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DETERMINANTS OF FINANCIAL GROWTH OF RETIREMENT BENEFITS IN KENYA: A CASE OF OCCUPATIONAL RETIREMENT SCHEMES

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Abstract

Pension fund is a pool of resources contributed by the employees with the aim of having enough resources to cater for their needs after retirement. Therefore, pension fund needs to be invested so as to meet the aim of the contributors. The study sought to investigate the determinants of financial growth of retirement benefits in Kenya, with a focus on occupational retirement schemes. The specific objectives were to examine the influence of the investment strategy, members' contribution, regulatory framework and demographics on the financial growth of retirement benefits in Kenya. The study adopted a descriptive research methodology. The study targeted the occupational pension schemes which included both defined contributions and defined benefits. The unit of analysis was the fund managers; the target population was 1216 while the sample was 291. Stratified random sampling was applied. Data was collected with the aid of questionnaires. Data was analyzed through descriptive and inferential statistics, through help of SPSS version 20. The study found out that investment strategy, members contribution and regulatory framework were key determinants of financial growth of occupational retirement schemes in Kenya. The three determinants were found to have a positive and significant relationship with the financial growth of occupational retirement schemes. The study concludes that investment strategies employed by the schemes have the potential to enhance financial efficiency and generate the highest possible returns in the pension fund. Members' contributions are also a major determinant to financial growth of retirement benefits. The study recommends that there is also need to put the contributions of pensioners to more productive investments other that just keeping the funds safely for the pensioners. There is also need to utilize assets and members contributions to generate income for the pension funds. The pension funds should use the increasing value of their funds to generate returns for the pensioners.

Key Words: *Retirement Benefits, Financial Growth, Occupational Retirement Schemes, investment strategy, members contribution, demographics, regulatory framework*

1. Introduction

Pension schemes are big investors which play a central role in ensuring the effectiveness, liquidity and robustness of capital markets around the world (Clark, Morril & Allen, 2010). Pension funds play an important part in provision of adequate income in retirement. They are also important players in the wider economy, given their large asset and liability bases thus it is in the public interest that they be managed efficiently and effectively, as well as in the interest of their beneficiaries and sponsors (Kemp & Patel, 2011). In the recent past, many countries around the globe have experienced rapid establishment and growth of pension funds. The growth of these institutions is one development that countries have given considerable attention because of the sensitivity of the transactions involved in pension funds. Pension funds act as an important stimulus to capital markets in most countries where they exist through financial intermediation. Pension funds tend to complement, and hence stimulate development of capital markets, while acting as substitutes for banks. Growth of pension funds is also the consequence of a number of non-financial and demand-side features (Davis, 2010).

The need for better managed pension funds in many countries has been necessitated by growing populations around the world. Most countries both developed and developing are experiencing increasing longevity in life expectance and reduced fertility rates that seem to threaten the sustainability of traditional pay-as-you-go pension systems. The pension contributions from the working population will not be sufficient to support the elderly. In response, countries are increasingly shifting their pension systems toward partial or full funding. In addition to the main purpose of coping with demographic pressures and unsustainable fiscal positions, other motivations for countries to reform their pension systems often include the hope that funded pensions will contribute to economic development by promoting national savings and capital market development (Meng & Pfau, 2010).

Kenya's pension fund system embraces four components namely the NSSF, Civil Servants Pension Scheme (CSPS), Occupational Retirement Schemes (ORS) and Individual Retirement Schemes (Raichura, 2008). 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 to develop the industry and advise the government on pension policy reforms (Ngetich, 2012). The enactment of the Retirement Benefits Act (‘RBA’) (1997) and the establishment of the Retirement Benefits Authority (‘the Authority’) in 2000 marked the beginning of a regulated, organized and more responsible retirement benefits sector in Kenya. Through the regulatory framework and policies, new legislation since then has been founded on the following two tenets: improvement of protection of member’s benefits and improved governance of schemes (Raichura, 2008).

Pension schemes play an important role in breaking intergenerational poverty cycles and thus increase the life expectancy of the elderly generation (Keizi, 2007). Over the last decade, Kenya has also undertaken a major reform of parts of its pension system. Whereas the primary motivation for reform of pension systems in many countries worldwide has been to address the growing fiscal burden of pension liabilities, in Kenya the major driver for reform was to strengthen the governance, management and effectiveness of the existing pensions system (Raichura, 2008).

Despite the reforms, the pension schemes in Kenya however have been characterized by rampant mismanagement and misappropriation of funds that led to underperformance. This has ultimately contributed to the low growth of the pension schemes. In addition, the management strategies employed by the Kenyan fund managers have been questioned which points to the efficiency in application of corporate governance practices in the pension schemes (Brunner, Hinz & Rocha, 2008). According to RBA (2010) most of the pension schemes in Kenya are grossly under-funded while others have poor investment strategies resulting to lack of prudence in the investment of pensioner's funds. In addition, the gross financial inefficiency that characterized most pension schemes in Kenya have resulted to higher costs of operation, low returns on investment and in extreme cases to the demise of the funds (Bikker & Dreu, 2009). Low investment returns and the closure of pension funds reduce the latter's contribution to the GDPs of countries. Bearing in mind that the Kenyan Pension industry remains a significant growth area, it is essential to examine the determinants that could hinder the industry's in order to meet the ever changing scheme member needs.

Despite the studies carried out on performance of organizations and pension funds, few studies have attempted to establish the factors affecting the financial growth of retirement benefits in Kenya: a study of occupational retirement schemes. Oluoch (2013) conducted a study on the determinants of performance of pension funds in Kenya. This study focused on all the schemes thus presenting a scope gap. The current study will focus on occupational schemes only. Ngetich (2012) carried out a study on determinants of the growth of individual pension schemes in Kenya. The study focused on all the individual pension schemes thus presenting a scope gap. Shikhule *et al.* (2012) also conducted a study on determinants of pension schemes governance effectiveness in Kenya. The study did not look at occupational schemes, which was the focus for this study. The current study therefore sought to examine the determinants of financial growth of retirement benefits in Kenya: a case of occupational retirement schemes.

2. Objectives of the Study

The general objective of the study was to examine determinants of financial growth of retirement benefits in Kenya: a case study of occupational retirement schemes.

The study was guided by the following specific objectives:

i. To examine the influence of the investment strategy on the financial growth of retirement benefits in Kenya.
ii. To determine the influence of members contribution on financial growth of retirement benefits in Kenya.
iii. To establish the influence of regulatory framework on the financial growth of retirement benefits in Kenya.
iv. To assess the influence of the demographics on the financial growth of retirement benefits in Kenya.

3. Empirical Literature Review

A review of the existing empirical literature shows that a there has been great interest by researchers and scholars on growth and performance of retirement benefits schemes and especially in developing economies. For instance, Musembi (2014) conducted a study on factors influencing asset growth of retirement benefits schemes: a case of CFC life assurance managed schemes. This study focused on retirement schemes in Kenya where retirement income accounts for 68% of the total income of retirees. The study revealed a positive relationship between fund governance, risk management, investment strategy and size of the fund all collectively have a positive relationship to growth of retirement scheme assets. The study found that investment strategy, risk management and size of the fund have a strong influence on growth of the fund while fund governance does not exert significant relationship to the growth of the fund assets.

Njeru (2014) conducted a study on the effects of regulations on financial performance of the retirement benefits funds in Kenya. The study revealed that there was a positive relationship between financial performance of retirement funds and liquidity of the scheme, the study also found that there was negative relationship between financial of retirement benefits fund and scheme expense ratio and financial distress or vulnerability. The study found that regulations affects the financial performance of retirement benefits funds in Kenya, thus the study concludes that since the enactment of the Retirement Benefits Authority Act, there has been significant growth in performance of retirement benefits fund. The relationship between regulatory changes and financial performance of pension schemes in Kenya is unidirectional and runs from regulatory changes to performance and not vice versa. The study further concluded that regulatory changes have a significant influence on the performance of pension schemes in Kenya as the results have passed significance tests.

Muathe (2014) conducted a study on the effects of corporate governance practices on the growth of pension schemes in Kenya. The findings showed that the members of the pension schemes receive inaccurate information which led to inappropriate decisions; late payment of contributions was also evident which led to delay or inaccuracies in payment of benefits. In addition, the existing IT system was found to be insufficient to handle the financial transactions effectively.

Kiprotich (2012) conducted a study on determinants of retirement benefits schemes financial performance in Kenya. The study sought to examine the determinants of retirement benefits scheme financial performance in Kenya through the use of regression model that related the determinants and retirement benefits schemes financial performance in Kenya. The findings of the study shows that portfolio management strategies, risk of asset class, selectivity and timing had a positive relationship with the schemes financial performance. This implies that how well the retirement benefits schemes manage their portfolios and risks, how well they choose the investment to invest on and the timing determines the performance and growth of the schemes.

On the influence of the demographics on the financial growth of retirement benefits, Lungu (2009) found out that the age of a contributor to a pension fund is very significant in determining its performance. If a pension fund has majority young contributors who have not attained retirement age, it implies that they will have more financial resources that can be channeled into investment activities thus earning more income. On the other hand if most of the contributors are old and almost attaining retirement, the fund has to spend more funds to service retirement packages for the contributors and this implies there will be less funds available for investments.

4. Materials and Methods

This study adopted descriptive research design. The research design was deemed fit for the study as it facilitated collection of information and opinions to portray accurate current facts through data collection or answering questions to conclude the study. This study population consisted of 1216 occupational schemes operating in Kenya, which were categorized into 101 Defined Benefits schemes and 1115 Defined Contributions schemes. The sample size of the study was 291 fund managers of registered pension schemes in Kenya who were selected using stratified random sampling which. This method was used because the sample represented the target population and eliminated sampling bias.

This study used both primary data and secondary data. Primary data was collected using structured questionnaires which had both close ended and open ended questionnaires. The secondary data for this was collected from the annual financial statements of the pension funds. The collected data was thoroughly examined and checked for completeness, cleaned, coded and entered in the Statistical Package for Social Sciences (SPSS Version 20) for analysis. The data was analyzed through descriptive and inferential statistics. Descriptive statistics included means, standard deviation, frequency and percentage distribution were used to analyze the data. In inferential statistics, a linear regression model was used to establish the relationship between the study variables.

5. Results and Discussion

5.1 Investment Strategy and Financial Growth of Retirement Benefits

The study results in Table 1 shows that the respondents agreed that the schemes had an appropriate investment mix of the pension fund, to balance between investment risks and returns (mean score = 4.32). The respondents also agreed that the investment portfolio had continually grown over the years; as shown by the mean score 4.26. The respondents also agreed that the investment strategies employed by the schemes enhanced financial efficiency of the pension fund; and that the current investments generated the highest possible returns; as shown by a mean score of 4.10 and 3.97 respectively. The respondents further agreed that the investment options adopted had lesser risks on the pension fund; as shown by a mean score of 3.90.

Table 1: Investment Strategy and Financial Growth of Retirement Benefits

Statements on Investment strategy	Mean	Std. Deviation
The current investments generate the highest possible returns.	3.97	0.752
The investment options adopted has lesser risks on the pension fund	3.90	0.944
Investment portfolio has continually grown over the years	4.26	0.773
The schemes has an appropriate investment mix of the pension fund, to balance between investment risks and returns	4.32	1.013
The investment strategies employed by our scheme enhances financial efficiency of the pension fund.	4.10	0.870

5.2 Members' Contribution on Financial Growth of Retirement Benefits

The study findings in Table 2 show that the respondents agreed the target contributing group/members had the potential to contribute large amounts to the schemes (mean score = 4.52); and that these contributions were adequate to earn better revenues/better return on investments (mean score = 4.39). The respondents also agreed that the members' contributions to the scheme were adequate (mean score = 4.16). On the other hand, the respondents agreed that the amount of contributions from the members were adequate enough to enable the fund enter into meaningful asset investment (mean score = 3.87).

Table 2: Influence of Members' Contribution on Financial Growth of Retirement Benefits

Statements	Mean	Std. Deviation
The current members' contributions to the scheme are adequate	4.16	0.934
The target contributing group/members have the potential to contribute large amounts to the scheme.	4.52	0.508
The amount of contributions from the members is adequate enough to enable the fund to enter into meaningful asset investment.	3.87	0.991
The members contribution funds are adequate to earn better revenues/better return on investments	4.39	0.420

5.3 Regulatory Framework and Financial Growth of Retirement Benefits

The study results in Table 3 show that their pension schemes strictly complied with all regulations governing pension schemes (mean score = 4.35); and that they did not tolerate risk beyond the guidelines given by RBA (mean score = 4.07). The respondents also agreed that regulatory framework and policies had improved governance of schemes (mean score= 4.05). Moreover, the respondents agreed that the effective regulation of compliance costs by the RBA was important in the governance or regulatory framework of pension funds (mean score = 4.02). The respondents further agreed that the regulatory framework and policies had improved protection of members' contributions and benefit; as shown by a mean score of 3.92.

Table 3: Influence of Regulatory Framework on Financial Growth

Statement	Mean	Std. Deviation
We strictly comply with all regulations governing pension schemes.	4.35	0.483
The regulatory framework and policies have improved protection of members contributions and benefits	3.92	0.942
The regulatory framework and policies have improved governance of schemes.	4.05	0.758
The effective regulation of compliance costs by the RBA is important in the governance or regulatory framework of pension funds	4.02	0.794
We do not tolerate risk beyond the guidelines given by RBA	4.07	0.722

5.4 Members' Demographics and Financial Growth of Retirement Benefits

The respondents agreed that the number of salaried and pensionable population affect the financial growth of retirement benefits schemes to a great extent; as show by a mean score of 4.46. The respondents also indicated that the retirement age of the employees/members affected the financial growth of retirement benefits schemes to a great extent (mean score = 3.79). However, the respondent reported that the age of registration affected the growth of retirement benefits to a moderate extent (mean score = 3.55).

Table 4: Influence of Demographic Characteristics on Financial Growth

Statements on Demographic Characteristics	Mean	Std. Deviation
Retirement age of the employees/members	3.79	0.410
Age of registration	3.55	1.150
The number of salaried and pensionable population	4.46	0.504

5.5 Regression Analysis

A linear multivariate regression model was applied to determine the relationship between the variables in the study. The study sought to establish the relationship between the independent variables (Investment strategy, member's contribution, regulatory framework, demographic characteristics) and the dependent variable (financial growth of retirement benefits). The model took the following form:

$$Y= \beta_0 + \beta_1 \chi_1 + \beta_2 \chi_2 + \beta_3 \chi_3 + \beta_4 \chi_4 + \epsilon$$

In the model Y represents financial Growth of Retirement Benefits, X_1 is Investment strategy, X_2 is Members contribution, X_3 is Regulatory framework, X_4 is Demographic characteristics, β_0 is the constant term while the coefficient $\beta 1$ to $\beta 4$ are used to measure the sensitivity of the dependent variable (Y) to unit change in the independent variable (X1, X2, X3, X4, X5). ε is the error term which captures the unexplained variations in the model.

The regression results in Table 5 show an R value of 0.796 which implies that there is high relationship between the variables. The R-Squared explains how well the model predicts the observation; is a statistical measure of how close the data is to the fitted regression line. The

Value of R square (coefficient of determination) was 0.633. This implies that the investment strategy, members contribution, regulatory framework, demographic characteristics explained 63.3% of financial growth of occupational retirement schemes in Kenya. The remaining percentage of 36.7% can be explained by other variable/predictors not included in the study.

Table 5: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.812(a)	0.660	0.642	0.24619

a Predictors: (Constant), Investment strategy, member's contribution, regulatory framework, demographic characteristics

The regression co-efficient results in Table 6 show that there is a positive and statistically significant relationship between investment strategy and financial growth of occupational retirement schemes in Kenya as shown by β = 0.449, p=0.001<0.05. The results further show a positive and significant relationship between members contribution and financial growth of occupational retirement schemes as shown by β = 0.404, p= 0.001<0.05. The regression results further shows that there was positive and significant relationship between regulatory framework and financial growth of occupational retirement schemes (β = 0.115, p=0.016<0.05). However, the there was an insignificant relationship between demographic characteristics and financial growth of occupational retirement schemes in Kenya as shown by β = 0.018 and p= 0.676>0.05.

Table 6: Regression Coefficients(a)

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	0.564	0.408		1.382	0.171
	Investment strategy	0.449	0.094	0.359	4.763	0.000
	Members Contribution	0.404	0.056	0.568	7.203	0.000
	Regulatory Framework	0.115	0.047	0.172	2.475	0.016
	Demographic Characteristics	0.018	0.043	0.031	0.420	0.676

a Dependent Variable: Financial Growth

From the results, it can be deduced that investment strategy, member's contribution and regulatory framework positively influences the financial growth of occupational retirement schemes. However, demographic characteristics do not have any significant influence on the financial growth of occupational retirement schemes in Kenya.

6. Conclusion

The study concludes that there is a positive and statistically significant relationship between investment strategy and financial growth of retirement benefits in Kenya. The investment strategies employed by the schemes have the potential to enhance financial efficiency and generate the highest possible returns in the pension fund. While choosing the investment strategy, the pension schemes should consigned the nature of investment in terms of the possible returns and also consider the risks involved the various potential investments.

The study also concludes that there is a positive and significant relationship between members' contribution and financial growth of retirement benefits in Kenya. Members' contribution is a major determinant to financial growth of retirement benefits. The amount of contributions by the members should be adequate enough to enable the fund to enter into meaningful asset investment, which would in turn enhance financial growth of retirement benefit schemes.

The study also concludes that there was positive and significant relationship between regulatory framework and financial growth of retirement benefits in Kenya. Pension fund regulations affect funding costs and the operations of the pension schemes which in effect have a strong influence on the investment and contribution strategies of pension funds. The existing retirement benefits laws and regulations in Kenya are adequate to protect the members' contributions and benefits; and reduce risks in the pension schemes. This enhances the efficiency of the operations which enhances financial growth.

7. Recommendations

The study recommends that there is also need to put the contributions of pensioners to more productive investments other that just keeping the funds safely for the pensioners. The irresponsiveness of returns to pension contribution could indicate that the funds do not contribute to income generation. Policies should be put in place to allow investment of pension funds to generate higher returns. However, the pension schemes should consider and analyze the investment risks involved in the investment strategies they want to undertake.

There is need to utilize assets and members contributions to generate income for the pension funds. The pension funds should use the increasing value of their funds to generate returns for the pensioners. If the assets are well utilized it would mean that the assets available in the pension funds are used to generate income leading to a strong financial growth and returns.

There is need to include the needs of the different age brackets in the management of the pension schemes. The membership of the pension schemes in Kenya is varied, with both the young and the old. While the older pensioners may be satisfied with stable old age income, the younger may want their funds to be used in more income generating activities. There is therefore need for pension fund managers to invest in most productive investments that would cater for the needs of all the members.

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