.1 Data Validity and Reliability

Data is valid or true if it represents accurately those features of the phenomena, that it is intended to describe, explain or theorize, (Hammersley's, 1987). The researcher got the data using a questionnaire which have the factors affecting the individual pension schemes clearly outlined in it.

Reliability means that the members of a scientific community agree on talking about the same phenomena, that their data are about something agreeably real, not fictional. The methods frequently used to test reliability are test-retest, split-half, equivalent-form and the Cronbach alpha (Cant, Gerber-Nel, Nel and Kotze, 2003). The test-retest method estimates reliability as the Pearson product-moment correlation coefficient between two administrations of the same measure (Bland and Altman 1997). The respondents of the study were employees and trustees of individual pension scheme in Kenya thus made the findings reliable.

3.4.2 Data Collection

The researcher will use primary data. The primary data helped the researcher to establish a regression model on how the variables are related. The variables in this case were the dependent variable which is the growth of IRS and independent variables which are the factors affecting the growth of IRS. The primary data was collected from respondents using a semi-structured questionnaire as a method of data collection.

A five point non-comparative Likert scale was used for the closed ended questions, the intent of the Likert is that the statement represented different aspects of the same attitude (Brace 2004). Likert scale was simple to construct, and made it easy for the respondents to read, understand and respond appropriately to the statements put across. The Likert scale also enhanced the production of highly accurate results during analysis. With semi-structured questions, the respondents were able to give insight information on all the individual pension funds as much as possible. Questionnaires allowed greater uniformity in the way questions were framed, thus ensured greater compatibility in the responses. The questionnaire used had three sections. The first one covered the demographics of the respondents, the second section covered the organization profile and the last section covered the factors affecting the growth of individual pension schemes. The questionnaires were distributed to all the IRS by 'drop and pick later' technique which made the respondents take his/her time to answer the questionnaire in an effective manner. By doing so, the researcher was able to document the determinants of growth of individual pension schemes in Kenya.

3.5 Operationalization of Variables and Data Analysis

In empirical models, pension fund governance, was measured by the use of board composition and financial expertise of trustees variables. The fund Governance variables used in this study were; effect of the CEO on the leadership of the pension fund, finance education to trustees, appointment of service providers, communication to members, avoiding conflict of interest in decision-making, monitoring performance of service providers, defining the roles of trustees, defining the roles of service providers, having an effective performance measurement system and outsourcing specialized fund management functions.

Fund regulations prescribed the registration, administration and operations of pension funds. In terms of operational efficiency, pension fund regulations relate to the regulation of compliance costs, limitation of the number of trustees, fees charged by service providers, taxation of pension benefits, regulatory levies, risk based supervision and financial reporting.

Operational efficiency is defined as the ability of a pension fund to meet non-financial objectives (Canadian Treasury Board 2009). In this study, empirical variables that were used to evaluate operational efficiency are; investment costs, timely processing of pension benefits, improvement in the internal control systems, efficiency in the conduct of trustee meetings, timely reporting to members, decrease in compliance costs, increasing the rate of return, and critical involvement of members in decision making.

The investment strategy used by a pension fund results in the investment mix between various investments options (Stanko 2002; Asebedo and Grable 2004). In this study, the elements of investment strategy that were used include; investment regulations,

liability insurance for investment decision makers, investment policy, discretion to investment managers and maintaining a risk management policy.

Fund ethics in this study had been captured using the following elements; confidentiality in trusts matters, sponsor's influence, honesty in information sharing, avoiding conflict of interests with the service providers, avoiding bias in decision-making and proper utilization of authority.

Data analysis techniques include univariate analysis, bivariate analysis and more generally multivariate analysis, (*Hair et al 1995*). Since the study focused on one dependent variable and more than one independent variables, regression analysis was best the suitable one. First, data was checked for completeness, accuracy, errors in responses, omissions and other inconsistencies. Then statistical package for social sciences (SPSS) Version 17.0 was used for the purpose of coding and analysis.

The researcher then used descriptive and inferential statistics to seek answers for the study question with accuracy and a meaningful way from the results. With regression analysis, the researcher was able to measure the degree of correlation that exists between the independent variables and the dependant variable. The coefficients of determination were generated for this purpose to measure the strength of the relationship that exists between the variables.

The researcher came up with the below model with five independent variables; X_1 and one dependent variable, Y

$$Y = p_0 + p_1 X_1 + p_2 X_2 + p_3 X_3 + p_4 X_4 + p_5 X_5 + E \text{ Where :-}$$

Y = The growth of individual pension schemes (Dependant variable)

$P_0 + P_1 X_1 + P_2 X_2 + P_3 X_3 + P_4 X_4 + P_5 X_5 = \text{Explained Variations of the Model.}$

$E = \text{Unexplained Variation i.e. error term.}$

$X_1 = \text{Fund governance}$

$X_2 = \text{Fund regulations}$

$X_3 = \text{Operational Efficiency}$

$X_4 = \text{Investment strategy}$

$X_5 = \text{Pension fund ethics}$

$P_0 = \text{Constant. It defines value of growth of individual pension schemes without inclusion of predictor variables.}$

$P_1, P_2, P_3, P_4, P_5 = \text{Regression Co-efficient. Define the amount by which Y is changed for every unit change of predictor variables. The significance of each of the co-efficient was tested at 95 percent level of confidence to explain the variable that explained most of the problem. The five variables were measured by coding and analyzing the opinions given by the respondents being employees of IRS in Kenya in SPSS since they are attributes. The unit measurement of growth of IRS is the level of members' contributions.}$

CHAPTER FOUR

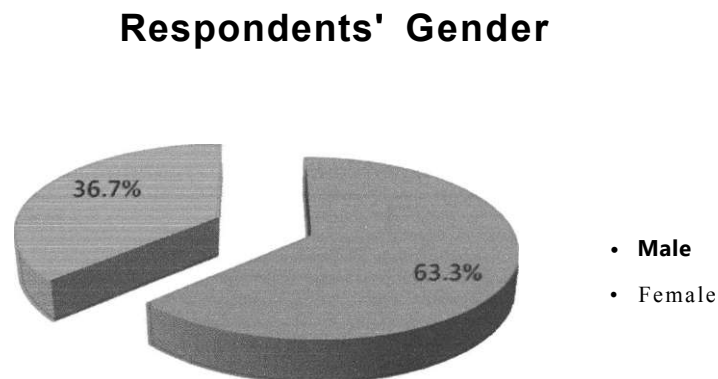
DATA ANALYSIS RESULTS AND DISCUSSION

4.1 Introduction

This chapter presents the quantitative analysis of data collected from pension funds in Kenya. It gives the findings from the questionnaires and other observations that were encountered during the fieldwork. The data has been categorically analyzed to give clear and vivid findings of the study. The study targeted a total of 70 employees of pension funds, there was 90% response rate since 63 respondents filled and returned the questionnaires.

4.2 Demographic Information of the Respondents at the pension funds

Figure 4.1: Respondents Gender



The researcher sought to determine the ages of the respondents, from the findings on figure 4.1, 63.3% are male while 36.7% are female implying that the gender distribution of employees at the individual pension schemes is not balanced.

Table 4.1: Ages of the Respondents

Age Bracket	F	%
18- 24 years	.	.
25-34 years	21	33.3
35-44 years	31	49.2
45-54 years	8	12.7
Over 55 years	3	4.8
Total	63	100.0

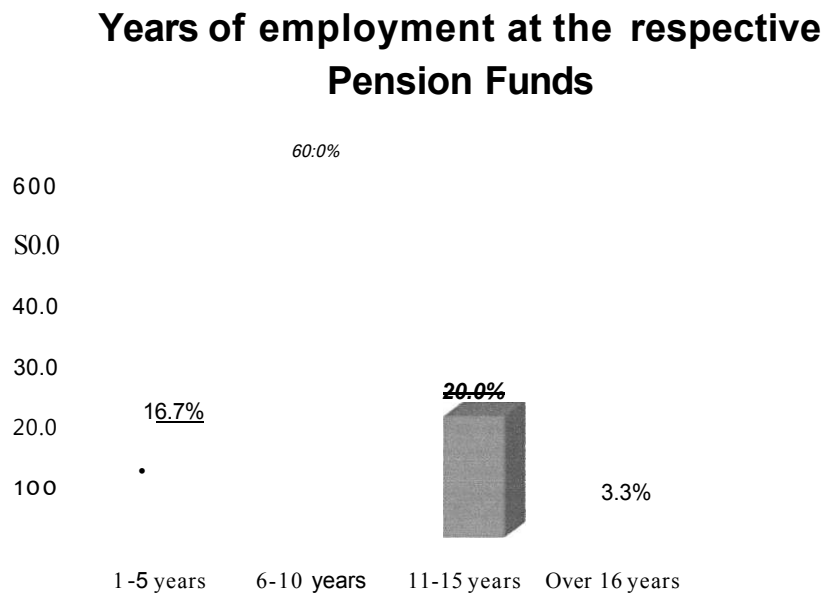
Findings on Table 4.1 revealed that majority of the respondents 31(49.2%) were aged between 35-44 years, 21(33.3%) between 25-34 years and 8(12.7%) between 45-54 years. This shows that majority of the respondents were mature with appropriate work experience and therefore they were well versed with growth in the individual pension scheme which was needed for the study.

Table 4.2: Respondents' Education level

Age Bracket	F	%
Diploma	.	.
Bachelors Degree	34	53.9
Masters Degree	25	39.7
PHD	4	6.4
Total	63	100.0

Findings on table 4.2 reveal that majority 34(53.9%) of the respondents had Bachelors degree, 25(39.7%) master degree. However 4(6.4%) have PhD. Degrees, this suggests that the respondents were well conversant with the issues relating to the factors affecting the growth of individual pension scheme and therefore they gave accurate and relevant information needed for the study.

Figure 4.2: Years of employment at the respective pension funds



The Findings on figure 4.2 reveal that majority of the respondents (60.0%) have worked at the respective pension schemes for a period of 6-10 years, while 20.0% have worked for 11-15 years, this implies that the respondents were well conversant with the operations of the pension schemes and therefore they gave the correct and accurate information the researcher needed for needed for the study.

Table 4.3: Factors influencing members' savings

	Mean	SD	N
Low incomes earned	4.606	0.846	63
Lack of incentives	4.823	0.243	63
Economic hardships	3.451	0.341	63
Low returns on savings	4.588	1.025	63
Lack of awareness and education	3.697	0.234	63
Lack of formal employment	4.756	0.846	63
Social culture influence	3.683	0.263	63
High dependency of old age family members.	3.745	0.703	63
Lack of confidence in individual pension schemes	4.728	0.425	63
Delays in payment of retirement benefits by individual pension schemes	3.697	0.845	63
Current legislation of pension benefits.	3.945	0.445	63

The researcher to establish the factors that influences savings for retirement in the individual pension schemes, the respondents were instructed to respond to the statements on a 5 point Likert scale and indicate the extent they consider the statements important that is: 5-very important, 4-important, 3-fairly important, 2-less important 1-not important. A mean (M) score of 0-1.5 means that the respondents indicated 'not important', between 1.50 to 2.50-less important, 2.50 to 3.50-fairly important, 3.50-4.50-important, and a mean above 4.50 means the respondents indicated 'very important.' From the findings on table 4.3, the respondents considered the following factors as important in influencing members saving for retirement in the individual pension schemes. Low incomes earned (M=4.606;SD=0.846), Lack of incentives (M=4.823;SD=0.243), Low returns on savings (M=4.823;SD=1.025), Lack of confidence in individual pension schemes (M=4.728;SD=0.425).

Table 4.4: Fund governance

Fund governance	Mean	SD	N
The CEO's leadership of the pension scheme	4.564	0.984	63
Continuous education to trustees by the pension scheme	3.838	0.574	63
Effective communication to members by the pension scheme	4.550	0.756	63
The pension scheme's ability to avoid conflict of interest in decision-making	4.823	1.342	63
The pension scheme monitoring the performance of service providers	3.973	0.645	63
The pension scheme clearly defining the roles of trustees	4.544	0.923	63
The pension scheme maintaining an effective performance measurement system	4.803	0.274	63
The scheme outsourcing specialized fund management functions	3.456	0.723	63
The pension fund using competitive bidding in appointing service providers	4.787	0.345	63

The researcher sought to determine the extent to which fund governance affects the growth of individual pension schemes in Kenya, the respondents were instructed to respond to the statements on a 5 point Likert scale and indicate the extent they agree with the statements that is. 1 = very low extent; 2 = low extent; 3 average extent; 4 = Great extent; 5 = very great extent. Based on the findings on table 4.4, the factors that the respondents considered to affect the growth of individual pension schemes included. The CEO's leadership of the pension scheme (M=4.564;SD=0.984), effective communication to members by the pension scheme(M=4.550;SD=0.756), the pension scheme's ability to avoid conflict of

interest in decision-making (M=4.823;SD=1.342),the pension scheme maintaining an effective performance measurement system (M=4.803;SD=0.274), The pension fund using competitive bidding in appointing service providers (M=4.787;SD=0.345).

Table 4.5: Fund Regulations

Fund regulations	Mean	Standard Deviation	N
The existence of RBA as a retirement benefits regulator	4.762	0.984	63
RBA's regulation of fees charged by service operators	4.834	0.270	63
Tax on non-exempt incomes of pension fund members as imposed by the Kenyan Revenue Authority	3.454	0.705	63
The scheme's compliance with RBA levies	4.883	1.030	63
The schemes' regulatory meetings (4 per year) with the service providers as stipulated by RBA	4.471	0.673	63
The application of a risk based approach adopted by RBA in the supervision of pension funds	4.560	0.845	63
Adherence of RBA financial reporting regulations	4.538	0.463	63
The risk tolerance limits imposed by the RBA	3.455	0.348	63

The researcher sought to determine the extent to which regulatory factors affect the growth of individual pension schemes in Kenya, the respondents were instructed to respond to the statements on a 5 point Likert scale and indicate the extent they agree with the statements that is 1 = very low extent; 2 = low extent; 3 average extent; 4 = Great extent; 5 = very great extent. Based on the findings on table 4.6, the regulatory factors that affects the growth of individual pension schemes in Kenya include: The existence of RBA as a retirement benefits regulator (M = 4.764; SD=

0.984), the scheme's compliance with RBA levies (M=4.883;SD=1.013), the application of a risk based approach adopted by RBA in the supervision of pension funds (M=4.560;SD=0.845), adherence of RBA financial reporting regulations (M=4.538;SD=0.463).

Table 4.6: Operational Efficiency

Operational	Mean	Standard Deviation	N
The administration costs being incurred by the scheme	2.565	0.456	63
The adherence of benefits processing period stipulated by RBA	3.833	0.463	63
The usage of an effective internal control system by the scheme	4.554	0.234	63
The time being spent in trustee meetings	4.884	0.425	63
The efficiency of benefits processing system being used by the scheme	3.976	0.734	63
Member involvement in decision-making	4.562	0.845	63
Regular training of employees	4.836	0.552	63
Constantly monitoring the level of funding (the ratio between schemes liabilities and assets)	3.453	0.923	63
The scheme complying with RBA regulations to minimize compliance costs	4.782	0.425	63

From the findings on table 4.6, the factors that are very important for operational efficiency in the individual pension schemes as indicated by the respondents include: The usage of an effective internal control system by the scheme (M=4.554;SD=0.234), the time being spent in trustee meetings(M=4.884;SD=0.425), member involvement in decision-making(M=4.562;SD=0.845), rregular training of

employee(M=4.836;SD=0.552), and the scheme complying with RBA regulations to minimize compliance costs(M=4.782;SD=0.425).

Table 4.7: Investment strategy

Investment strategy	Mean	Standard Deviation	N
Schemes' guidelines which doesn't restrict investments in any company	4.564	0.436	63
The scheme investment committee making investment decisions	3.832	0.243	63
Trustees being covered by a liability insurance	3.458	0.347	63
More investment in fixed interest securities (bonds and Treasury bills) than equities.	4.682	1.042	63
RBA rules on investment portfolio	3.970	0.345	63
The Scheme conducting independent confirmation of the rates given by the fund managers	4.563	0.245	63
The implementation of a risk management policy in place	3.834	0.563	63
Adopting investment strategies which are based on the findings of market research conducted by fund managers	3.453	0.341	63
Setting of quarterly targets on investment returns and strategize to achieve them	4.804	0.425	63
Having clear investment policy that is strictly implemented	3.975	0.345	63
Trustees giving total investment discretion to the fund managers	4.830	0.925	63

The researcher sought to determine the extent to which certain factors on investment affect the growth of individual pension schemes in Kenya, the respondents were instructed to respond to the statements on a 5 point Likert scale and indicate the extent they agree with the statements that is 1 = very low extent; 2 = low extent; 3 average extent; 4 = Great extent; 5 = very great extent. Based on the findings on table 4.7, the following factors were considered by the respondents to affect the growth of pension funds: Schemes' guidelines which doesn't restrict investments in any company (M=4.564; SD=0.436), more investment in fixed interest securities (bonds and Treasury bills) than equities (M=4.682; SD=1.042), setting of quarterly targets on investment returns and strategize to achieve them (M=4.804; SD=0.425), trustees giving total investment discretion to the fund managers (M=4.830; SD=0.925).

Table 4.8: Fund Ethics

Fund ethics	Mean	Standard Deviation	N
Ensuring confidentiality in all tinst matters	4.716	0.845	63
The scheme having a code of conduct that is strictly adhered to	4.803	0.463	63
Honestly sharing scheme's information with the members	4.440	0.341	63
Complying with the requirements by all the stakeholders	4.883	0.425	63
Avoiding Bias in decision making	3.974	0.734	63
Withholding the truth when the pension fund has experienced losses due to poor investment or weak policies	4.882	0.425	63
Proper utilization of authority by trustees	4.645	0.345	63

The researcher sought to establish the extent to which some factors related to fund ethics affect the growth of individual pension schemes in Kenya, the respondents were instructed to respond to the statements on a 5 point Likert scale and indicate the extent they agree with the statements that is 1 = very low extent; 2 = low extent; 3 average extent; 4 = Great extent; 5 = very great extent. From the findings on table 4.6, the respondents indicated that the following factors influence the performance of individual pension schemes to a very great extent since the factors had mean scores above 4.5. Ensuring confidentiality in all trust matters (SD=4.716;SD=0.845), the scheme having a code of conduct that is strictly adhered to (M=4.803;SD=0.463), complying with the requirements by all the stakeholders (M=4.883;SD=0.425), withholding the truth when the pension fund has experienced losses due to poor investment or weak policies (M=4.882;SD=0.425), proper utilization of authority by trustees (M=4.645;SD=0.345).

Regression Analysis

The model was as follows:

$$Y = P_0 + P_1 X_1 + p_2 x_2 + p_3 x_3 + P_4 X_4 + p_5 x_5 + E \text{ Where :-}$$

Y = Growth of individual pension schemes (Dependant variable)

$P_0 + P_1 X_1 + p_2 X_2 + p_3 X_3 + p_4 X_4 + p_5 X_5$ = Explained Variations of the Model.

E = Unexplained Variation i.e. error term.

X_1 = Fund governance

= Fund regulations

X_3 = Operational Efficiency

X_4 = Investment strategy

X_5 = Pension fund ethics

Po = Constant. It defines value of growth of individual pension schemes without inclusion of predictor variables.

4.2.1: Strength of the Model

The model arrived at was a suitable one since the presence of all the five factors influencing the growth of IRS. Analysis in table 4.9 shows that the coefficient of determination (the percentage variation in the dependent variable being explained by the changes in the independent variables) R^2 equals 0.843, that is, fund governance, fund regulations, operational efficiency, investment strategy and pension fund ethics leaving only 15.7 percent unexplained. The P- value of 0.000 (Less than 0.05) implies that the model of service delivery is significant at the 5 percent level of significance.

Table 4.9: Model Summary

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.896 ^a	.843	.974	2.04756

ANOVA						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	94.234	4	23.376	79.730	.000 ^a
	Residual	63.649	56	.292		
	Total	146.783	60			

a. Predictors: (Constant), fund governance, fund regulations, operational efficiency, investment strategy and pension fund ethics

b. Dependent Variable: Growth of individual pension schemes.

Source: Research data 2012

ANOVA findings (P- value of 0.00) in table 4.9 show that there is correlation between the predictor's variables (fund governance, fund regulations, operational efficiency, investment strategy and pension fund ethics) and response variable (growth of individual pension schemes). An F ratio is calculated which represents the variance between the groups, divided by the variance within the groups. A large F ratio indicates that there is more variability between the groups (caused by the independent variable) than there is within each group, referred to as the error term.

Table 4.10: Coefficients of regression equation

Coefficients¹

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	.240	.058		.930	.354
Fund governance	.896	.077	.297	3.798	.000
Fund regulations	.735	.070	.188	3.290	.001
Operational Efficiency	.913	.062	.013	.215	.001
Investment strategy	.851	.077	.406	5.445	.000
Pension fund ethics	.434	.034	.673	.982	.000

a. Dependent Variable: Growth of individual pension schemes

Source: Research data 2012

The established multiple linear regression equation becomes:

$$Y = 0.240 + 0.896X_1 + 0.735X_2 + 0.913X_3 + 0.851X_4 + 0.434X_5 + 2.04756$$

Where

Constant = 0.240, this implies that without the existence of predictors, the growth of individual pension schemes in Kenya will be 0.240 units. That means the coefficients of fund governance, regulations, investment strategy, operational efficiency and fund ethics will be zero thus has no influence on the growth at all.

$X_1 = 0.896$, implies that one unit change in fund governance results in 0.896 units increase in growth of individual pension schemes

$X_2 = 0.735$, implies that one unit change in fund regulations results in 0.735 units increase in growth of individual pension schemes

$X_3 = 0.913$, implies that one unit change operational Efficiency results in 0.913 units increase in growth of individual pension schemes

$X_4 = 0.851$, implies that one unit change in investment strategy results in 0.851 units increase in growth of individual pension schemes

$X_5 = 0.434$, implies that one unit change in Pension fund ethics results in 0.434 units increase in growth of individual pension schemes

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter provides a discussion of the findings reported in chapter four, the conclusions of the study are drawn and recommendations made. The chapter further presents the suggestions for future research.

5.2 Summary of the Findings

The findings of the study reveal that the regulatory factors that affects the growth of individual pension schemes in Kenya include, the existence of RBA as a retirement benefits regulator (M=4.764;SD=0.984), the scheme's compliance with RBA levies (M=4.883; SD=1.013), the application of a risk based approach adopted by RBA in the supervision of pension funds (M=4.560; SD=0.845), and adherence of RBA financial reporting regulations (M=4.538; SD=0.463). The results suggest that convening regulatory meetings influence operational efficiency in the individual pension schemes significantly. The Kenyan RBA (2008) stipulates statutory meetings of pension fund trustees with administrators, fund managers and custodians of importance in pension fund management. These meetings are held quarterly to evaluate the quarterly financial performance of the pension fund. The empirical results suggest that respondents view these meetings as an important factor in achieving growth in the individual pension schemes in Kenya.

The factors that affect the growth of pension funds based on the findings include: Schemes' guidelines which doesn't restrict investments in any company (M=4.564;SD=0.436), more investment in fixed interest securities (bonds and Treasury bills) than equities (M=4.682;SD=1.042), setting of quarterly targets on investment returns and strategize to achieve them (M=4.804;SD=0.425), trustees giving total investment discretion to the fund managers (M=4.830;SD=0.925).The results suggest that there is a lack of leadership in Kenyan pension schemes or a lack of understanding of how pension schemes should be led. This could indeed be the case given the hurdles in today's business environment.

Under fund governance, the following factors were noted to be the major determinants of growth of individual pension schemes: The CEO's leadership of the pension scheme (M=4.564; SD=0.984), effective communication to members by the pension scheme (M=4.550; SD=0.756), the pension scheme's ability to avoid conflict of interest in decision-making (M=4.823; SD=1.342), the pension scheme maintaining an effective performance measurement system (M=4.803; SD=0.274), The pension fund using competitive bidding in appointing service providers (M=4.787; SD=0.345).The presence of the CEOs in the board of trustees makes them the default leaders on pension scheme matters because all other trustees are subordinate to the CEOs. This means that the CEOs can easily influence the pension scheme decisions and the agenda in the board of trustees' meetings. It was established that pension schemes that maintain the CEOs as the pension schemes board's chair, record lower efficiency levels compared to those that the CEO takes a lesser active role.

The findings of the study showed that fund governance exert a significant relationship on the growth of the pension schemes. This means that pension fund governance lead to improved growth of the individual pension schemes. The result further shows that

reducing the benefits processing period, providing relevant education to the trustees, maintaining an appropriate internal control system, communicating regularly with members, defining the roles of the trustees clearly, regulating the fees charged by the service providers, controlling default risk on the part of the sponsor and implementing investment strategies that are major factors that influence the growth of individual pension schemes in Kenya.

The results revealed that fund regulations exert a significant relationship on the growth of individual pension schemes. This implies that the implementation of the following regulations improve the performance of individual pension schemes: monitoring of performance of the service providers; regulation of compliance costs; limiting the size of the pension fund board; conducting regulatory meetings; the separation of fund ownership from the sponsor's business; and the investment policy. The results further suggest that the implementation of a clear investment policy influence the growth of individual of pension schemes significantly. This result support the assertion of the OECD (2006) that a pension fund's investment policy reflects its investment strategy and dramatically affects pension scheme returns. Pension scheme returns are dependent on a proper investment strategy as all pension scheme assets are held in the form of investments (equities, bonds, bank deposits and real estate).

5.3 Conclusions

Based on the study, it can be concluded that the performance of pension schemes in Kenya, with regard to return on investment, is not sustainable owing low levels of growth against a backdrop of high overall inflation, the after-effects of the global financial and economic crisis, the inadequate legal and regulatory environment and

the incapacity challenges of the industry regulator to monitor and enforce governance, and investment guidelines for individual pension schemes and fund managers.

Some of the current prescriptive pension regulations, including quantitative asset restrictions on investment are only effective in the short run, but have proved ineffective in the long-term. The results can be interpreted to imply that regulations imposing quantitative limits on different asset classes reduce the set of otherwise admissible investment policies with consequential effect on return on investments.

5.4 Recommendations

The Regulator needs to implement measures to ensure that the individual pension schemes are insulated from inflationary and other risks to facilitate their growth. An effective way is to institute a pension risk insurance fund that will underwrite and compensate such losses as will be prescribed. Further, there is need for a systematic indexation of benefits to inflation.

The RBA should enhance its regulatory capacity of the industry in order to ensure compliance among pension schemes and fund managers. An evaluation should be conducted in order to map out areas, roles and departments that should be enhanced. Specifically, the authority needs to strengthen its compliance and enforcement function in order to ensure that it appropriately deals with emerging present and future regulatory challenges. The RBA also needs to move away from proactive supervision of schemes toward a more risk based supervision approach. The primary areas of risk once a scheme is properly set up in compliance with the law are: financial loss of funds; violation of member protection regulations; inefficiencies that increase costs or reduce returns to member's; and poor quality of service to members or beneficiaries. Investment regulations should be reviewed to enhance growth of the sector. The

investment policy of fund managers should ensure that the retirement benefits are ahead of inflation.

Fund managers should develop good systems to mitigate on the enormous risks they face in their duty as investment managers. Scheme Trustees should be trained in risk management in order to oversee the schemes' investments.

The government should enhance and provide substantial tax incentives to stimulate growth in the industry. The effort by the government to give tax incentives to retirement benefit schemes is commendable; however, the current tax limits on contributions and benefits are too low- contributions to registered retirement benefits schemes are tax deductible from gross income of a maximum of Ksh 20,000 per month.

5.5 Limitations

The issue of collection data collection in all head offices of all the 22 IRS in three weeks was the greatest challenge. Seven respondents failed to filled and returned the questionnaires on time thus affect the efficiency and effectiveness of the study.

5.6 Suggestion for Future Research

Various restrictions exist on portfolios of pension schemes, while these might appear at first glance to be regulatory constraints, which unambiguously lower consumer welfare, the issues of investment freedom and solvency regulation for pension funds can be quite intertwined. The study on growth of IRS should involve secondary data from RBA as well. Future research should therefore focus on this area.

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APPENDICES

APPENDIX I

QUESTIONNAIRE

The aim of this questionnaire is to establish the factors affecting the growth of individual pension schemes in Kenya. This is part of a study am doing at the University of Nairobi for the award of the degree of Masters in Business Administration. Please respond to the questions honestly by ticking the most appropriate responses.

PART A: Background Information

1. Gender • Male • Female

2. Age
(Tick where appropriate)
• 18-24 years • 25-34 years • 35-44 years • 45-54 years DOver
55 years []

3. Education level
(Tick where appropriate)
• Bachelors Degree • Masters Degree • PHD DAny other
(specify)

4. How many years have you worked for an individual pension scheme?

(Tick where appropriate)
• 1-5 years • 6-10 years • 11-15 years DOver 16 years

5. Please indicate the category you fall under.
(Tick where appropriate)
Trustee • Staff •

PART B: Organization Profile

6. Is your pension scheme sufficiently funded?

Yes • • No

7. Are individual pension schemes affected by underfunding in terms of their development?

Yes No I do not know

8 Who are your majority clients?

Company employed based informal sector based.

9. Which of the following factors influences members from saving for retirement in an individual pension scheme? *Please rank them in order of importance.*

Key (1) very important (2) important (3) fairly important (4) less important (5) not important

Factor	Rating				
Low incomes earned					
Lack of incentives					
Economic hardships					
Low returns on savings					
Lack of awareness and education					
Lack of formal employment					
Social culture influence					
High dependency of old age family members.					
Lack of confidence in individual pension schemes					
Delays in payment of retirement benefits by individual pension schemes					
Current legislation of pension benefits.					

10. What are the measures the management has put in place to ensure there is an effective growth in your pension scheme. *Please explain;*

PART C: Factors Affecting the Growth of Pension Schemes

11. Fund Governance

Indicate the extent to which the following issues on governance affect the development of Individual Pension Schemes in Kenya. Please use a scale of 1 to 5 where;

1 = Very low extent; 2 = Low extent; 3 Average extent; 4 = Great extent; 5 = Very great extent

Fund governance	1	2	3	4	5
The CEO's leadership of the pension scheme					
Continuous education to trustees by the pension scheme					
Effective communication to members by the pension scheme					
The pension scheme's ability to avoid conflict of interest in decision-making					
The pension scheme monitoring the performance of service providers					
The pension scheme clearly defining the roles of trustees					
The pension scheme maintaining an effective performance measurement system					
The scheme outsourcing specialized fund management functions					
The pension fund using competitive bidding in appointing service providers					

12. Fund Regulations

Please indicate the extent in which the following regulator}'factors promote the growth of individual pension schemes in Kenya. Please use a scale of 1 to 5 where;

1 = Not at all 2 = Little extent 3 = Moderate 4 = Great extent 5 = Veiy great extent

Fund regulations	1	2	3	4	5
The existence of RBA as a retirement benefits regulator					
RBA's regulation of fees charged by service operators					
Tax on non-exempt incomes of pension fund members as imposed by the Kenyan Revenue Authority					
The scheme's compliance with RBA levies					
The schemes' regulatory meetings (4 per year) with the service providers as stipulated by RBA					
The application of a risk based approach adopted by RBA in the supervision of pension funds					
Adherence of RBA financial reporting regulations					
The risk tolerance limits imposed by the RBA					

13. Operational Efficiency

Do you agree with the following statements influences the growth of individual pension schemes in Kenya? Please rank them in order of importance where,

1 = Not important 2 = Less important 3 = Fairly important 4 = Important 5 = Very important

Operational	1	2	3	4	5
The management of administration costs being incurred by the scheme					
The adherence of benefits processing period stipulated by RBA					
The usage of an effective internal control system by the scheme					
The time being spent in trustee meetings					
The efficiency of benefits processing system being used by the scheme					

Member involvement in decision-making					
Regular training of employees					
Constantly monitoring the level of funding (the ratio between schemes liabilities and assets)					
The scheme complying with RBA regulations to minimize compliance costs					

14. Investment Strategy

Please indicate the extent in which the following factors on investment promote the growth of individual pension schemes in Kenya; Please use a scale of 1 to 5 where;

1 = Not at all 2 = Little extent 3 = Moderate 4= Great extent 5 = Very great extent

Investment strategy	1	2	3	4	5
Schemes' guidelines which doesn't restrict investments in any company					
The scheme investment committee making investment decisions					
Trustees being covered by a liability insurance					
More investment in fixed interest securities (bonds and Treasury bills) than equities.					
RBA mles on investment portfolio					
The Scheme conducting independent confirmation of the rates given by the fund managers					
The implementation of a risk management policy in place					
Adopting investment strategies which are based on the findings of market research conducted by fund managers					
Setting of quarterly targets on investment returns and strategize to achieve them					
Having clear investment policy that is strictly implemented					
Trustees giving total investment discretion to the fund managers					

15. Fund Ethics

Please indicate the extent to which you agree with the following statements that, it influences positively to the development of individual pension scheme sub-sector in Kenya. Please use a scale of 1 to 5 where;

1 = Not at all **2** = Little extent **3** = Moderate **4** = Great extent **5** = Very great extent

Fund ethics	1	2	3	4	5
Ensuring confidentiality in all trust matters					
The scheme having a code of conduct that is strictly adhered to					
Honestly sharing scheme's information with the members					
Complying with the requirements by all the stakeholders					
Avoiding Bias in decision making					
Withholding the truth when the pension fund has experienced losses due to poor investment or weak policies					
Proper utilization of authority by trustees					

APPENDIX II

INDIVIDUAL PENSION PLAN PROVIDERS

1. Amana Personal Pension Plan
2. Alexander Forbes Vuna Pension Plan
3. Apollo Insurance Company Limited Individual Retirement Benefits Scheme
4. Blue Shield Personal Pension Fund
5. British - American Insurance Company (Kenya) Limited - Individual Provident Fund
6. British American Insurance Company (Kenya) Limited Individual Retirement Benefits Fund
7. CFC Life Assurance Limited Individual Pension Plan
8. CFC Life Assurance Limited Individual Provident Fund Scheme
9. ICEA Individual Retirement Benefits Scheme
10. Jubilee Insurance Company Ltd Personal Pension Plan
11. Kenindia Assurance Company Ltd. Personal Pension Plan
12. Madison Insurance Personal Pension Plan
13. Octagon Personal Pension Scheme
14. Pan Africa Life Personal Pension Plan
15. Pioneer Assurance Company Limited Personal Pension Scheme
16. Prudential Personal Pension Plan 17 The Heritage A.
17. I.I. Insurance Company Limited Individual Retirement Fund
18. The Kenya Alliance New Life Individual Retirement Benefits Scheme
19. The Monarch Insurance Company Individual Pension Plan
20. UAP Provincial Insurance Company Limited - Individual Retirement Benefits Plan
21. Zimele Guaranteed Personal Pension Plan
22. Zimele Personal Pension Plan



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14th September, 2012

TO WHOM IT MAY CONCERN

Dear Sir/Madam,

INTRODUCTORY LETTER

KIPKOECH CHARLES- REGISTRATION NO.D61/6Q117/2010

The above named is a bona fide MBA student at the School of Business, University of Nairobi. He would like to carry out a research on topic "*determinants of growth of individual pension schemes in Kenya*" in your organisation.

We request your organisation to assist the student with necessary data which forms an integral part of his research project.

The information and data required is needed for academic purposes only and will be treated in **Strict-Confidence**. A copy of the research project will be made available to your organization/firm upon request.

Your co-operation will be highly appreciated.

Thank you.

A handwritten signature in black ink, appearing to read 'Francis K. KMN PIT', written over a faint, illegible stamp.

FRANCIS K. KMN PIT
FOR: DEAN, SCHOOL OF BUSINESS

Fk/co