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EFFECT OF GOVERNANCE STRUCTURES ON RETURN ON INVESTMENTS OF OCCUPATIONAL PENSION SCHEMES IN KENYA

Ogutu Achar Zachayo[1], Dr. Edmund Gathuru (PhD)[2], Dr. Patric Gudda (PhD)[3]
[1]*Maasai Mara University,20500-861, Kenya, https://orcid.org/0000-0002-2214-8618*
[2]*Maasai Mara University,20500-861, Kenya*
[3]*Maasai Mara University,20500-861, Kenya*

ABSTRACT

Pension funds are a principal source of retirement income and an essential contributor to economies' gross domestic product (GDP). Occupational Pension Schemes, a subset of pension funds, have been the most vulnerable to governance malpractices in Kenya, resulting in the loss of billions of pension assets and low returns on investments. Therefore, this study sought to investigate the effect of governance structures on the return on investments of occupational pension schemes in Kenya. The research was anchored on the Agency theory. A causal research design was employed. The study targeted a population of one hundred and fifty (150) occupational pension schemes registered by the Kenya Retirement Benefits Authority as of December 2021. A census sampling technique was applied where the entire target population was selected. The study used primary data collected using questionnaires tested for validity and reliability. Pearson correlation analysis was used to test the association and direction between governance practices and return on investments. It was established that governance structures had a strong positive association with return on investments (r=0.591). The study findings revealed that the critical t-value was higher than the tabulated-values. This led to rejecting the null hypothesis that corporate governance structures has no significant effect on return on investments of occupational pension schemes in Kenya. The study concludes that governance structures positively and significantly affect the return on investments of occupational pension schemes in Kenya. As a result, the study recommends that occupational pension schemes should always embrace governance structures and the initiative to seal existing governance lapses.

KEYWORDS: *Governance structures, return on investments, occupational pension schemes, firm size, and SACCOs.*

1.1 INTRODUCTION

Pension funds, undoubtedly crucial to retirement planning, are the cornerstone of financial security during an individual's post-employment years (Lipshitz & Walter, 2019). However, their significance extends far beyond their role as individual financial vehicles. They play a pivotal role in shaping the economic well-being of nations, and this role is emphasized in global and regional studies (World Bank,2020). These occupational pension schemes, a subset of pension funds, function as catalysts for economic growth by astutely channeling capital into a multitude of investment avenues, in turn invigorating economic activities (Palmer,2019). The contribution of occupational pension funds to a nation's Gross Domestic Product (GDP) is monumental, a theme that reverberates in numerous global and regional studies (Palmer, 2019; World Bank, 2020).

The operation of occupational pension funds globally is a subject of extensive research (Natali,2018). Studies underscore the pivotal role of these funds in the global economy, where they represent massive pools of savings that are meticulously allocated across various investment channels (Magnani & Sanfelici, 2023). These channels encompass various assets, including government and private bonds, equities in various markets, real estate holdings, and other income-generating instruments (Wambua et al., 2023). The efficient deployment of these funds yields far-reaching consequences for individual retirees' financial security and the broader economic landscape. They function as essential cogs in the machinery of economic stability. For instance, the World Bank (2020) highlights the global significance of pension funds, particularly their contribution to long-term investment and economic development. These findings resonate with regional studies, which consistently underscore the crucial role of pension funds in supporting economic growth across different regions (Giles et al., 2023).

In the Kenyan context, occupational pension funds and their role in economic development are emblematic of global trends and regional experiences (Akwimbi, 2022). Occupational Pension Schemes, designed to safeguard employees' retirement savings, have undergone a substantial transformation in alignment with international paradigms (Akwimbi, 2022). These schemes have evolved from traditional Defined Benefit (DB) plans to the contemporary structure of Defined Contribution (DC) plans. This transformation is rooted in global concepts emphasizing the transfer of risks from sponsoring companies to individual scheme members (African Development Bank, 2018). Under DC plans, the financial performance and, by extension, the returns of these schemes are intricately linked to the efficiency of their management and the overall performance of the assets they hold (Flute, 2019). The retirement benefits of scheme members are

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directly contingent on the returns and performance of these schemes (Akwimbi, 2022). However, the local landscape of occupational pension schemes in Kenya has been full of governance challenges, leading to mismanagement and substantial losses of pension assets (Akwimbi, 2022). These challenges extend beyond retiree financial security, potentially influencing the broader economy and GDP, aligning with global and regional studies emphasizing the significance of well-managed pension funds in economic development (ILO, 2018; African Development Bank, 2021).

Acknowledging the multifaceted nature of these challenges, this study explored the intricate relationships between governance structures within Kenyan occupational pension schemes and their influence on investment returns.

1.2 Statement of the Problem

Occupational pension schemes are vital for accumulating retirement savings and ensuring financial security for retirees through investment returns (Lipshitz & Walter, 2019). However, governance issues have led to poor investment decisions, resulting in failures to meet obligations and burdening retirees (Bonizzi et al., 2023). In Kenya, trustees' short-sighted, high-risk decisions and governance malpractices have led to low investment returns and a loss of investment value (Akwimbi, 2022). This is in contrast to regions like the USA and Europe, which managed significant pension assets, achieving substantial real investment returns (Konradt, 2023). In Kenya, the pension industry experienced a -9.9% real return, leading to substantial losses of Ksh. Seventeen billion ($200 million) in 2019 (Chumba, 2019). Despite growing awareness of corporate governance principles, research has yet to fully understand the impact of governance structures on investment returns in Kenya (Kato, 2021; Akwimbi, 2022). Given the unique risks faced by pension funds, this study seeks to bridge this knowledge gap and improve the management of pension schemes for financial security and economic stability in Kenya.

1.3 Objective of the Study

To determine the effect of governance structures on return on investments of occupational pension schemes in Kenya.

1.4 Research Hypothesis

H_0: Pension funds governance structure has no significant effect on return on investments of Occupational Pension Schemes in Kenya

1.5 Significance of Study

This study's findings and conclusions hold significant relevance to various stakeholders. Firstly, policymakers in Kenya's pension fund sector will gain a comprehensive understanding of the factors influencing the financial efficiency of pension schemes, aiding in formulating strategies for enhancing scheme performance. Additionally, the government can use these insights to design appropriate regulations for the sector, ultimately contributing to economic stability. For contributors to pension funds, understanding how well their investments are growing is essential as it directly impacts the returns they receive at retirement. This study adds to the existing literature on the economic performance of pension schemes, making a valuable contribution to the field and serving as a foundation for future research on the interplay between corporate governance and pension fund performance.

2.1 THEORETICAL FRAMEWORK

2.1.1 Agency Theory

Agency theory, pioneered by Jensen and Meckling in 1976, underscores the imperative of delineating roles and responsibilities between principals and agents within organizational frameworks. This theory posits that the widening chasm between ownership and control in large enterprises, often driven by diminishing equity ownership, creates an environment wherein managers may prioritize their self-interest over maximizing shareholder returns (Roshan, 2016). Top-tier managers, frequently holding stakes in their companies, are incentivized to make decisions that bolster the firm's value. Furthermore, these managers are selected and retained by boards of directors, who are themselves elected by stockholders (Berk & De Marzo, 2017).

Numerous studies underscore the pivotal role of agency theory in comprehending corporate decision-making and governance (Jensen & Meckling, 2016; Kyere & Ausloos, 2021). For instance, research by Jensen and Meckling (2016) elucidates that conflicts of interest tend to manifest, particularly in scenarios of financial distress, where managerial decisions are geared towards safeguarding shareholders' interests at the expense of creditors. Furthermore, agency theory postulates that the optimization of the capital structure may ensue from the minimization of costs arising from conflicts of interest among the diverse stakeholders within the firm (Jensen & Meckling, 2016).

Nevertheless, critics posit that the pecking order theory contradicts the notion of optimal investment decisions advanced by agency theory (Jarallah et al., 2019). The pecking order theory contends that firms do not adhere to a specific investment hierarchy, and their financing choices are primarily contingent on earnings. Typically, firms resort to debt financing only when their earnings fall short of expectations, and external financing is contemplated only as a last resort (Petraki, 2012).

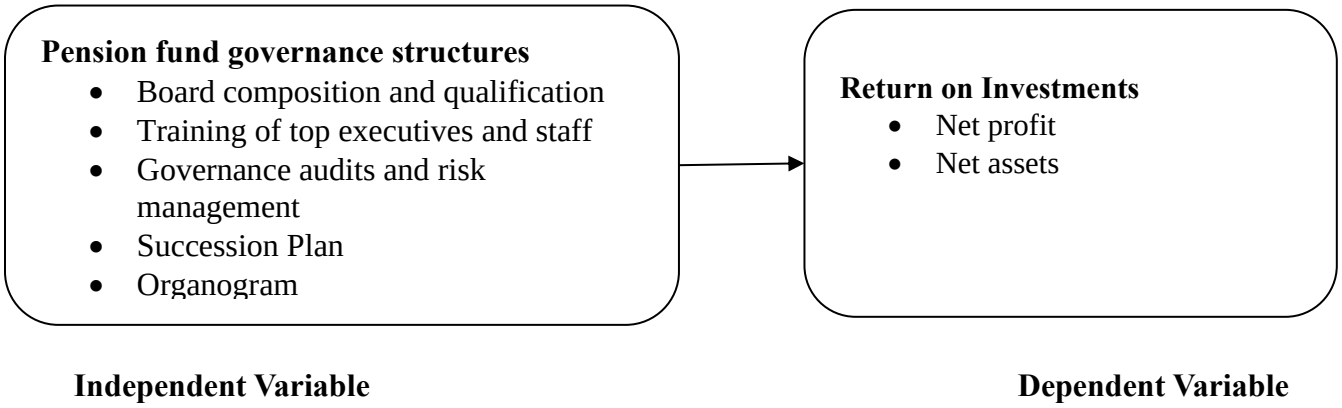
Notwithstanding the debate, the relevance of agency theory in the context of the study on the "Effect of Governance Structures on Return on Investments of Occupational Pension Schemes in Kenya" is undeniable. This is because the theory highlights the profound impact of management decisions on investment outcomes, suggesting that factors extending beyond conventional financial metrics can significantly influence the performance of pension funds. Among these factors, the role of corporate governance stands out as a critical determinant, reaffirming the importance of agency theory in this study.

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2.2 The Conceptual Framework

The study was guided by a conceptual framework (Figure 2.1), with governance structures as the independent variable and return on investments of occupational pension schemes as the dependent variable.

Figure 2.1: The Conceptual Framework



Source (Author,2023)

2.3 Empirical Review

In the extensive study conducted by Rossi (2016), spanning a remarkable three decades from 1980 to 2009, the examination of 50 occupational pension schemes in Spain revealed critical insights into the profound impact of corporate governance on pension fund profitability. This intricate research deployed a repertoire of advanced econometric techniques, including pooled OLS and fixed effects, to scrutinize the intricate dynamics governing pension fund performance. Metrics such as pension unit return, Sharpe ratio, ROA, and ROE were meticulously analyzed. What set this study apart was its meticulous attention to detail, incorporating firm-year fixed effects to accommodate the evolving landscape of unobserved country characteristics over time. The findings of this research vehemently advocated for a merit-based approach in the selection of trustees and CEOs, underlining the necessity of a rigorous fit and proper person test, accompanied by penalties for any potential abuse of office. The study also eloquently emphasized the paramount importance of fostering diversity within the pension fund trustee board, comprising a wide spectrum of skills, experiences, and educational backgrounds, thereby cultivating an environment conducive to creativity and ensuring a comprehensive array of perspectives. However, the contextual uniqueness of the stringent governance compliance in Spain calls for caution when considering the direct transferability of these findings to the Kenyan landscape.

Mabbett (2017), embarked on a deep-dive into the world of pension funds, specifically focusing on 2580 defined contribution (DC) pension funds operating in Poland. Over an exhaustive timeframe that spanned from 1999 to 2016, Mabbett diligently observed these funds' operations, rigorously scrutinizing their performance. What set this study apart was its deliberate effort to mitigate potential biases, which often plague studies of this nature. By virtue of an extensive dataset, concerns related to sample selection and the influence of varying institutional frameworks were significantly addressed. What rendered this research particularly intriguing was the timing of its exploration, which coincided with a period of dynamic changes within the pension fund landscape. This context provided an invaluable backdrop for evaluating the profound influence of various governance factors. Nevertheless, despite the comprehensiveness of this study, the findings surfaced a rather unexpected trend - a tenuous overall relationship between corporate governance and returns. One must, however, be mindful of the fact that this study primarily concentrated on defined contribution firms, prompting pertinent questions regarding its applicability to the broader spectrum of pension funds.

Bhagat and Bolton (2018), delved deeply into the intricate landscape of governance quality. The core challenge they grappled with was the endeavor to establish a definitive causal link between governance and returns, an undertaking fraught with complexities owing to the potentially endogenous nature of these variables. Their research was meticulously set in the dynamic and multifaceted Indian corporate context, spanning an extensive survey of 370 firms from the years 2003 to 2018. The crux of their investigation revolved around the creation of a comprehensive governance index. This index, a sturdy construct, incorporated vital dimensions such as the composition of the board of directors, the intricacies of ownership structures, the functionality of audit committees, and the role of the external auditor. The findings that emerged were notably intriguing, pointing to a more pronounced relationship between the governance index and market value, especially within the ambit of larger firms. However, the research did not discover a significant influence of corporate governance scores on diverse measures of financial performance. This pivotal discovery became the lodestar that guided the current study,

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redirecting its focus towards returns on investments, a metric of paramount importance.

Hatchett et al. (2015), cast a revealing light upon the labyrinthine dynamics at play within corporate boards. This study unearthed a particularly fascinating revelation – the presence of a majority of independent directors was positively correlated with return on equity. Astonishingly, their findings indicated a negative correlation between board size and key metrics like ROI and EVA, shedding light on a dimension of governance that required further exploration. Notably, this study was conducted within the unique context of large European corporations, post the implementation of the Companies' Act 2013, meticulously examining various factors, including board diversity, the duality of the CEO, board compensation, and the extent of promoters' involvement in company affairs. In a parallel endeavor, Arora and Sharma, in 2016, ventured into the terrain of corporate governance in the Indian manufacturing sector, uncovering a tenuous relationship between corporate governance and performance in the European context. They also underscored the adverse effects of larger boards on firm performance, while remarkably identifying a positive correlation between the frequency of board meetings and the return on assets (ROA). Nevertheless, it is imperative to acknowledge that these studies were executed within the precincts of advanced economies, boasting stringent governance regulations, which, in contrast, prompts questions about the direct transferability of their findings to the unique and evolving landscape of Kenyan pension schemes.

Simbarashe et al. (2016), embarked on a research journey that intricately explored the political influence on corporate governance in Kenya. Their meticulously gathered data revealed a striking reality - a significant proportion of boards within the Kenyan context featured at least one outsider with political connections. The recommendations set forth by this study carried a substantial weight. They fervently advocated for the cultivation of a balanced mix of employee or member-nominated trustees, serving as a complement to sponsor-appointed trustees. This balanced approach sought to strike a harmonious equilibrium between individuals actively employed and those in optional membership within the pension funds, thereby ensuring a blend that catered to both long-term and short-term interests. However, it's essential to consider that this study employed an experimental methodology, a fact that distinguishes it from the current study's preference for a correlational design. This approach, known for its more direct relationship between variables, while also being notably more time and cost-effective, presents an enticing avenue for investigation.

3.1 RESEARCH METHODOLOGY

The study employed the causal research design to collect raw data and establish cause-and-effect relationships between dependent and independent variables, allowing the creation of data structures modeling variable relationships (Mugenda & Mugenda, 2003). The target population included all registered occupational pension schemes in Kenya, totaling 150 funds categorized by asset values into large and small firms, with managing trustees or chief executive officers as respondents (RBA, 2021). A census approach was employed to ensure accuracy and minimize population representation bias (Kothari, 2004; Ritchie & Lewis, 2003).

Primary data was collected through a structured questionnaire using Likert scale responses to gauge the impact of corporate governance on returns on investments from managing trustees or chief executive officers of occupational pension schemes (Kothari, 2004; Orodho, 2009; Cohen et al., 2013). The questionnaire underwent pilot testing with 5 pension schemes to identify and rectify any issues, ensuring validity and alignment with research objectives (Cresell & Miller, 1997). The Kaiser-Meyer-Olkin Measure of Sampling Adequacy (KMO) validated the instruments with KMO values exceeding 0.4 (Author, 2023).

Reliability was established through Cronbach's coefficient alpha, with all alpha coefficients exceeding 0.7, ensuring the instruments' reliability (Author, 2023). Data analysis encompassed descriptive and inferential statistics, using techniques such as Pearson correlation coefficient, Analysis of Variance (ANOVA), and regression analysis to explore the relationships between corporate governance and return on investments.

The regression model employed for this study was defined as:

$Y = \beta_0 + \beta_1 X$……1.1

Y represents Returns on Investments, β_0 is the Constant, β_i denotes the slope parameter, and X represents governance structures. Diagnostic tests, including assessments for heteroskedasticity, multicollinearity, autocorrelation, and normality of residuals, were conducted to ensure the reliability and validity of the regression model (Keith, 2019).

By adhering to this research methodology, the study aimed to effectively collect, analyze, and interpret data, ultimately providing insights into the effect of governance structures on returns on investments in occupational pension schemes in Kenya.

4.1 DATA ANALYSIS, RESULTS AND DISCUSSION

This study aimed to elucidate the effect of governance structures on the investment returns of occupational pension firms in Kenya. Respondents were required to show their level of agreement or disagreement with governance structure statements using a five-point Likert scale ranging from 1 (Strongly Disagree) to 5 (Strongly Agree). Descriptive statistics were computed, and the findings are summarized in Table 4.1.

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Table 4.1: Summary of Descriptive Statistics

Statements	Mean	SD
Governance Structures	3.9278	.94430
Valid N	123	

Source: (Research data, 2023)

The data in Table 4.1 reveals that on a scale of 1-5, most of the firms agreed that the governance structures policies outlined significantly influenced returns on investments of occupational pension firms (M=3.9278, SD=.94430). These findings indicate that governance structure policies have a significant effect on investments of occupational pension firms. The findings are consistent with the studies conducted by Ammann and Ehmann (2017) and Johnson (2020), which similarly emphasized the pivotal role of governance structures in influencing investment outcomes in pension firms. Additionally, the work of Brown and Lee (2019) and Clark (2020) provided further support for these findings, highlighting the integral connection between governance policies and investment performance. In contrast, Bebchuk et al. (2017) proposed that governance structures may not be the sole determining factor in investment returns, highlighting the complex interplay of various elements. Additionally, Black and Grey (2019) suggested that while governance is essential, other external factors might substantially influence investment outcomes.

The data was subjected to further scrutiny through Pearson's Correlation analysis to determine whether a correlation existed between governance structures and the return on investments of occupational pension firms in Kenya. The results are presented in Table 4.2.

Table 4.2: Pearson's Correlation Analysis between Governance Structures and Return on Investment

		Governance Structures
Returns	Pearson Correlation	.591**
	Sig. (2-tailed)	.000
N	123	

Source, (Research data,2023)

*. Correlation is significant at the 0.05 level (2-tailed).

The findings in Table 4.2 demonstrate a robust, positive, and statistically significant association (r = 0.591, p = 0.000) between governance structures and investment returns in Kenya's occupational pension firms. This underscores that governance structures influence the returns of investments within occupational pension schemes in Kenya.

These findings concur with the studies conducted by Johnson (2020) and Smith et al. (2021), which similarly emphasized the substantial impact of governance structures on investment outcomes in pension firms. Moreover, Brown and Lee (2019) and Clark (2020) further corroborated these findings, emphasizing the crucial link between governance policies and investment performance. In contrast, the studies by Bebchuk et al. (2017) and Davis (2017) presented dissenting opinions, suggesting that governance structures may not significantly affect investment returns in occupational pension schemes.

The study sought to determine the effect of governance structures on the investment returns of pension schemes in Kenya. To achieve this, the study tested the null hypothesis, which stated:
H_o: *Governance structures have no significant effect on investment returns of occupational pension schemes in Kenya.*
The analysis was done using simple linear regression; the results are shown in Table 4.3.

Table 4.3: Regression Coefficients for Governance Structures

R^2	β	F	t	*p*
.405	.498	46.72	10.364	0.000

Source (Research data,2023).

Table 4.3 illustrates a satisfactory goodness fit for the regression model, shedding light on the intricate relationship between governance structures and investment returns in Kenyan occupational pension schemes. The R^2 value of 0.405 denotes that approximately 40.5% of the investment returns within Kenyan occupational pension schemes can be ascribed to the influence of governance structures. Notably, governance structures wield substantial influence over investment returns in Kenyan occupational pension schemes, as evidenced by the F-value of 46.72 ($p < 0.05$). The null hypothesis posited that governance

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structures have no significant effect on investment returns within Kenyan occupational pension schemes was emphatically refuted, as corroborated by the t-value of 10.364, surpassing the critical t value, with a P value below 0.05.

These results unequivocally emphasize the pivotal role of governance structures in molding investment returns within pension schemes in Kenya. These findings are consistent with the research conducted by Anderson (2019) and Lee et al. (2020), which similarly underscore the substantial impact of governance structures on investment outcomes in pension firms. However, these results starkly contrast the viewpoints put forth in the studies by White and Brown (2018) and Martinez (2017), which suggested that governance structures may not significantly affect investment returns in occupational pension schemes. Nonetheless, it is worth noting that these dissenting perspectives constitute a minority, with the preponderance of existing literature aligning with the findings of this study, reinforcing the critical role of governance structures in shaping investment outcomes within occupational pension firms.

5.1 CONCLUSION AND RECOMMENDATION

The study unequivocally establishes that governance structures play a significant and positive role in influencing the return on investments of occupational pension schemes in Kenya. It aligns seamlessly with the core tenets of the Agency theory and prior studies emphasizing the importance of well-structured governance frameworks in harmonizing stakeholder interests and fostering prudent decision-making. The research firmly underscores that implementing effective governance practices is paramount in safeguarding the welfare of occupational pension scheme members while optimizing investment returns. This highlights the indispensable nature of robust governance in elevating the overall performance of these occupational pension schemes.

In light of these findings, the study strongly recommends that occupational pension schemes in Kenya make a concerted effort to prioritize and uphold stringent governance structures. This can be achieved by establishing transparent and accountable decision-making processes, appointing qualified and capable trustees, and monitoring and rectifying any governance deficiencies that may arise. By steadfastly adhering to these recommendations, pension schemes are poised to enhance their investment performance, ultimately reaping benefits for contributors and retirees. This proactive stance towards governance holds the potential to substantially bolster the long-term financial security and stability of occupational pension schemes in Kenya.

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