**The impact on Financial Performance of Unit Trust Funds in Kenya by Investment Diversification**

***Abstract***

*The main objective of investors was to increase their wealth when taking part in investment. This can be achieved when there is upsurge in share prices. Kenya unit trust funds have been performing poorly compared to the other parts in the rest of the world. The lowly performance is deterrence to persons and commercial investors. Experiential literature from developing and develop markets suggests that fund features elucidate the unit trust funds performance. In Kenya there is limited empirical literature elucidating the connection between investment diversification and financial performance of unit trust funds. This research thus was to examine the relationship between investment diversification and financial performance of unit trust funds in Kenya. The study was guided by the following objectives: define the influence of equity fund, define the influence of bond fund, define the influence of money market fund, define the influence of balanced fund and define the influence of special fund on financial performance of unit trust funds in Kenya. The study also pursued to institute the moderating effect of inflation on the relationship between independent variables and dependence variable. The behind theories of the study were modern portfolio theory, diversification strategy model, and pecking order theory, financial theory of finance and efficient market theory. Positivism philosophy and explanatory non-experimental research design was adopted in the study. The population will comprised of 36 unit trusts funds in Kenya as at the end of the year 2023. The study used a census approach. Secondary data was collected from the Audited reports from 2013 to 2023 using a data collection schedule. Descriptive analysis which was done include the mean and standard deviation. Inferential statistics which included panel regression was also performed. Diagnostic tests such as normality, heteroskedasticity, multicollinearity, stationarity and model specification was conducted. The study found out that financial performance is positively affected by investment diversification*

***Key terms: Financial Perfomance, money market fund, special fund, Investment diversification***

**Introduction:**

The investment principle by (Aketch, 2019) suggests that earnings are the main motive for investments by every stockholder. Motivation of investors is to grow wealth over time. Investment returns pay off for time, the economic inflation and the reimbursement of uncertainty (Bodar, 2013).

A venture in unit trusts is an avenue for investors the same way they invest in securities and is predominant among shareholders generally since it gives them an opportunity to obtain profits Carroline (2019). Unit trusts investment gives stakeholders an opportunity receiving regular earnings. It aids as a substitute to saving (Hynu, 2017). Objective of advancing in unit trust is for capital gain. Capital gains are recognized when there is growth in the market value (Ibery, 2016).

Globally, the United States unit trust sector by year-end 2016 is the leading with net value of $21.5 trillion. In the past 20 years, the progress has been stable in the sector accounting for more than $55.4 trillion in unit trust assets worldwide. The growth of unit trust in investment industry (World Bank,2015). Kauri (2017), establishes out that, In china riskiness, availability of funds and regulation requirements.

Regionally, according to Muhgyi (2016) the unit trust fund industry in South Africa has seen some steady progress with three 369 billion rand invested in South Africa domestic equity fund alone by 2016. Investor in S. Africa has varieties of choices ranging from passive index tracking funds to actively manage. According to Jensen's Alpha, unit trust in Africa lacked both specified acquaintance and the capacity to predict the performance (Uddin, 2021)).

Locally, as a way of investing, in Kenya, prospective and active investors are relying on unit trust funds (Udosen, 2019). This kind of investment is not sound in Kenya and common in Kenya.

According to Jensen's Alpha, unit trust in Africa lacked both specified acquaintance and the capacity to predict the performance (Ho, C. 2019).

There are many techniques for evaluating performance and proficiency analysis as suitable gears for investment firms which include Treynor index, the Sharpe index and the Jensen index. These indices can be useful in evaluating the return of the firm. Goldreyer and Diltz (1999) used an extended sample of ethical funds involving equity, bond and balanced funds. By applying Jensen alpha, Sharpe and Treynor indices and concluded that social screening does not affects the investment performance of a balance portfolio.

An investment diversification can be defined as a group of investment assets which are based on the investor’s attitude towards the relationship between the risk and return. It is made up of either a group of financial assets such as equities and bonds, or real estate (Delios, W. (2019). Equity securities are more unpredictable than bonds and therefore a greater risk. SMEs equities involve greater risks than those normally associated with corporate. Bonds are affected by interest-rate, inflation rates and credit risks

Investment diversification is not well studied locally since most investors are risk averse. According to Castaldi, C., & Giarratana, M.S. (2018), investment diversification is naturally the largest asset and the dominant source of financial returns. As such, it is one of the highest sources of risk to business safety and soundness. Effective management of the investment diversification and the credit function is central to the business’s safety and soundness.

**Problem Statement**

Around the globe unit trust funds are stirring economies in a rising course. In Kenya, unit trust fund has persistently shown not so good performance where some recording losses after losses from one year after another. Flimsy exhibition of unit trusts in Kenya is discouragement to individuals and investors. Particularly, Kenya’s Mutual Funds/UTFs to GDP ratio in 2023 was 4.6% pointedly inferior matched to a mean of 57.6% among [world markets](https://databank.worldbank.org/source/global-financial-development/Series/GFDD.DI.07) a sign of a necessity to improve our capital markets. Furthermore, in countries south of Saharan have superior mutual funds to GDP ratios of 61.5% and 43.1%, respectively as at [23](https://databank.worldbank.org/source/global-financial-development/Series/GFDD.DI.07) (CMA, 2023)..

Whereas Kenya’s total value of unit financial trust is USD 1.91 billion, nations such as Morocco, whose total value is USD 53.8 billion, Peru with an total net value of over USD 7.28 billion and Turkey, valued at more than USD 20 billion. Kenya (World Bank, 2023). The Kenyan case validates low-slung growth.

Several studies carried out in Kenya have not extensively addressed the connection between performance of unit trusts and the characteristics of the funds. For instance, Adhav, Sunil. M. (2021) concentrated on net asset value and dividend paid by equity unit trust funds, Bijja. Srinivas. (2020) focused only on equity and money market funds, Chaitra, K S. (2021) examined the challenges faced by unit trusts, Chalshi, Nisha. A., & Vidya.R (2022 focused on behavior elements on making investment decision by unit trusts. Dhanush, B. (2023) focused only on equity fund in a single year period. The time of the studies was also short, therefore not suitable to form a significant foundation for generalizing conclusions to the entire sector.

Discrepancies in outcomes on the same matter stimulated the current study. Thus, the study precedes with rounded methodology in appraising the conclusion of investment diversification on the performance of unit trusts in Kenya.

**Literature Review**

According to Kusuma, T.& Chowdary, Venu Gopal. Rao. (2020), bond investments on Kenyan unit trust fund, have an insignificant effect on return on assets. More so, equity investments had a positive influence on liquidity while bond investments had an little effect on liquidity.

Magdum, Anuja., & Samanta, Girish. A. (2019) balance fund financing on financial performance of unit trust funds in Kenya. SPSS was used for examination and descriptive scrutiny was adopted to come with the results that financial performance is affected balance fund..

Meera, N. & Venktaramaraju, D. (2020) examined the effect of equity funds on the financial performance of unit trust funds in Kenya. The study recognized that equity portfolio had noteworthy effect on the financial performance of the investment firms.

Nagarajan, Rekha. (2020) concluded that bonds offer periodic interest throughout their lifecycle and a return of the entire principal investment upon elapsing of the bond. The study used descriptive statistics to arrive at this conclusion.

Investors of short term securities are eligible to receive attention over the securities’s life time as well as the nominal value of the investment amount upon maturity (CBK, 2022). At the same time, housing bonds are securities backed by real estates, and they are considered the safest bonds type, hence bearing law interest rates (Nandini. Seal., & Soumya. Mukherjee, 2022).

According to Patel, J yoti. J. (2020) investigated investment diversification effects on financial performance with inflation as control variables and found out that financial performance is positively affected by investment.

Rokade, Ekta. (2021) carried investigation and concluded that investment in bonds has a significant positive effect on financial performance. Descriptive research design as well as secondary data was utilized. At the same time Sharma, Komal. Bansidhar. (2023) determined that investment portfolio in bonds influence financial performance.

Gumo, M. S. (2013) studied the relationship between performance and money market fund for companies quoted at the Nairobi Securities Exchange (NSE) and it was found out that financial influenced the portfolios of listed firms with firms with high percentage

Ayako, A., Githu, T., & Kungu, G. (2015) examined a study on influence of investment in money market fund and financial perforce for unit trust funds and settled that one of the difficulties of unit trust funds investment is selecting and choosing proper investment strategies for paying future liabilities. The study noted that what disturbed unit trust fund manager most was capability of paying liabilities more than profitability and returns.

Nekasa, M. O., Namusonge, G. S., & Makokha, E. N. (2017) investigated the existence of unit trust fund requirements by institutional stockholders and the result was that stockholders wanted a way of investing in unit trust fund. Census method used in this study and panel analysis model were incorporated.

Murage, S. M., & Onyuma, S. O. (2015) scrutinize the relationship between money market fund and financial performance. The result was significant correlation between money market fund and financial performance. The study used regression analysis and examined all firms listed in the security exchange.

According to Omondi, M. M., & Muturi, W. (2013) the association between financial performance and bonds is strong. Bond is predicted to have an effect on the entire financial performance of unit trust funds. The goal was to yield a hypothetical investment diversification.

Kimeu, F. M. (2015) conducted a study on the effect of specialized fund on financial performance in Asia for the period 2015 to 2023. Inferential statistics was utilized with the diversification potential of specialized fund compared to financial performance. The outcome indicated that specialized fund positively affects financial performance.

Kioko M., D. & Ochieng M (2020) studied the influence of balance funds on the finance performances in Nigeria. Balance fund was regressed on RGDP, Consumer Price Index, Real effective exchange rate, Money supply (M2), Share price index, Treasury bill, Nigerian stock exchange transactions. The study discovered that balance fund has an insignificant and undesirable influence on the economy and the macroeconomic variables that ascertain the finance performances of the Nigerian stock market.

**Theoretical Review**

**Modern Portfolio Theory**

Harry Markowitz framed it in 1952. The main objective was to navigate the expected return of an investment diver. Investors make decisions subject to their choice of investment portfolio (Markowitz, 1952). Many investors are risk averse and will pick portfolios with less risk but more returns. Irrespective of this preference, risk is intrinsic in corporate, and the higher the risk, the higher the predictable rewards (Hannes and Sara, 2012). This leads to conclusion that investors always choose a portfolio with a reduced risk but has a superior predictable return.

**Diversification Strategy Model**

Was advanced by Igor Ansoff in 1957 as part of the product matrix's four strategies. Market penetration, according to the notion, comprises the marketing of a company's current items in an prevailing marketplace. Diversification can be utilized instead of the other three techniques to help a firm expand (Hussain, Khattak, Rizwan, & Latif, 2013).

When it comes to diversification, there are two forms of diversification: diversification techniques and diversification types. Diversification techniques include acquiring a company, generating new goods, forming partnerships, and coming up with new technology and licensing them. Vertical, horizontal, concentric, and conglomerate diversification are the four forms of diversification identified by Thierry, A. Z. (2018).

**Pecking Order Theory**

It was proposed by Donaldson in 1961 and modified by other authors’ preceding research on capital structure. In addition to pecking order theory, many enterprises preferred to use currencies from reserve internal streams of finance first when in quest of resources for financing capital investments rather than external sources of financing (Myers and Majluf, 1984). If inside funds are inadequate to cover the investment, the establishment may now examine extra bases of capital. This is done in such a way so the business suffers no extra responsibilities that would distress its financial condition. This theory is mostly constructed on asymmetric information costs. As per this assumption, organizations normally give inside produced finance sources top precedence, then debt and finally equity.

**Financial Theory of Investment**

It is based on investment decisions. It was advocated by Minsky (1986). This theory links financial market fragility, in the everyday living cycle of an economy, with speculative investment in financial markets (Ljungqvist, 2019). Adopt that the market rate of interest signifies the capital structure to the firm which does not alternate the sum of investment it makes.

**Efficient Market Theory**

Market Theory was put forward by (Fama, 1970). Fama argues that the primary role of any market is allocation of ownership of the economy’s capital stock. He opined that an ideal market would provide accurate signals of resource allocation. He explained than in a market, firms make production and investments decisions and investors chose securities that represent ownership of firms. Apiyeva (2017) utilized the theory and argued that a market which the 19 securities price fully reflect all available information is an efficient market. Jensen (1968) opines that it is impossible to beat the market. This implies that an investor cannot make abnormal profits by trading in the stock markets. Tursoy, Gunsel, and Rjoub (2018) indicates that stock prices follow a random walk and it is therefore not possible to accurately predict prices based on the past trends. The theories categorize markets based on their efficiency and bring out three forms of market efficiency. The weak form of market is a level of efficiency which prices reflect all past information that is available. Therefore, investors cannot beat the market by analysing historical information of stocks. The semi strong efficiency is the level of efficiency at which the prices in the stock prices reflect past and present information that is publicly available. This level is concerned more with the speed of adjustments of information to the stock market prices (Fama, 1970).

**Research Philosophy**

It had chosen by complement the research design. Kothari, C. R., & Garg, G. (2014) itemized that in, that is; the positivism and phenomenology. It contains content, importantly organized style, in contextual model. Bell, E., Bryman, A., & Harley, B. (2022) postulated that place is measured by modesty, with experiential corroboration sought through managements. Phylosophological on the additional hand trails the going description. Gathering is the data approach to figures get-together. According to Mohamed 2013 based on the bright research model

**Research Methodology:**

**Research Design**

Non explanatory research was the design adopted by this study. Kothari, C. R., & Garg, G. (2014), defined non-experimental design as where the researcher is directing and operating by classifying the essential aspects that incident conversion in it while there is no handling of the sovereign variable.

**Data Collection Methods**

Investment diversification was collected from published records of unit trust funds.

**Sampling Strategy**

The target population for this study was be 36-unit trust funds registered with CMA. Census method was adopted because of small number of respondents.

**Data Analysis**

Analysis of data will be carried out using descriptive statistics, correlation and panel multiple regression method. Hypothesis testing was also done using panel results from panel. The panel analysis results output on test between –topics’ effects on financial performance of unit trust funds will ascertain whether to accept or reject the null hypothesis.

### **Panel Regression model.**

The Panel Regression model will take the form below.

Y = β0 + β1X1 + β2X2+ β3X3 + β4X4 + β5X5 + ε

Where:

β0 = Constant

β1, β2, β3, β4 and β5 are the coefficients of independent variables

X1 – equity fund

X2 – bond fund

X3 – money market fund

X4 – balanced fund

X5– special fund

ε- Error term

Correlation analysis will be used to test the strength of regression model and significance of each of the independent variable. Statistical significance of the whole regression will be tested by F- Test at 5%. R2 will be utilized to determine the strengths of which the independent and dependent variable vary from each other

**Ethical Considerations**

Legally accepted procedures were used in the data collection respondents. Privacy and confidentiality of information were guaranteed. A permit and letter of authorization was obtained from National Council for Science and Technology in the ministry of education. This permit and letter was used together with the university’s department consent letter to confirm the legitimacy of the study. Anonymity was guaranteed by using code numbers instead of names.

# Limitations of the study

Due to sensitivity of financial information to enterprises, some were unwilling give detailed answers to the questions and to address this, the respondents were guaranteed that the answers was to be used only for examination purpose and not to compromise their positions. In addition assurance was also given that information will not be available for public witch-hunt.

**Result and Discussion:**

The result symbolizes that financial performance is positively affected by investment diversification. This agreed Chepkorir, N., Kemboi, R., & Bett, A. (2022) which found out that investment diversification have significant connection with financial performance of unit trust funds.

There is significant incorporation of equity fund in the investment diversification contributed to better financial performance. This was in agreement with Cooper, D. R., & Schindler, P. S. (2014) which established that equity fund have significant relationship with financial performance.

Additionally bond funds are also affecting financial performance positively but not significantly meaning that the businesses should not ignore them since they are very important ingredient for their stability of investment firms. This support with Kimeu, F. M. (2015) which recognized that bond funds have positive association with financial performance

On the same line money market funds positively affect financial performance which means that incorporating then into the portfolio will alleviate the businesses financial performance. This bring into line Musembi M, M., & Jagongo A., (2018) who acknowledged that money market fund have positive connection with financial performance.

Simultaneously balance funds positively affect financial performance where involving them into the portfolio will improve the firm’s financial performance. This support with Murithi, B. K. (2021) which documented that balance fund has strong relationship with financial performance of unit trust fund.

Finally special funds was having a weak affect financial performance of unit trust fund which means that including them into the investment diversification will reduce the asset financial performance unit trust fund. This is in agreement with Nzau, M, N., Kung’u, J, & Onyuma, S, O., (2019) which established that special fund has strong relationship with financial performance.

**Conclusion**

The study concluded that unit trust fund financial performance is affected by diversification portfolio. There were strong and positive correlations but some were significant.

The study's main objective was to determine how investments diversification affected the financial performance of unit trust funds in Kenya. The study exhibited a relationship between investment diversification and financial performance on unit trust fund was favorable. Outcomes from panel data further reinforced a promising connection between unit trust fund and financial performance.

The next objective was to evaluate equity fund affects the financial performance of unit trust funds. Notwithstanding lack of strength to draw firm conclusions, the analysis suggested a weakly positive relationship between financial performance and equity investments. As a result, these investments have relative impact on financial performance.

Measuring the influence of money market fund on the financial performance in Kenya was the other objective. Though there was a positive connection between financial performance and unit trust fund, the connection remained shaky and insignificant since statistical significance was not achieved.

The assessment of the influences of balance fund investments on the financial outcomes was the main objective of the fourth set of objectives. The investigation established a statistically significant (p-value 0.05) and considerable positive relationship between financial performance and balance fund investments.

The fifth objective was to look at how investment diversification affects financial performance of unit trust fund in Kenya in the presence of inflation as control variable. The study established that since inflation significantly decreases the relationship between investment diversifications and the financial performance of unit trust funds in Kenya.

**Recommendations**

Due to nature of the study findings, it will be in order for the managements of portfolio to mitigate risk and analyze the best proportion of assets in order to enhance their performance. It’s better for the management to balance risk and profitability.

Meanwhile the finding favors equity investment than other kind of investments because of its stability and performance. It is in order for investors who are looking for stability to invest more in equity portfolio. These will results into greater capital gains and dividend payout ratio.

Since bond investment are also affects financial performance positively but not significantly, the study proposes that even though there exists a strong affirmative connection between returns on Investments (ROI) and investments in bonds, this connection may not be substantial enough to markedly affect ROI, therefore investors should circumspect allocating their resources to bonds and contemplate diversifying their portfolios into other classes of portfolio to enhance their inclusive financial performance.

Since money market funds absolutely shake financial performance therefore the study recommend that investment firms to incorporate them into the portfolio which will improve the businesses financial performance.

Investment firms must be careful how they channel their resources into asset asset portfolio to avoid risk and enhance returns. The study therefore suggests that investment firms should evaluate the risk and return profile of their portfolio and contemplate alternative avenues for investment.

Equally, the study recommends that investors should manage asset portfolio opportunities to supplement their risk to other funds. Finally, the study that investors should considerately balance the option of diversifying their allotments to asset portfolio as a precaution against inflation.

**Ethical Approval:**

A permit and letter of authorization was obtained from National Council for Science and Technology in the ministry of education. This permit and letter was used together with the university’s department consent letter to confirm the legitimacy of the study. Anonymity was guaranteed by using code numbers instead of names.

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