

**EFFECT OF INCOME SOURCE DIVERSIFICATION ON FINANCIAL
PERFORMANCE OF DEPOSIT TAKING SAVINGS AND CREDIT COOPERATIVE
SOCIETIES IN NAIROBI COUNTY**

BY

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DECLARATION

I declare that this dissertation is my original work and has not been previously published or submitted elsewhere for award of a degree. I also declare that this contains no material written or published by other people except where due reference is made and author duly acknowledged.

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ABSTRACT

SACCO industry has experienced growth that has increasingly brought competition and this has made a number of SACCOS to diversify their sources of income thus bringing to question the impact of such diversification on the performance of SACCOS. This study was carried out with an aim to analyse the effect of income source diversification on the financial performance of SACCOS. Specifically, the study focused on the effect of service charges, sale/lease of assets and other sources of non-interest income on financial performance of deposit taking SACCOS in Kenya. The study used descriptive study design and targeted a population of 36 licensed deposit taking SACCOS in Nairobi County. The sample of the study was 100 respondents selected from 5 SACCOS. Purposive sampling was used to collect data from the unit of the study who are the managers in the SACCOS. The study used questionnaire method to collect data from the respondents with the questionnaire piloted before data collection to test for reliability and validity. Data collected was analysed through SPSS through the use of Pearson correlation and ordinal regression. The data analysed was presented through tables, frequencies charts, graphs and frequencies. The study findings indicated that there is no significant relationship between service fees and financial performance of SACCOS. The study findings further revealed that sales/lease of assets and other non-interest income has significant relationship with financial performance of SACCOS. The study results indicated that 44.1% of the changes in financial performance of SACCOS can be attributed to service fees, sale/lease of assets and other sources of non-interest income. The study concludes that sales and lease of assets and other non-interest income affect financial performance of SACCOS. The study recommends that SACCOS should increasingly diversify their income source to sale/lease of assets and other non-interest income.

Keywords: Financial performance, Income Source Diversification

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TABLE OF CONTENTS

ABSTRACT	iii
ACKNOWLEDGEMENT.....	iv
DEDICATION.....	vii
LIST OF TABLES	viii
LIST OF FIGURES	ix
ACRONYMS AND ABBREVIATIONS.....	x
TERMS AND DEFINITIONS	xi
CHAPTER ONE	1
INTRODUCTION.....	1
1.1 Background of the Study	1
1.2 Statement of Problem.....	4
1.3 Main Objective.....	6
1.4 Significance of the Study	6
1.5 Assumption	7
CHAPTER TWO: LITERATURE REVIEW.....	8
2.1 Introduction.....	8
2.2 Theoretical Framework.....	8
2.3 Empirical Review.....	10
2.4 Income source Diversification	12
2.5 Service Fees Charged on Loans by SACCOs	13
2.6 Sale and lease of assets owned by the SACCOs.....	15
2.7 Other Source of Non-Interest Income Diversifications of SACCOs	17
2.8 Performance of SACCOs.....	19
2.9 Conceptual Framework.....	21
Research Hypothesis	22
2.10 Summary of Literature Review.....	23
CHAPTER THREE: RESEARCH METHODOLOGY	24
3.1 Introduction.....	24
3.2 Research design	24
3.3 Population	24
3.5 Data Collection methods.....	25
3.6 Research Instrument.....	25
3.7 Data Analysis.....	26
3.8 Ethical Considerations	28
CHAPTER FOUR: FINDINGS AND DISCUSSIONS	29
4.1 Introduction.....	29
4.3 Demographic characteristics of the respondents.....	29
4.4 Sources of Income.....	33
4.5 Service fee and financial performance of SACCOs	35
4.6 Sale or lease of SACCO assets	37
4.7 Other sources of non-interest income	39
4.8 Regression Model Analysis	42
CHAPTER FIVE	46
SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATION	46
5.3 Discussion of Findings.....	48
5.4 Conclusion	50
5.5 Recommendations.....	50

5.6 Suggestions for further research	51
5.7 Limitations of the study	51
REFERENCES	52
APPENDICES	55
Appendix I	55
Questionnaire	55

DEDICATION

I dedicate this dissertation to my loving son Shuahib and my dear husband Salim for the Moral and Financial support that they gave me during the entire Masters programme.

LIST OF TABLES

Table 1: Operationalization of the Variables	22
Table 2: Reliability Test.....	29
Table 3: Gender.....	30
Table 4: Age of the Respondents	30
Table 5: Length of service of Respondents.....	32
Table 6: Positions held by the Respondents in the SACCO	32
Table 7: Sources of income for the SACCOS	34
Table 8: Extent to which Service fees influences the Financial performance of SACCOs.....	35
Table 9: Respondent's perception on influence of Service fees on Performance of SACCOs	36
Table 10: Relationship between service fees and Financial Performance of SACCOs.....	37
Table 11: Extent to which Sale or Lease of assets Influence Performance of SACCOs	37
Table 12: Sale or Lease of Assets and Financial Performance of SACCOs.....	38
Table 13: Relationship between Sale or Lease of Assets and Financial Performance of SACCOs.....	38
Table 14: Extent to which Other Sources of Non-interest income affect Financial Performance of SACCOs.....	39
Table 15: Other Sources of Non-interest income and Financial Performance of SACCOs	40
Table 16: Relationship between Non-interest income and Performance of SACCOs.....	41
Table 17: Test for Normality	42
Table 18: Model Fit Results.....	42
Table 19: Results of the R^2	43
Table 20: Coefficients of the regression Model.....	43

LIST OF FIGURES

Figure 1: Conceptual Framework	21
Figure 2: Highest Level of Education attained	31
Figure 3: License renewal by the SACCOs	33
Figure 4: Extent of Service fees influence on Financial Performance of SACCOs	35
Figure 5: Sale or Lease of Assets.....	38
Figure 6: Other Sources of Non-interest Income	40

ACRONYMS AND ABBREVIATIONS

ACOSCCA -Africa Confederation of Savings and Credit Associations

BOSA- Back Office Saving Activity

DTs -Deposit Taking SACCOs

FOSA - Front Office Saving Activity

NIM: Net Interest Margin

ROA: Return on asset

ROE: Return on Equity

SACCOs: Savings and Credit Cooperatives

SASRA: SACCO Societies Regulatory Authority

NIM: Net Interest Margin

TERMS AND DEFINITIONS

Financial performance: is the measure of financial health of an organization measured over a period of time and in comparison, to similar firms in the same industry in sector Weche, 2004)

Income Source Diversification: This is the shifting from traditional sources of income to new sources of income (Stiroh, 2004)

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

The competitive environment is very broad in scope and to a large extent uncontrollable. The significance of this to an organization is that changes caused by the external environment are difficult to control and demand prompt response. Failure to respond appropriately would subject the organization to strategic misfit and hinder the success of the organization. An organization's success is therefore determined by the way it responds to the forces of the environment. The competitive environment of the firm comprises various factors including suppliers, buyers, product substitutes, threat of new entrants, and the degree of competition among rivals that have direct influence on a company, its responses and its competitive actions. An organization's strategic response can be considered as the matching of its activities to the environment wherein it operates and one such response is diversification (Gijssels & Devetere, 2007).

To effectively sustain performance and play the role of financial intermediation as envisaged in the Kenya Vision 2030, it is necessary for SACCOs to improve their competitiveness in the highly competitive and unstable financial services sector. Consequently, it is vital for managers to familiarise themselves with the trends, rate and level of this competition. They must therefore manage their firm in such a manner that it can compete favourably, thus guaranteeing the SACCOs' growth and survival (Maina, 2007).

Conversely SACCOs that lack proper competitive advantages over others have not fully adopted diversification. However, a number of SACCOs have increasingly adopted diversification to increase its income and revenue. To raise more funds, the modern day SACCOs have expanded their investments in services ; some sell life insurance, others act as

brokers for group insurance plans where state permits. Many SACCOs are now active in offering 24 hour automated services, financial planning services, retirement savings, home equity and first mortgage loans and payment services, all with a view to increasing their income reserves. However, credit unions' permissible investments in securities are limited to a list prescribed by state regulations. For instance, the Sacco Societies Act of Kenya specifies the various investments that SACCOs in Kenya can market (Keasey, et al., 2004).

1.1.1 Income Source Diversification

Financial institutions in recent years have increasingly been generating income from “off-balance sheet” business and fee income. Uzhegova (2010) noted that the decline in interest margins, has forced financial institutions to search for other sources of income, leading to diversification into trading activities, other services and non-traditional financial operations. The concept of diversifications revenue follows the concept of portfolio theory which states that individuals can reduce firm-specific risk by diversifying their portfolios. However there is a long history of debates about the benefits and costs of diversification in banking literature. The proponents of activity diversification or product mix argue that diversification provides a stable and less volatile income, economies of scope and scale, and the ability to leverage managerial efficiency across products (Choi and Kotrozo, 2006). Chiorazzo et al (2008) noted that as a result of activity diversification, the economies of scale and scope caused through the joint production of financial activities leads to increase in the efficiency of banking organizations.

1.1.2 Concept of Financial Performance of SACCOs

Financial performance is the measure of financial health of an organization measured over a period of time and in comparison, to similar firms in the same industry in sector. There are many different ways to measure financial performance, and these measures may take either

the form of subjective or objective. The objective measurement of financial performance of an organization usually includes reference to the financial statement and includes the use of the following ratios; Return on Equity(ROE), return on asset(ROA) and Net Interest Margin(NIM) are the main ones (Weche, 2004). ROA is a key ratio that shows the prosperity of a business unit. ROA refers to the ratio of income to total assets whereas NIM refers to a measure of the difference between the interest incomes generated by SACCOs/ banks and the sum of interest paid out to their lenders, compared to the quantity of their assets. ROE is the financial ratio that describes the amount of profit a company earned relative to the total amount of shareholders equity it invested. Subjective financial performance measurement has also been used to measure the financial performance of organizations through collection of primary data from employees, managers, shareholders, investors among others. Subjective financial performance will be used in this study to measure the financial performance of SACCOs.

1.1.3 Deposit Taking SACCOs in Nairobi County

The SACCO industry is a component of Kenya's cooperative sector, which has had an impact on lives of many Kenyans who are disadvantaged over the years. The sector may be grouped into financial and non-financial cooperatives. Non-financial cooperatives deal with the marketing of members' produce and services such as dairy, livestock coffee, tea, handicrafts and many more similar cooperatives. On the other hand financial cooperatives comprise SACCOs, housing and investment cooperatives. The SACCO sub sector can be described as two-tiered given the range of financial services to members and regulatory regime (SASRA, 2013)

The SACCOs are defined in law as Non-Deposit Taking societies that provide savings and credit products of a limited range. The registration and supervision of SACCOs is provided under the Cooperative Services Act, CAP 490. The Deposit Taking SACCOs

besides the credit products and basic savings, also offer basic ‘banking’ services (payments services, demand deposits and channels such as quasi banking services commonly known as ATMs), FOSA and are licensed and supervised under the Sacco Societies Act of, 2008. SASRA (2013) argues that the general development is that SACCOs begin as non-deposit taking Sacco business and develop into deposit taking Sacco business to enlarge the range of financial services to members

By December 2013 there were 215 deposit taking Sacco’s out of which one hundred and thirty-five (135) were licensed by SASRA, out of which 36 Sacco’s are based in Nairobi. The remaining 80 SACCOS were still working to satisfy the licensing requirements as they had up to June 17th 2014 to conform or cease the business of deposit taking Sacco. The 215 DTS account for 78% of the total deposits and assets of the entire sub-sector of SACCOs. Further, they have membership of 82% in the Sacco industry (SASRA, 2013).

1.2 Statement of Problem

SACCOs operate under complex and dynamic environment which is unique and specific to the sector. This has contributed to either collapse or deteriorating performance for those that survived. This is due to numerous challenges encountered in this volatile environment. Generally, these challenges are caused by economic and stiff competition from their competitors, Economic liberalization and regulation of business. The challenges that SACCOs have faced have led a number to turn to diversification for more income (Okello, 2006).

Hughes (2001) and Hsueh and Tu (2004) have established that highly competitive SACCOs that adopt diversification strategies can improve their performance. As a result of increased threat to survival of SACCOs, they argue that SACCOS should increasingly adopt income source diversification and product diversification to improve their financial performance.

The adoption of diversification strategies by SACCOs in Kenya has been established by a number of studies. According to a study by Mugambi *et al* (2015) they found that a number of SACCOs are increasingly engaging in diversification of their products and sources of income all with an aim of reducing risks. Magali (2012) in a Study in carried out in Tanzania that established that SACCOs predominantly engage in product diversification as opposed to income source diversification.

Internationally a number of studies have been carried out on the relationship between income source diversification and financial performance of banking institutions. These studies include: Gürbüz(2013) carried out a study in Turkey to establish the effect of income source diversification on banking sectors. This study focused on the following variables of service charge, insurance income and forex trade and its effect on performance of commercial banks. Karakaya¹ & Er (2013) also carried out a study in Iran on the effect of non-interest income on the financial performance of commercial banks. This study only focused on fee based income in commercial banks.

Regionally, Amediku (2012) carried out a study in Ghana to establish the relationship between income source diversification and financial performance of banks, with the study focusing only on banks and on fee-based income, Investment income, and mutual fund income. Locally, Murithi (2013) did a study that focused on the effect of non-interest income on financial performance of banks. This study focused on service charges, foreign exchange and sale assets and their effect on five most profitable commercial banks. Mwau (2013) carried out a study on relationship between product diversification and performance of SACCOs. This study focused on diversification of SACCOs in new product lines, with emphasis on FOSA and its effect on the financial performance of SACCOs while excluding other product line. In addition the study focused on both deposit taking and non-deposit taking SACCOs.

Due to limited studies that have focused on the effect of Income source diversification on financial performance of SACCOs this study has been carried out with an aim to determine the effect of income source diversification on the financial performance of deposit taking SACCOs in Kenya.

1.3 Main Objective

The main objective of the study was to establish the effect of income source diversification on the financial performance of deposit taking SACCOs in Nairobi County

1.3.1 Specific Objective

- i. To determine the effect of service fees on the financial performance of deposit taking SACCOs in Nairobi County
- ii. To determine the effect of sale and lease of assets on financial performance of deposit taking SACCOs in Nairobi County
- iii. To determine the effect of other non-interest income diversification on financial performance of deposit taking SACCOs in Nairobi County

1.3.2 Research questions

- i. How do service fees affect the financial performance of deposit taking SACCOs in Nairobi County?
- ii. How does sale and lease of assets affect the financial performance of deposit taking SACCOs in Nairobi County?
- iii. How does other non-interest income source affect the financial performance of deposit taking SACCOs in Nairobi County?

1.4 Significance of the Study

The study was expected to generate new knowledge which enables SACCOs to adopt diversification strategies and remain competitive in the global market furthermore it is noted

that there is limited research undertaken by cooperatives, government or training institution leading to limited reliable data on cooperatives hence there is need to utilize the research findings from this research for their growth and progress.

This study will give insight in the government and policy makers to understand the nature and uniqueness of the cooperatives and the need to introduce tax regime that is fair and just to cooperative societies. According to International Cooperative Alliance (ICA) 2012 statistics indicate that 1 out 5 Kenyans is a member of a cooperative societies translating to 20million Kenyans.

1.5 Assumptions

1. The SACCOs in Nairobi have adopted income source diversification
2. The respondents will be willing to provide the required information by the researcher

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter will focus mainly on information by the researcher about the effect of income source diversification on financial performance of SACCOs. The specific areas to be researched on include theoretical review; financial intermediation theory, resource based theory, Income diversification components and conceptual framework.

2.2 Theoretical Framework

There are a number of theories that have been propagated to explain the relationship between income source diversification and the financial performance of financial institutions. In this study the following theories were used.

2.2.1 Resource-Based View Theory

The resource based-view is a theoretical perspective of the firm that advances the sustainable competitive advantage usually has its origin from within the firm and that at the level of the firm strategy is therefore determined by resources and capabilities that are specific to the firm. There resource-based view of the firm suggests that diversification arises as firms attempt to leverage non-tradable firm-specific resources, among them human resources. Studies of diversification have long been a mainstay of economics as well as strategic management research (Hoskisson and Hitt, 2010). Resource-based view theory generally assumes that firms are organized with a single product focus and face a homogeneous factor market. Based on those assumptions, a market power is at the expense of its competitors and customers. More skeptical views offered by agency theorists emphasize the benefits that diversification offers to firm managers themselves, often at the expense of its shareholders.

The level at which existing resources are being utilized and exploited determines the effectiveness of the company's strategies. To the extent that firms have pools of underused resources, these create unique, firm-specific opportunities for exploitation (Montgomery, 2004). Diversification is one such strategy for exploiting existing firm-specific resources: firm diversification can be understood as a process through which managers first identify resources that are unique to their firm, and then decide how to diversify to maximize returns to the firms. This theory will be crucial to the study in that it will help understand why firms have diversified into non-interest income activities and the benefit that the firm will achieve through the diversification.

2.2.2 Financial intermediation Theory

Financial intermediation is a process which involves surplus units depositing funds with financial institutions who then lend to deficit units. According to Stiroh (2004) there are four major criteria that make financial intermediaries distinct. The first criterion is that the main groups of liabilities are specified for a set figure which has no relationship with a portfolios performance. The Second is that the deposits are usually short-range and their duration is shorter than that of their assets. The third criterion is that a high percentage of the liabilities of financial intermediaries are cheque able (can be withdrawn on demand). Finally, the assets and liabilities of financial intermediaries to a great extent are non-transferable. Bosch & Kick (2009) argues that the most significant input of financial intermediaries is a stable flow of money from units that have surplus to units that have deficiencies.

According to Scholtens and van Wensveen (2003), the role of the financial intermediary is essentially seen as that of creating specialized financial products. Financial products are always created every time an intermediary find that it can sell them for prices that are expected to cater for all production costs; both opportunity costs and direct costs.

Market imperfections are the major causes of financial intermediaries. Financial intermediaries cannot exist in a 'perfect' market environment where information or transaction costs are absent. The major characteristic of most markets is informational disparity between buyers and sellers. Information asymmetry is most conspicuous in financial markets. Borrowers are usually more informed on their industriousness, warranty, and moral integrity than the lenders. On the other hand, entrepreneurs possess inside information about their own projects for which they seek financing. According to Scholtens and van Wensveen, (2003) moral risks impede information transfer between market participants, which is a vital factor for financing projects of good quality.

2.3 Empirical Review

Theoretically, diversification among sources of income in any financial institution is favoured, because net trading profits, service fees and other non-interest income are either not correlated or not perfectly correlated with net interest income. Therefore, diversification of income should lead to advanced risk-adjusted financial performance and more steady net operating income. Nevertheless, empirical studies examining the effects of diversification of income in banking do not plainly support the hypothetically expected diversification benefits. The outcomes of studies investigating this relationship are varied. While some studies verify that diversification of income leads to reduction of risks in banks and improve risk-adjusted performance, other studies in the literature do not show any noteworthy connection or find the negative effects of diversification income on the performance and risk reduction of banks.

Between 1989 and 2001 a research was conducted by DeYoung and Rice (2004) to investigate the relationship between financial performance and non-interest income in the banking sector of the United States. Their results showed a negative relationship between risk-adjusted financial performance and non-interest income of banks in the U.S. Stiroh (2004) who conducted a similar study between 1970 and 2001 found that the relationship

between non-interest income and bank insolvency risk is positive. This was an indication that diversification of income raises the liquidation risk of banks. Mercieca et al. (2007) investigated effects of income diversification on small banks in Europe. They exclusively examined whether increased non-interest income activities could lead to any improvement on the performance of small credit institutions in Europe or not by use of 755 small banks dataset for the 1997 – 2003 period. The outcome of their research was that there is an inverse relationship between risk-adjusted performance and non-interest income performance of banks. Lepetit et al. (2008) conducted a similar from 1996 to 2002 and found that the relationship between banks default risk and non-interest income and was positive.

Diversification of income sources is said to comparatively yield to advantages since it can reduce the shocks to net interest margins (idiosyncratic risk) arising from adverse changes in lending rates (Lin et al., 2012). Lepetit et al. (2008) carried out a study that found out a bank expansion into fee-based services leads to low lending rates, observing that diversification impacts on loan pricing and interest rate margins effectively curb volatility in bank earnings. This finding ties in well with the fact that it has been established lending to specific loan activities is one cause of banking crises in the last 5 years (Tabak et al., 2011).

A research by Laeven and Levine (2007) assessed how the market value is affected by diversification in large banks from 42 different states and established that diversified banks exhibited lower market values when compared against their specialized counterparts. A study by Demirguç-Kunt and Huizinga (2009) analysed the implications of activities of the banks and short-term funding plans for bank returns and risks using a sample of 1334 banks in 101 countries. The conclusion was that universal banking can be useful in terms of risk diversification and increase of returns, but banking plans mainly depend on generating non-interest income or attracting non-deposit funding are very risky.

Molyneux & Yip (2012) in a study to investigate the effect of diversification of income on the performance of Islamic banks in Saudi Arabia, Malaysia, United Arab Emirates, Kuwait, Qatar and Bahrain and where they function together with usual banks in a dual banking system. Accounting information was drawn from 42 Islamic banks and 68 usual banks from 1997 to 2009. The major focus of the research was to investigate whether a greater dependence on non-financing income impacts on earnings quality and, if so, how this may differ between conventional and Islamic banks.

Fee and Commission income, trading income and other non-financing income comprise non-financing income. This is referred to as non-interest income for usual banks. However, the name is different in Islamic banking since the payment or receipt of interest is not allowed. In such banking, it is known as non-financing income. The term means that the income is not associated to loan granting and deposit taking. The study, using different approaches, established that the influence non-financing income has on banks' risk-adjusted performance is positive on the basis of a net overall impact. On its own, more income diversification leads to increased income volatility, which in turn impacts negatively on the risk-adjusted performance of the banks. The study also revealed that, considering that the source of income for Islamic banks has lower diversification, they seem less susceptible to the volatility of earnings. In general, on a risk-adjusted basis, Islamic banks exhibit lower profitability than their conventional counterparts.

2.4 Income source Diversification

Mercieca et al. (2007) advances three dimensions of diversification in the banking sector namely, (a) financial products and services diversification, (b) geographic diversification, and (c) a combination of geographic and business line diversification. In the banking sector, income diversification means that the net trading profits, the share of fees and other non-interest income are increasing within a bank's net operating income. Income sources

diversification in finance theory should result in a greater risk adjusted performance and a lower risk level. The income sources diversification is expected to lead to greater stability of the bank's net operating income given that net trading profits, service fees, and other non-interest income are uncorrelated or poorly connected with the net interest income. Nevertheless, some studies focusing on how income diversification affects the risk-adjusted bank performance show evidence that diversification may result in a higher volatility of the operating income of a bank. DeYoung and Roland (2001) advanced three major reasons that can explain why non-interest income may lead to an increase in a bank's operating income volatility. The first reason is that activities that are loan-based may need higher costs of switching when compared to activities that are fee-based. Secondly, the requirement for operating leverage is lower in lending activities than in fee-based activities. Finally, the financial leverage required for lending activities is lower when compared with activities that are fee-based (DeYoung and Roland, 2001).

2.5 Service Fees Charged on Loans by SACCOs

The main business activity for most financial institutions in the banking sector is lending. The lending sector is usually the largest asset and the dominating source of returns. As such, it is one of the greatest sources of risk to the safety and soundness of banks. Whether due to poor portfolio risk management, weakness in the economy or lax credit standards loan portfolio problems have traditionally been the main cause losses and failures of banks. Effective management of the credit function and loan portfolio is elemental to safety and soundness of a bank. Lending has been, and still is, the mainstay of banks' business, and this is more true to economies that are emerging like Kenya where capital markets are not fully developed. To most of the transition economies, however, and Kenya in particular, lending activities have been controversial and a difficult matter (Richard, 2006).

For many years, managers of good loan portfolios have exerted most of their efforts on prudently approving loans and carefully monitoring loan performance. Although these activities continue to be mainstays of loan portfolio management, analysis of past credit problems, has revealed clearly that there is a need for portfolio managers to do more. Such credit challenges include the ones connected with commercial real estate lending in the 1980s, agricultural lending, and oil and gas lending. There is an over reliance of traditional practices on non-accrual, delinquency, risk rating trends and other trailing indicators of credit quality. Stauffenberg (2002) notes that banks have realized that these indicators fail to provide adequate lead time for corrective action during a systemic increase in risk.

The shift towards fee-based income and new business lines for banks has occurred more frequently in developed countries, which explains why such literature has majorly come from Europe's and US' banking industries. Based on De Young and Rice (2004), one part of flow increases in non-interest income for the US economy was stemming from new business lines enabled by deregulations initiated in the 1990s. The other part emanated from the production of traditional banking services using new processes of production that were facilitated by information technology advances, progress in communications channels and improvements in financial processes.

Stiroh (2006) explained that increased focus on non-interest activities at financial institutions in U.S. was associated with declines in risk-adjusted performance, but lacked sufficient potential for benefits of diversification across broad banking business lines. Staikouras and Wood (2003) conducted a research in 15 countries in Europe to investigate the effects of diversification of non-interest income. The study concluded that in the long run, the volatility of non-interest income is higher than that of interest income and also found negative associations between these two income streams. These findings led them to make the conclusion that service fee-based income tends to stabilize bank earnings.

DeYoung and Roland (2001) established that a shift toward fee-based activities is associated with greater revenue volatility and an advanced degree of total leverage, both of which signify more volatility in earnings for SACCOS. In order to meet the challenges of other financial institutions, SACCOS have started to restructure their business. According to Oyoo (2002), before liberalization in 1997, SACCOS were controlled by the government. After deregulation, SACCOS have begun entering the financial market with innovative services and products on virtually daily basis to obtain maximum profits by gaining maximum market share. The SACCOS have started to diversify their activities into fee-based activities (non-interest income) that earn fee rather interest (Stiroh, 2004).

Busch and Kick (2009) conducted a study of German universal banks in which they investigated the influence fee-based income activities have on risk-adjusted performance measures for the period between 1995 and 2007. The study concluded that the risk-adjusted returns could be enhanced by higher fee-based income. Elsas et al. (2010) carried out research to determine the effects that diversification of income had on both the market value and the performance of the bank at the period between 1996 and 2008 by using a panel data of 9 states. The research advanced that diversification of income, more so through service charges could improve bank profitability and market value.

2.6 Sale and lease of assets owned by the SACCOS

Prohibition from direct ownership of real estate for bank holding companies, national banks and several state-chartered banks with the exception of cases where the real estate is used for bank premises or acquired through foreclosure is effected up to this day. Moreover, institutions of loan and savings have usually had authority to invest directly in real estate and to make commercial real estate loans for only slightly above a decade. Every bank group has the option of starting a leasing arm/department, which provides new sources of income. The leasing business has two counter parties, the lessor and the lessee. The lessor is the one that

gives the leased item to the lessee, for which it receives payments. According to International Accounting Standards, there are two types of contracts. These are "operating lease" contracts and "financial lease". Their difference in accounting is significant, and it plays an important role in non-interest income (Smith *et al*, 2003)

Operating lease contracts are simple lease contracts, for which the lessee pays a “rent” for the use of the leased item. All the risks and the rewards of the leased item stay with the lessor that is why the lessor keeps the leased item in its financial statements. The rents that the lessor receives are its source of income from this business, and in the consolidated financial statements it is classified as non-interest income. Financial lease contracts on the other hand are a lot more complicated. In this case, the lessor operates as a bank or with the SACCO. All the risks and rewards of the leased items stay with its user (the lessee). Although legally the owner is still the lessor, accounting wise the lessee keeps the leased item in its financial statements also calculating depreciation (Tortosa-Ausina, 2003)

Rosen *et al.* (2009) carried out a study with a focus on 319 banks involved in real estate activities from 1980-1985 and conclude that shifts toward high-levels of real estate investment will likely increase risk. Based on a study by Templeton and Severiens (2012) that examined market data with a focus on 54 bank holding firms since 1979 to 1986, diversification, (whose measure is the market value share that is not accredited to bank assets) is connected with lower variance of shareholder returns. This suggests some diversification benefits, although their measure of diversification is a rough proxy at best. Similarly, Kwan (2008) reports that bank Section 20 subsidiaries typically posted more volatile accounting returns, although not necessarily higher returns.

A study by Baele *et al.* (2007) set out to assess whether diversification of income through lease of sale of assets could result in improved performance or a better risk profile in

banks in Europe between the years 1989 to 2004. The study established a positive association between diversification of income and the anticipation of the market on bank profits in the future. It also advanced that lease or sale of assets could reduce the aggregate risk for most banks. However, banks that had higher portions of non-interest income exhibited more systematic risk. A research by Chiorazzo et al. (2008) focused on the connection between diversification of income and profitability of banks in Italy using yearly individual bank data between the years 1993 to 2003. The research findings indicated that diversifications of income by sale of assets could lessen risk-adjusted returns and this association was stronger at larger Italian banks. Recently, Sanya and Wolfe (2011) analyzed income diversification of banks in emerging countries. They found evidence that sale of assets as a source of income had a positive effect on risk-adjusted performance of emerging market banks.

2.7 Other Source of Non-Interest Income Diversifications of SACCOs

Banks are active in multiple markets, so they tend to be able to find and recognize possible opportunities in the real estate sector. Apart from that, they also have access to cheaper funds (i.e. their base of depositors), so they can be more competitive and profitable compared to fashioned real estate enterprises. In order to be able to make profit from the aforementioned advantages, most of the bigger banks or SACCOs have their own real estate companies. Such companies proceed in the purchase of pieces of land or complete buildings, which they either hold as stock in order to profit from possible rises in value, or they rent to individuals and enterprises. Any rental income is recognized on an accrued basis as non-interest income. They also have another source of income, which we will examine in the following lines.

Ankrah (2012) notes that the functioning of banks and how they deliver banking services has undergone a paradigm shift as a result of technology. The application of Technology in banking services delivery has become increasingly widespread having proven to be more reliable, less costly and efficient to operate (Joseph *et al.*, 1999). ICT has a crucial

role in modern banking and its application across the world has largely contributed to the fast changing nature in the manner in which businesses are conducted. These changes have turned the world into a ‘global village.’

The banking industry based on DeYoung and Rice (2004), has seen transformation over the last two decades following the sweeping deregulation and the swift advances in technology in communication infrastructure, financial markets and information flows. The two hypothesize that deregulation has encouraged competition in financial markets between banks and non-banks in situations where such competition did not exist. These threats and opportunities of a competitive nature have evoked a response by various banks to embrace new technologies. The move has brought about drastic alterations in their production and circulation strategies resulting in huge non-interest income increases. Rice (2004) observes that the exact nature of participation in non-traditional activities at a specific bank may be connected to diverse bank-specific characteristics.

Kwan (2007) studied the implications of investment in listed and non-listed equity on bank safety and soundness. He examined the returns on equity activities conducted by Section 20, subsidiaries that were authorised by the Federal Reserve Bank to conduct bank-ineligible securities activities -and their relationship with the returns on banking activities. He found that listed equity investments tend to be riskier but not necessarily more profitable than their bank affiliates. For equity subsidiaries that are primary dealers of in stock exchange, their higher riskiness partially comes from their higher leverage, whereas for those that are not primary dealers, despite having lower leverage, they tend to be riskier than their bank affiliates because of their aggressive trading behaviour. Nevertheless, in this study, equity subsidiaries appear to provide diversification benefits to bank holding companies. Kwast (2009) found that both the mean and standard deviation of equity investment returns are

greater than those of non-equity investments. Some potential for diversification gains is found, although this appears to be quite limited.

The banks are financial institutions and as such, they employ many professionals with experience in the financial sector. They have access to a lot of products that can potentially take advantage of any situation of the market. They keep an eye for arbitrage opportunities, and also use derivatives in order to hedge their risks, or even to take advantage from opportune situations in the market. These derivative instruments do not require initial investments since the outcome will be settled in cash at the end of the contract (Saunders et al, 2014).

2.8 Performance of SACCOs

The arguments by various authors on the functions and objectives of credit unions provide the yard stick upon which the performance of a Sacco society can be measured. The starting point in evaluating a Sacco's performance is its ability to mobilize members' savings. Various authors agree that Sacco societies should help their members to accumulate their savings. This is however a bridge towards the second and most important objective of a SACCO society; that of offering loans or credit facilities. A meeting point in the various definitions of credit unions is that the core function of a Sacco society is to mobilize savings with the intention of affording members credit facilities. Therefore, one of the key measures of a Sacco's performance is the amount of loans that a Sacco society is able to advance to its members (Kellie, 2010)

Equally important is the cost that the SACCO society charges its members for the loans advanced to them. Interest rates charged by Sacco societies are decided by their members and should be fair to the members. Credit unions should make loans to its members at reasonable rates of interest. Credit unions are able to charge lower interest rates to their customers partly because they are non-profit oriented and partly because they enjoy a cost

advantage of being tax exempt. Additionally, credit unions enjoy a lot of gratuitous (volunteer) benefits from its members in an attempt to reduce their operation costs since any cost reductions are passed on to the depositors (members) and therefore the volunteers feel they are working for the common good. Frequently, the sponsoring employer or association provides free office facilities and credit union members elect directors and officers who frequently serve with no compensation at all. Another factor that enables credit unions charge a lower rate of interest is that they experience lower levels of default. The members of a credit union have a common bond which makes them committed to meeting their obligations with the credit union. Therefore, credit cooperatives have the potential to provide affordable credit to their members because they can reduce transaction costs and have a lower risk of default. Even in some instances, credit unions frequently grant their members interest refunds up to 20 percent of the amount of interest due from a loan in addition to accepting a very small spread between their loan and deposit interest rates (Saunders et al, 2014).

Another important indicator of a SACCOs performance is the time it takes between when a loan facility is requested and when the Sacco actually grants the facility. If a Sacco cannot provide a loan as and when a member needs it, then it will be failing in its duty of service to members. A Sacco Society ought to exhibit similar functioning to banks for it to enjoy success and sustainability. Such functions include that it is a group's money market whereby the group shares a common bond, mobilizes funds from members as shares and savings and provides easy access to loans to its members. From these views, it can be concluded that the function of a Sacco society is not just to provide loans but those loans should be easily accessible and available to members on time. The loan turnaround time is not only necessary but of essence for any successful and Sustainable Sacco society (Saunders et al, 2014).

Yet another important indicator of a credit unions performance is the number of its members who benefit from credit facilities. Over 61.4% Of a credit unions asset are invested in loans advanced to its members. These loans are usually relatively small in keeping with the mission of credit unions to provide loans to small borrowers and therefore the number of loan beneficiaries is a more important indicator of a Sacco society’s performance than may be the total volume or amount of the loans.

Another dimension on which the performance of a Sacco can be evaluated is on the ratio of loans given to a member relative to the member’s savings with the Sacco. Usually, Sacco loan size is based on leveraging or a “multiple” of a member’s share and deposit account balances, which guaranteed the loan. The leveraged funds are usually not withdrawable from the credit union while the loan is still outstanding. This ratio is usually not fixed but depends on the Sacco’s policy but normally SACCOs usually give loans to their members equal to three times a member’s savings. This multiple ranges between three and five times the sum of both shares and savings deposits.

2.9 Conceptual Framework

FIGURE 1
Conceptual Framework

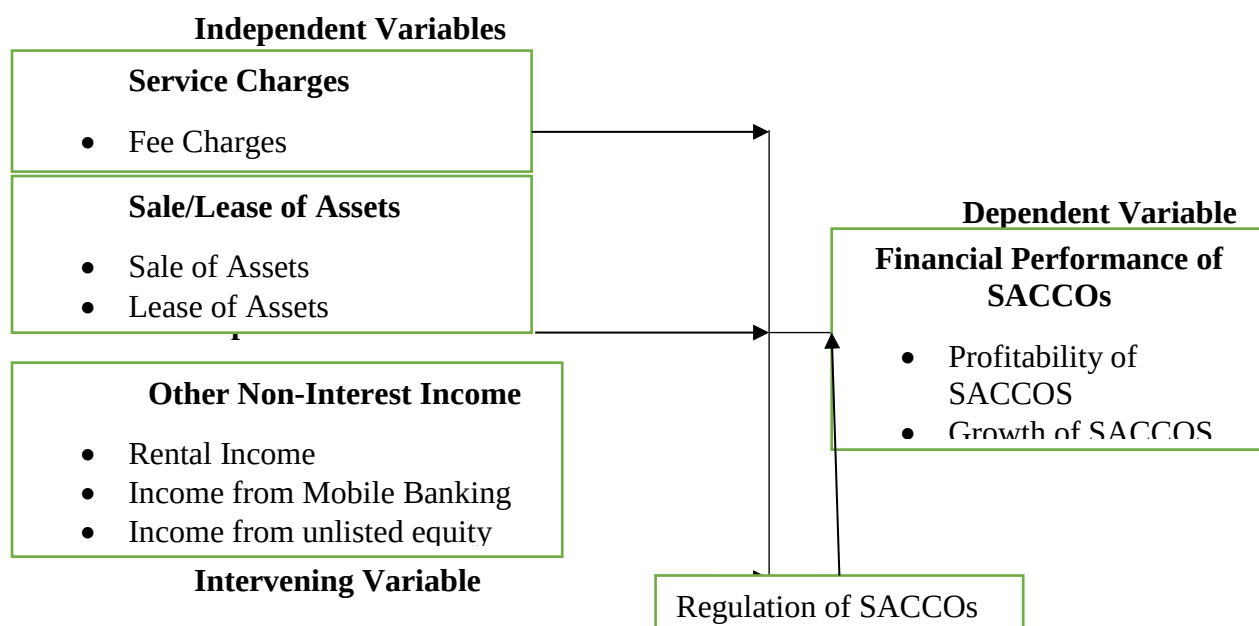


TABLE 1
Operationalization of the Variables

Types of Variables	Variables	Measurement	Level of measurement	Questions
Independent	Service Charge/Fees	Service Fees charged	Ordinal/Nominal	Section B
Independent Variable	Sale/lease of assets	Assets sold or leased	Ordinal/Nominal	Section C
Independent Variable	Other-Non interest income	Rental income earned	Ordinal/Nominal	Section D
Intervening Variable	Sacco regulations	Registration by SASRA	Ordinal/Nominal	Section A Question 6
Moderating Variable	Financial performance	Improved profitability	Ordinal/Nominal	Section E

Source (Researcher) 2015

Research Hypothesis

H1: There is no significant relationship between service charges and financial performance of SACCOs

H1a: There is significant relationship between service charges and financial performance of SACCOs

H2: Sale of assets as form of income diversification does not result to improved financial performance of SACCOs

H2a: Sales of assets as a form of income diversification result to improved financial performance of SACCOs

H3: The use of other non-interest income as a source of income diversification does not lead to better financial performance of SACCOs

H3a: The use of other non-interest income as a source of income diversification does not lead to better financial performance of SACCOs

2.10 Summary of Literature Review

Diversification is a key strategy for financial institutions aiming to improve their performance, with different firms adopting various diversification strategies. Income source diversification is a strategy that has been adopted by financial institutions, more banks with positive results depending on the income source diversification activity.

From the reviewed studies it is evident that majority of the studies have focused on commercial banks both in developed and developing countries. A number of studies have also focused on Islamic bank in developed countries. The reviewed studies have also established that income source diversification has positive effect of the financial performance of banks. However, the same cannot be said to be the case with other financial institutions such microfinance institutions and SACCOs thus necessitating the need for a study in such financial institutions, more so in developing counties.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter focuses on the research methodology which contains the procedures and methods used to collect and analyze data. The chapter looks at study design, target population, study sample size and procedure, data collection, research instruments, ethical considerations and data analysis.

3.2 Research design

Descriptive research design was used in the study. A research design is defined as the blue print and a detailed plan of how a research study is to be conducted (Neuman, 2006). This design was used because of its successful use in management studies and also because it is able to provide information from the respondents within shortest time and at a minimal costs. In addition descriptive design provides accuracy in the study since accuracy is one of its major foundations.

3.3 Population

A target population is the collection of elements about which we wish to make some inferences (Cooper & Schindler, 2008). The target population under study consisted of the 5 deposit taking SACCOs that were selected from the 36 licensed deposit taking SACCOs in Nairobi county having a staff of 2100 (SASRA, 2014). The unit of analysis was managers from licensed deposit taking SACCOs in Nairobi.

3.4 Sampling Size and Sample Procedure

The population of the study comprises 5 selected SACCOs and from the SACCOs, 20 managers were purposively selected bringing the total sample size to 100. Purposive sampling was used to select the respondents who participated in the study. This is because it

enabled the researcher to select respondents who could provide information that would meet the research objectives.

3.5 Data Collection methods

Data is anything given or admitted as a fact on which a research inference is based, (Oso & Onen, 2009). The study used primary data collected through the use of a questionnaire. The researcher used email to send out the questionnaires to the respondents. Each respondent received the same set of questions in exactly the same way. The questionnaires were attached to a cover letter from the researcher explaining the purpose of the study.

3.6 Research Instrument

The research instrument in this study was a questionnaire. The questionnaire was addressed to the managers of selected SACCOs. The questionnaire had both open and closed ended questions. The questionnaire is appropriate for collection of data from a cross-section of respondents. The questionnaire had five parts. The first section sought background information on each respondent. The second section sought information on the fees. Section three on sale and lease of assets. Section four sought information on other non-interest income. Section five provided information on the financial performance of SACCOs.

3.6.1 Reliability and Validity of Instrument

The questionnaire used for data collection was pretested for its face validity through a pilot study that was carried out among five respondents. This was to help gain respondents view on the validity and reliability of the questionnaire. The selected respondents were not allowed to participate in the main study. In addition, the pilot results helped the researcher to fine tune the questionnaire for objectivity and efficiency of the process. Expert views and suggestions of supervisors were included in the questionnaire during the development and fine tuning of the questionnaire. Pre-testing also helped to assess whether the respondents were able and willing to provide the needed information. Pre-testing was conducted in circumstances that

were as similar as possible to actual data collection and on population members as similar as possible to those that would be sampled. As a result of the pilot test, changes in the research instrument were made to improve the reliability and validity of the research instrument.

The instrument was subjected to reliability test using the Cronbach alpha (α) test. An alpha (α) value of $f = \geq 0.7$ was interpreted to mean the instrument was reliable.

3.7 Data Analysis

Data analysis refers to examining what has been collected in a survey or experiment and making deductions and inferences (Kombo and Tromp, 2006). Data collected was edited and checked for completeness and comprehensibility; summarized; coded for easy classification and tabulated. The tabulated quantitative data was then analyzed by using Statistical Package for Social Sciences (SPSS) software to establish the patterns, trends and relationships using both descriptive and inferential statistics.

The Pearson product moment coefficient (R) was used to establish the association between the variables (Financial performance and income source diversification) based on the population data. A coefficient of determination (R^2) was also performed to determine how much of the dependent variable comes about as a result of the independent variable being tested. The study also used ordinal regression to test the relationship between the independent variables and dependent. The data was presented in tables, pie charts and Narratives.

3.7.1 Regression Model

The study examined the effect of income source diversification on financial performance of SACCOs. The variables in the study were classified into dependent and independent variables. The independent variable is the income source diversification unique to SACCOs and the dependent variable is the financial performance of the SACCOs. The relationship between the variables is stated using a mathematical function.

3.7.2 Analytical Model

This is the algebraic expression of the conceptual model.

An analytical model of a linear multiple regression equation of the form shown below was developed.

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + e \dots \dots \dots (i)$$

Y = Financial Performance of SACCOs

X₁ = Fees Charged

X₂ = Sale and lease of Assets

X₃ = other non-interest income

β₀ is the constant of the regression model,

β₁, β₂, and β₃ are the coefficient of independent variables;

While e is an error term normally distributed about a mean of 0 and for purpose of computation, α is assumed to be 0. β₁ is the degree to which a change in fees charged by one unit results in change in financial performance of SACCOS. β₂ is the degree to which a change in sale and lease of assets by one-unit results in change in Financial performance of SACCOs. β₃ is the degree to which a change in other non-interest income by one-unit results in change in financial performance of SACCOs. e refers to the effect of diversification activities that have been omitted in the regression model.

The regression model was tested through Pearson correlation test and ordinal regression analysis. P-value was used to test the relationship between each independent variable and the dependent variable with a p-value of less than 0.05 indicating a significant relationship. R² was used to test the relationship between income source diversification and

financial performance with R^2 nearing 1 showing that a great change in financial performance of SACCOs is caused by income source diversification.

3.8 Ethical Considerations

The researcher first sought a permit from the KCA University and national science of technology to provide explanation and permission that was shared with managers of the selected SACCOs thus enabling the data collection process. The researcher also sought permission from the management of each SACCO. The researcher also sought individual consent and assent from the participating employees with the study participants assured of confidentiality and privacy. The responses given were kept confidential. The responses were used for academic purposes only. All citations were referenced to avoid the problem of plagiarism.

CHAPTER FOUR

FINDINGS AND DISCUSSIONS

4.1 Introduction

The study was conducted to establish the extent to which income source diversification influences the financial performance of the deposit taking SACCOs in Nairobi County.

4.2 Reliability Tests

The researcher carried out a pilot test among 5 selected respondents from licensed deposit taking SACCOs in Nairobi County. The reliability score was done based on the each objective and according to various sections. The reliability scores on each objective indicated that the cronbach's scores were all above 0.70 thus indicating that the questions were reliable.

TABLE 2
Reliability Test

Questions	Cronbach's Alpha Scores
Service fees	0.75
Sale/Lease of Assets	0.78
Other sources of non-interest income	0.82

Source (Researcher) 2015

4.3 Demographic characteristics of the respondents

A total of 71 respondents were interviewed. Table 3 below shows the distribution of the respondents based on gender. The two classes of gender were equally represented with the male being 49% and female 51%.

Table 3**Gender**

Gender	N	%
Female	36	51%
Male	35	49%
Total	71	100%

Source (Researcher) 2015

Table 4 below shows the results of the age groups of the respondents. Majority of them (52%) were between 26 and 35 years, 35% were between ages 36 and 45 years and 7% were above 45 years and 6% were between 18 and 25 years. The results reveal that majority of them (56%) were youths. This indicates the reason for SACCO continued employment over the past few years with major focus on graduates.

TABLE 4**Age of the respondents**

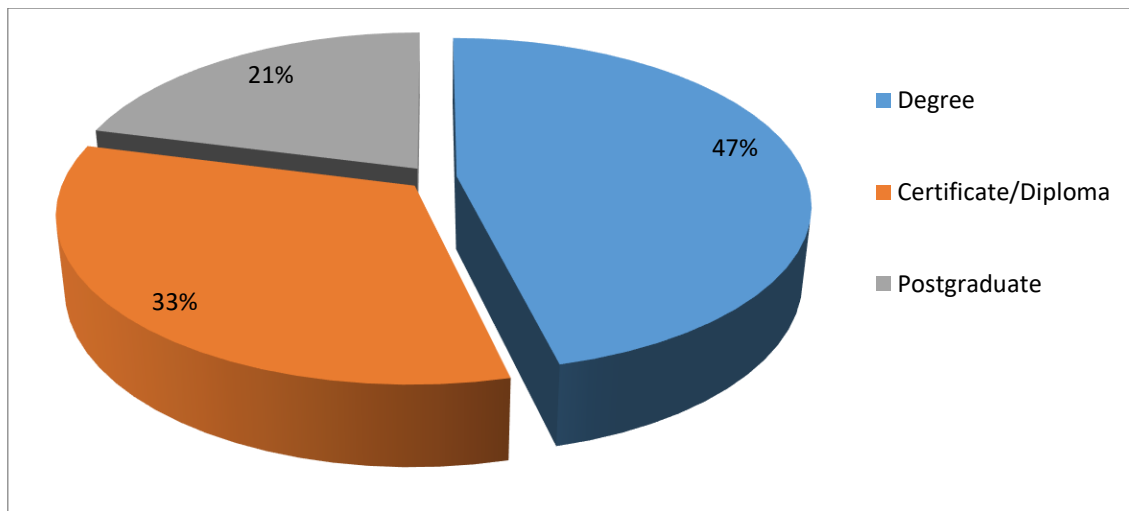
Age of the respondents	N	%
26 - 35 years	36	52%
36 - 45 years	24	35%
46 years and above	5	7%
18 - 25 years	4	6%
Total	69	100%

Source (Researcher) 2015

The researcher also sought to find the level of education of the respondents and the results were as presented in Figure 2 below. All the respondents had at least a tertiary training and above. Majority of them (47%) had degree level of education, 33% had certificate and/or diploma education and 21% had postgraduate education. This indicates the biasness of most SACCOs in employing persons with at least degree level of education. In addition this could

be explained by the reason that a number of employees are increasingly pursuing higher education in their work places, SACCOs notwithstanding.

FIGURE 2
Highest level of education attained



Source (Researcher) 2015

Majority of the respondents (39%) had worked in the various SACCOs for less than three years and 17% had worked for 4-6 years. Another 14% had worked for 7-9 years and 30% had worked for 10 and more years. SACCOs just like other firms are faced with employee turnover challenges since most employees will move into better opportunities thus creating opportunity for SACCOs to hire. In addition with increased diversification of SACCOs into new revenue generating sources over the past five years hence the need to hire new staff in some of the new departments.

TABLE 5
Length of Service of Respondents

Number of years worked in the SACCO	N	%
Less than 3 years	28	39%
4-6 years	12	17%
7-9 years	10	14%
10 and above years	21	30%
Total	71	100%

Source (Researcher) 2015

Majority of the respondent (45%) interviewed were accountants, 16% managers, 10% assistant managers and 10% were credit officer. The rest were 6% ICT officers, 4% FOSA officers, 3% internal auditor, 3% senior risk and compliance officers and 1% each loans officer and CEO as indicated in the table 6 below. This represents the target respondents who had the required information that will meet the research objectives.

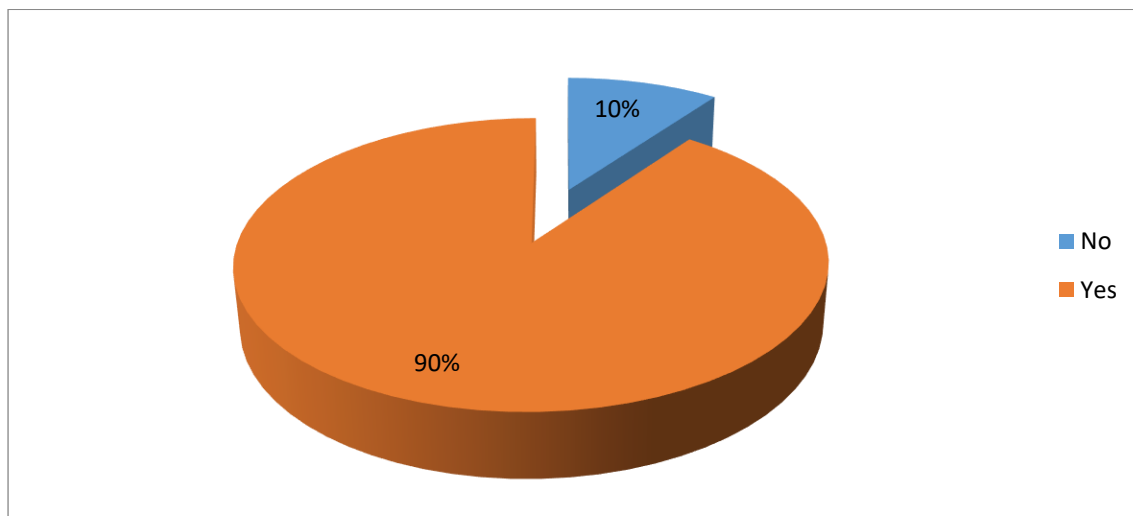
TABLE 6
Positions held by the respondents in the SACCO

Position in the SACCO	N	%
Accountant	31	45%
Manager	11	16%
Assistant Manager	7	10%
Credit Officer	7	10%
ICT Officer	4	6%
FOSA Officer	3	4%
Internal Auditor	2	3%
Senior Officer Risk and Compliance	2	3%
Loans Officer	1	1%
CEO	1	1%
Total	69	100%

Source (Researcher) 2015

The study further sought to find out whether the SACCOs had renewed their licenses with SASRA and 90% of the respondents agreed that their respective SACCOs had renewed the licenses while 10% believed they had not (Fig. 3) below. This is explained by the reason that SACCOs are required by law to register with SASRA and get a license

FIGURE 3
License renewal by the SACCOs



Source (Researcher) 2015

4.4 Sources of Income

Table below shows the various sources of income to the SACCOs. The results revealed that most SACCOs had diversified sources of income. Ninety-four per cent agreed that service fee was one of the diverse income sources to the SACCOs, 85% cited that rental income was another source, 69% pointed out that mobile delivery services also generated income for the SACCOs and 49% agreed that sale of assets was also one of the income sources. Further 48% pointed out that private equity was one of the sources of income, 41% and 34% cited insurance and lease of assets respectively (Table 7).

The other sources of income mentioned were fixed deposits, interests, membership contribution, mortgages and banking and real estates. The possible reason for service fees as

the most common source of non-interest income could be explained by the reason that service fees has been one of the oldest form of non-interest income available to financial institutions and it requires minimal cost.

TABLE 7
Sources of income for the SACCOs

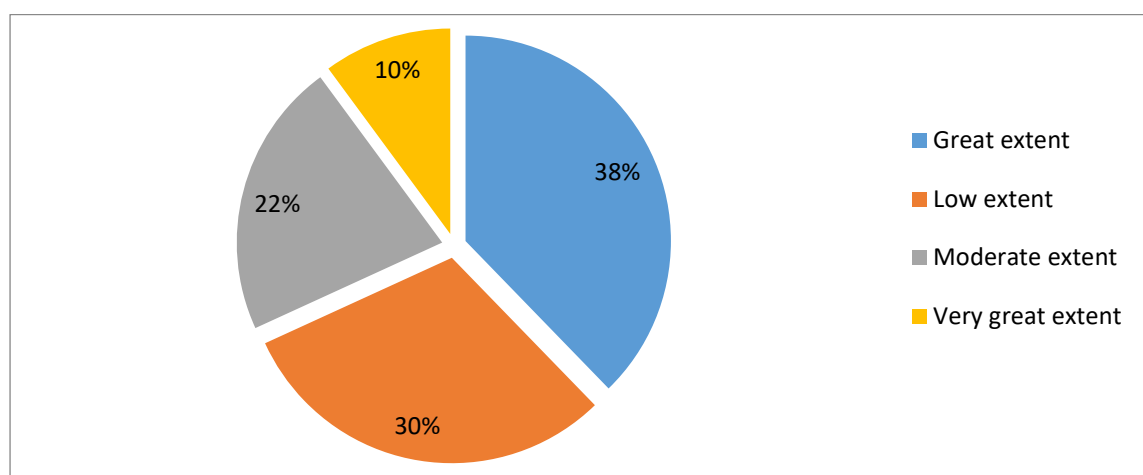
Source of income	N	%
Service fee	67	94%
Rental Income	60	85%
Mobile e-delivery	49	69%
Sale of assets	35	49%
Private equity	34	48%
Insurance	29	41%
Lease of assets	24	34%

Source (Researcher) 2015

The study sought to find the respondents perceptions on the impact the income source diversification have on the financial performance of the SACCOs. The results revealed that 38% believed it influences to a great extent, 30% believed it does to a low extent, 22% to a moderate extent and 10% to a very great extent (Figure 4). Therefore, income diversification is important to ensure that the SACCOs financial position flourishes. Majority of the respondents believe that non-interest income does not contribute more than what interest income contributes to financial SACCOs performance. This is because interest income is still the core business of SACCOs unlike non-interest income of SACCOs.

FIGURE 4

Extent of service fee influence on financial performance of SACCOs



Source (Researcher) 2015

4.5 Service fee and financial performance of SACCOs

The study sought to establish the extent to which service fee contribute to financial performance of the SACCOs. Respondents agreed that service fee was important in making spending and investment decisions. They also agreed that service fee was a vital income source and backbone of trade and that it had improved the profitability of the SACCO (Table 8) below. Service fees has become a major component of SACCOs who attach such fees to their services this explains the reason why respondents agreed that service fees improves financial performance of SACCOs

TABLE 8

Extent to which Service Fee influence the Financial Performance of SACCOs

Statement	N	Mean	SD
Service fees is important in making spending and investment decision	71	4	1.241
Service fee is vital income source and backbone of trade influences financial performance of a SACCO	71	4	1.375
Service charges have improved the profitability of the SACCO	71	4	1.025

Source (Researcher) 2015

The results of respondents' perception on service fee influence on financial performance of SACCOs were as presented in table 9 below. Majority of them 69% agreed that service fee contribute to the financial performance of SACCOs while 25% were not sure and Only 6% disagreed.

TABLE 9

Respondents' perception on the influence of service fee on financial performance of SACCOs

Service fee	N	%
Strongly agree	26	37%
Agree	23	32%
Neutral	18	25%
Strongly disagree	2	3%
Disagree	2	3%
Total	71	100%

Source (Researcher) 2015

Concerning the relationship between the effect of service fees on financial performance of SACCOs the study established that there exist no significant relationship between service fees and financial performance of SACCOs (Table 10). This was established through a correlation tests that was carried out through bivariate analysis which yielded a p-value of 0.292. P-value is used to indicate the probability of relationship between variables with a p-value of less than 0.05 indicating the probability of a relationship. This could be attribute to the reason that service fees is relatively small and thus may not form a major component of income to SACCOs and since it is linked to active membership in SACCOs.

4.4.1 Relationship between service fee and financial performance of SACCOs

TABLE 10

Relationship between Service Fees and Financial Performance of SACCOs

Extent to which financial performance of the SACCOs has improved		
Service fees	Correlation Coefficient	-0.058
	Sig. (2-tailed)	0.292

* Correlation is not significant at the 0.05 level (1-tailed).

Source (Researcher) 2015

4.6 Sale or lease of SACCO assets

The respondents were asked to give their opinion with regards to the extent to which sale or lease of assets influence SACCO performance. Majority of them (46%) believed it influenced to a great extent, 25% to a moderate extent and 13% to a very great extent. However, 10% believed it influenced to a low extent while 5% believed it did not influence at all (Table 11).

TABLE 11

Extent to which Sale or Lease of Assets influence Financial Performance of SACCOs

Extent to which sale or lease of assets influence financial performance	N	%
Great extent	31	46%
Moderate extent	17	25%
Very great extent	9	13%
Low extent	7	10%
Not at all	3	5%
Total	67	100%

Source (Researcher) 2015

The views on the influence of sale or lease of assets on the financial performance of the SACCOs were analyzed and the results of the means presented in Table 12 below. The respondents were not sure on whether sale or lease of assets had improved financial of performance or enabled the SACCOs to have more money for investments or were a source of revenue to the SACCO. However, they agreed that it had increased the profitability of the

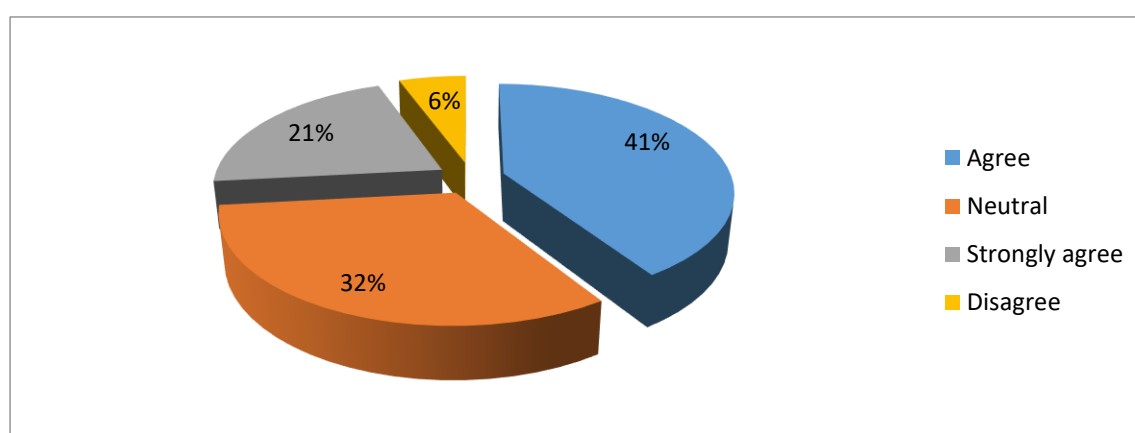
SACCO. This could be attributed to the reason that SACCOs are increasingly using assets acquisition as a way to keep their surplus funds, and then sell or lease the assets when funds are required (Table 12).

TABLE 12
Sale or Lease of Assets and Financial Performance of SACCOs

Statement	N	Mean	SD
Sale or lease of assets has improved the financial performance of the SACCO	71	3	0.974
Sale or lease of assets has enabled the SACCO to have more money for investments	71	3	1.059
Sale or lease of assets has been a source of revenue stream to the SACCO	71	3	1.106
Sale or lease of assets has increased the profitability of the SACCO	71	4	0.993

In general, 62% of the respondents agreed that the sale or lease of assets contribute to the financial performance of SACCO while 32% were not sure and 6% disagreed (Fig 5).

FIGURE 5
Sale or lease of assets



Source (Researcher) 2015

4.5.1 Relationship between Sale/lease of assets and Financial Performance of SACCOs

TABLE 13
Relationship between Sale/lease of Assets and Financial Performance of SACCOs

Extent to which financial performance of the SACCOs has improved		
Sale/Lease of Assets	Correlation Coefficient	.0.179*
	Sig. (2-tailed)	0.04

* Correlation is significant at the 0.05 level (1-tailed).

Source (Researcher) 2015

Concerning the relationship between the effects of sales/lease of assets and financial performance of SACCOs the study established that there exist a significant relationship between sale/lease of assets and financial performance of SACCOs (Table 13). This was established through a correlation tests that was carried out through bivariate analysis which yielded a p-value of 0.04. P-value is used to indicate the probability of relationship between variables with a p-value of less than 0.05 indicating the probability of a relationship. The study further established that the relationship is weak as indicated with a correlation coefficient of 0.179. This finding only attest that SACCOs have increasingly engaged in sale and lease of assets like other financial institutions, and this has a slight significant effect on financial performance of SACCOs.

4.7 Other sources of non-interest income

Regarding the contribution of other non-interest sources of income, 46% believed that it influences to a moderate extent, 29% to a low extent, 15% to a great extent, 3% to a very great extent and 8% believed to have no influence at all (Table 14).The study imply that other non-interest income such as private equity, real estate income have yet to fully take root in SACCOs and thus have relatively minimal effect on financial performance of SACCOs

TABLE 14

Extent to which other sources of non-interest income influence financial performance of SACCOs

Extent to which other sources influence performance	N	%
Not at all	5	8%
Low extent	19	29%

Moderate extent	30	46%
Great extent	10	15%
Very great extent	2	3%
Total	66	100%

Source (Researcher) 2015

The study further sought to establish the influence of other non-interest sources of income on the financial performance of SACCOs. Respondents were neutral on the fact that rental income had improved the liquidity position. They also were neutral that income from unlisted equity had improved the financial performance of the SACCOs. In addition, they agreed that income from investment arm of the SACCO had improved the financial performance of the SACCO (Table 15).

TABLE 15

Other sources of Non-interest Income and Financial Performance of SACCOs

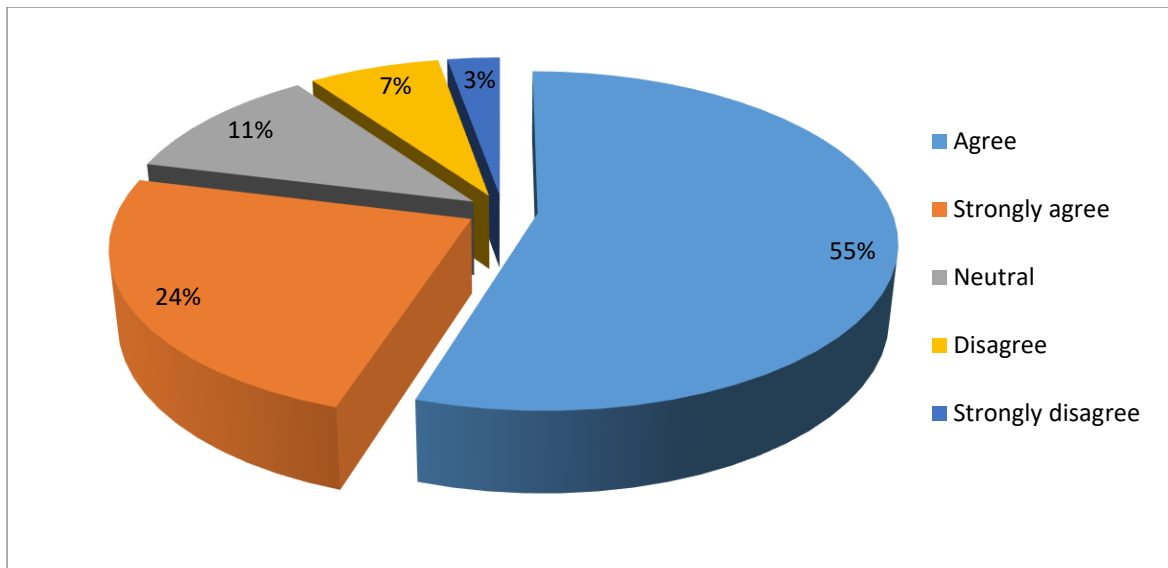
Statement	N	Mean	SD
Rental income has improved the liquidity position	71	3	1.205
Income from unlisted equity has improved the financial performance of the SACCO	71	3	1.026
Income from investment arm of the SACCO has improved the financial performance of the SACCO	71	4	0.952

Source (Researcher) 2015

In general, 79% of the respondents agreed that other source of non-interest income had influence on the financial performance of the SACCOs. However, 11% and 10% were neutral and disagreed respectively.

FIGURE 6

Other sources of non-interest income



Source (Researcher) 2015

The study further sought to determine the association between other sources of non-interest income and financial performance. The results revealed that there was a positively significant relationship at 5% with a p-value of 0.03. However the relationship is weak as shown by the r value of 0.228.

4.6.1 Relationship between other sources of non-interest income and financial performance of SACCOs

Table 16

Relationship between Non-interest Income and Financial Performance of SACCOs

Extent to which financial performance of the SACCOs has improved		
Other sources	Correlation Coefficient	.228*
	Sig. (2-tailed)	0.03

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

Source (Researcher) 2015

On the relationship between other sources of non-interest income and financial performance of SACCOs the study established that there exist a significant relationship between other

sources of non-interest income and financial performance of SACCOs (Table 16). This was established through a correlation test that was carried out through bivariate analysis which yielded a p-value of 0.03. P-value is used to indicate the probability of relationship between variables with a p-value of less than 0.05 indicating the probability of a relationship. The study further established that the relationship is weak as indicated with a correlation coefficient of 0.228. These findings only attest to the fact that SACCOs have increasingly diversified into other sources of non-interest income such as real estate and this has provided more income to SACCOs thus improving its financial performance slightly

4.8 Regression Model Analysis

Ordinal regression was carried out to test the relationship between income source diversification and financial performance of SACCOS. Ordinal regression was used because all the variables were categorical variables. The results of the regression analysis are presented below.

Before carrying out the results of the study the researcher sought to establish if the data met the assumption of normality and to do this the following tests were carried out on the variables. The results of the normality test indicated that the data was normal since the significance was greater than 0.05.

TABLE 17
Test of Normality

Kolmogorov-Smirnov			Shapiro-wilk test		
Statistic	df	Sig	Statistic	df	sig
0.468	69	0.056	0.867	69	0.07

Source (Researcher) 2015

TABLE 18
Model Fit Results

Model Fitting Information

Model	-2 Log Likelihood	Chi-Square	f	Sig.
Intercept Only	133.355			
Final	93.204	40.151	11	0.000

Source (Researcher) 2015

TABLE 19
Results of the R²

Pseudo R-Square	
Cox and Snell	0.441
Nagelkerke	0.478
McFadden	0.226

Source (Researcher) 2015

In order to obtain the regression implications of the independent variables, the percentage data was regressed with the following results obtained. The model shows three different results for the R square as is the case on ordinal regression outputs. In the selection of R² value the researcher is required to use his/her judgment based on the correlation to select R² value for the model. Due to two independent values being significant the researcher selected 0.441 as the R² value for the model (Table 4.18). The model shows R square of 0.441 meaning 44.1% of the outcome was predicted by the independent variables; service fees. Sale / lease of assets and other sources of income. This means that 55.9% of the remainder cannot be explained by the model.

The coefficients analysis gives β_0 (Beta) at 2.425, β_1 at 0.623, β_2 at 2.072 and β_3 at 2.264 (Table 4.19). Where β_0 is the constant, β_1 , β_2 and β_3 are parameter for estimation of the independent variables; service fees, sale and lease of assets and other sources of non-interest incomes.

TABLE 20
Coefficients of the regression model

Parameter Estimates	Estimate	Std. Error	Wald	df	Sig.
---------------------	----------	------------	------	----	------

Constant	2.425	0.776	9.778	1	0.002
Service fee	0.623	0.593	1.105	1	0.293
Sale and lease of assets	2.072	0.663	9.758	1	0.002
Other sources	2.264	1.111	4.154	1	0.042

Source (Researcher) 2015

From our regression equation;

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 \dots \dots \dots (i)$$

Where service fees, sale and lease of assets and other sources of non-interest income, are denoted by X_1 , X_2 and X_3 respectively while financial performance is Y , the regression equation of the model becomes;

$$Y = 2.425 + 0.623X_1 + 2.072X_2 + 2.264X_3 \dots \dots \dots (ii)$$

It is evident from the above regression model that if all factors were to be held constant including service fees, sale and lease of assets and other sources of non-interest income then changes in financial performance would be at 2.425 of a unit.

From the fitted model it can be explained that one unit increase in service fees results in change of financial performance by 0.623, one unit increase in sale/lease of assets results in improved financial performance by 0.623 and one unit increase in other sources of non-interest income results in changes in financial performance by 2.264.

It can also be established from the coefficient of the regression that only sale/lease of assets and other sources of non-interest income are significant. These are indicated with p-values of 0.002 and 0.042. Table 4.19 above shows that service fees had a p-value of 0.293 which was greater than 0.05, service fees therefore had no significant effect on financial performance of deposit taking SACCOs and thus null hypothesis (H_{01}) was not rejected Table 4.19 shows that sale and lease of assets had a p-value of 0.002 which was less than

0.05. The null hypothesis (H_0) was rejected and thus sale and lease of assets had significant effect on the financial performance of deposit taking SACCOs.

Table 4.19 shows that other sources of non-interest income had a p-value of 0.042 which was greater than 0.05. The null hypothesis was rejected and thus other sources of non-interest income had a significant effect on the financial performance of deposit taking SACCOs.

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATION

5.1 Introduction

The major focus of this chapter is to provide the summary of the research findings, the conclusion of the study and the recommendations advanced by the research based on the findings. The study's overall objective was to establish the extent to which income source diversification influences the financial performance of deposit taking SACCOs in Nairobi County. Specifically, the study sought to determine the effect of service charges, sale/lease of assets and other sources of non-interest income on financial performance of licensed deposit taking SACCOs in Nairobi County.

5.2 Summary of Findings

The following were the findings obtained from the survey: The total number of respondents interviewed was 71, with a fair gender distribution of 49% male and 51% female. Based on the results, majority of the respondents were youths (56%); had degree level of education (47%); had worked in the various SACCOs for less than three years (39%); and 45% of them were accountants.

The study revealed that majority of the respondents (90%) agreed that their SACCOs had renewed their licenses with SASRA. Further, it established that most SACCOs had diversified sources of income. Based on the findings, the prevalent sources of income for the SACCOs include service fee; rental income; mobile delivery services; sale of assets; private equity; insurance and lease of assets in that order. The other sources of income mentioned were fixed deposits, interests, membership contribution, mortgages and banking and real estates.

The study also established that income source diversification is important to ensure that the SACCOs financial position flourishes. This was arrived at through seeking the respondents' perceptions on the impact income diversification had on the financial performance of the SACCOs. Majority (38%) believed it influences performance to a great extent.

5.2.1 Findings on the effect of service fees on the financial performance of deposit taking SACCOs in Nairobi County

The study found out that service fee is important in making spending and investment decisions and contributes greatly to financial performance of the SACCOs. This conclusion was based on the respondents' perceptions whereby 69% agreed that service fee was a vital income source and backbone of trade and that it had improved the profitability of the SACCO. However, the results indicated that there was no relationship between service fees and financial performance of SACCOs. This was indicated by p-value of 0.292.

5.2.2 Findings on the effect of Sale/lease of Assets on financial performance of deposit taking SACCOs in Nairobi County

The study revealed that the respondents were certain of the influence the sale or lease of assets had on financial performance of SACCOs. Specifically, they were sure that it was a source of revenue to the SACCO or if it enabled the SACCOs to have more money for investments. However, majority (69%) agreed that it had increased the profitability of the SACCO. This was also indicated through correlation analysis that indicated by a p-value of 0.04. However, the relationship between sale/lease of assets and financial performance was a weak relationship as indicated with a p-value of 0.179.

5.2.3 Findings on the effect of other sources of non-interest income on the financial performance of deposit taking SACCOs in Nairobi County

The research established that generally, 79% of the respondents agreed that other sources of non-interest income influence the financial performance of the SACCOs. However, 11% and 10% were neutral and disagreed respectively. The study results further indicated that there is a relationship between other sources of non-interest income and financial performance and this was indicated with a p-value of 0.03 and a correlation of 0.228 which indicates that the relationship is weak.

5.3 Discussion of Findings

A discussion of the findings based on the objectives of the study is provided in the section below

5.3.1 Discussion on the effect of service fees on the financial performance of deposit taking SACCOs in Nairobi County

The study established that service fees are not significantly related with the financial performance of SACCOs. These findings contradict the results of Molyneux & Yip (2012) in a study to investigate the effect of income diversification on the performance of Islamic banks where they established that service fees is positively correlated with the financial performance of banks. The difference in this finding could be explained by the customer numbers in banks which are more than SACCOs. Thus any service charge expended in SACCOs will not have a big impact as in the commercial banking sector. Similarly the findings align to the results of Frida (2014) who established that services fees do not have any significant effect on low tier of commercial banks in Kenya.

5.3.2 Discussion on the effect of Sale/lease of Assets on financial performance of deposit taking SACCOs in Nairobi County

The study found out that sale/lease of assets is positively related with the financial performance of SACCOs, albeit with a weak relationship. These findings align themselves to the findings of Wolfe (2011) in a study that analysed income diversification of banks in emerging countries. The study found evidence that sale of assets as a source of income had a positive effect on risk-adjusted performance of emerging market banks. These results indicate that sale/lease of assets reduces the profit risk of financial institutions, SACCOs included. Similarly the findings confirm the results of Anjili (2014) who established that sale of assets are contributors to the financial performance of commercial bank through their asset liability management. These findings confirm that sale/lease of assets can result in improved liquidity position of financial institutions.

5.3.3 Discussion on the effect of other sources of non-interest income on the financial performance of deposit taking SACCOs in Nairobi County

From the study findings it was found out that other sources of non-interest income are significantly related with the financial performance of SACCOs though the relationship is a weak relationship. This is similar to the findings of Akinyi(2014) and Mndeme(2015) who established that other non-interest income such as income from real estate are positively correlated with financial performance of commercial banks. Unlike the findings of Akinyi (2014) that indicated a strong positive correlation the study findings showed a weak positive correlation. This could be explained by the fact that engagement in other non-interest income such as real estate requires huge capital outlay to reap good benefits which SACCOS may not necessarily have thus the weak relationship.

5.4 Conclusion

In conclusion, the research demonstrated that income source diversification is necessary to enhance the SACCOs' financial performance. Among the various sources of income identified for the SACCOs; service fee, rental income, mobile delivery services and sale or lease of assets were ranked first in that order. The rest of the sources were generally classified under the category of other sources of income. Moreover, the study revealed that accountants, managers, assistant managers, and credit officers among other officers interviewed were aware of the importance of income source diversification on the financial performance of SACCOs.

The influence the specific income sources had on financial performance of the SACCOs was, however, not clearly distinguished by majority of the respondents. Moreover, an analysis of the relationship between financial performance and other sources of non-interest income revealed that there is a significantly positive association ($p=0.03$, $p<0.05$). The association is, however, weak as demonstrated by the r value of 0.228. This implies that, while SACCOs would benefit more from the highly ranked sources of income, they would reap low benefits from the lowly ranked sources, herein categorized as other sources of income.

5.5 Recommendations

From the findings and conclusion, the study recommends:

That deposit taking SACCOs should carefully consider the type of sources of income they adopt since the sources have varying levels of contribution to the financial performance of the SACCOs. The SACCOs should therefore identify and invest in sources of income that greatly improve their financial performance since some sources may have little or no impact on their performance.

The study recommends that SACCOs need to develop asset management policies like other commercial banks for this will aid in the management of SACCO assets and thereby increasing the financial performances of SACCOs

There is need for the government to develop policies that will fully allow SACCOs to engage in Mortgage just like the commercial banks. This will further entrench real estate as a source of income for SACCOs.

The management of SACCOs should analyse the sources of income to establish and adopt the most feasible for them. Moreover, the SACCOs should seek to determine the influence each source of income has and educate the relevant stakeholders.

5.6 Suggestions for further research

There is need for more survey, particularly at national levels to establish the effect of non-interest income on the financial performance of SACCOs. There is also need for more studies that focus on various categories of SACCOs with a focus on the effect of non-interest income source diversification on the financial performance of SACCOs.

5.7 Limitations of the study

The study faced a limitation in regards to the methodology that the study used since it used primary data and not secondary data or both as this would have provided a better understanding of the effect of income source diversification on financial performance of SACCOs. The study also faced the limitation in terms of respondents with some of the respondents been hard to get due to their schedules and thus they were included.

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APPENDICES

APPENDIX I

Questionnaire

SECTION A: BACKGROUND INFORMATION

You are requested to fill in your personal information in the spaces below. Please tick only one response.

- (1) Please indicate your position in the SACCO.....
- (2) Gender Male: ☐ Female: ☐
- (3) In what category does your age fall?
18-25 ☐ 26-35 ☐ 36-45 ☐ 46 and above ☐
- (4) Highest Level of education 0- Level ☐ Certificate/Diploma ☐ Degree ☐ Postgraduate ☐
- (5) How long have you worked in this organization? Less than 3 years ☐ Between 4 and 6 years ☐ Between 7 and 9 ☐ 10 years and above ☐
- (6) Has the SACCO renewed its license with SASRA
☐ Yes ☐ No ☐ I don't Know

7. The table below contain income source diversification activities that the SACCO engages in. Please tick any of the following income activities sources.

Income Source Diversification activities	Tick
Service Fees	
Sale of Assets	
Lease of Assets	
Rental Income	
Insurance Income	
Income for mobile and E delivery services	
Investment in Private Equity	

Others (specify).....	
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SECTION B: SERVICE CHARGES/ FEES AND FINANCIAL PERFORMANCE OF SACCOS

1. To what extent do you think diversification into service fees influences financial performance of the Sacco? Not at all ☐ Low extent ☐ Moderate extent ☐ Great extent ☐ Very great extent ☐

2. Please indicate your level of agreement with statements below that shows the relationship between service charges/fees and financial performance of the Sacco. On a scale of 1 to 5, where 1 = strongly disagree; 2 = disagree; 3 = Neutral; 4 = Agree and 5 = Strongly Agree

Statement	1	2	3	4	5
Service fees is important in making spending and investment decision for the SACCO					
Service fees is a vital income source and backbone of trade and influences financial performance of a SACCO					
Service Charges have improved the profitability of the SACCO					

SECTION C: SALE/ LEASE OF ASSETS AND FINANCIAL PERFORMANCE OF SACCOS

1. To what extent do you think income from assets owned by the SACCO influences financial performance of the Sacco? Not at all ☐ Low extent ☐ Moderate extent ☐ Great extent ☐ Very great extent ☐

2. Please indicate your level of agreement with statements below that shows the relationship between sale/lease of assets and financial performance of the SACCO. On a scale of 1 to 5, where 1 = strongly disagree; 2 = disagree; 3 = Neutral; 4 = Agree and 5 = Strongly Agree

statement	1	2	3	4	5
Sale/lease of assets has improved the financial performance of the SACCO					
Sale/ lease of assets has enabled the					

SACCO to have more money for investments					
Sales/ lease of assets has been a source of revenue stream to the SACCO					
Sale/lease of assets has increased the profitability of the SACCO					

SECTION D: OTHER SOURCES OF NON-INTEREST INCOME AND FINANCIAL PERFORMANCE OF SACCOS

1. To what extent do you think other sources of non-interest income influences financial performance of SACCO? Not at all ☐ Low extent ☐ Moderate extent ☐ Great extent ☐ Very great extent ☐
2. Please indicate your level of agreement with statements below that shows the relationship between other sources of non-interest income and financial performance of the Sacco.
3. On a scale of 1 to 5, where 1 = strongly disagree; 2 = disagree; 3 = Neutral; 4 = Agree and 5 = Strongly Agree

Statement	1	2	3	4	5
Income from Rental income has improved the liquidity position of the SACCO					
Income from unlisted equity has improved the financial performance of the SACCO					
Income from investment arm of the SACCO has improved the financial performance of the SACCO					

SECTION E: FINANCIAL PERFORMANCE OF THE SACCO OVER THE LAST 5 YEARS (OPTIONAL)

1. To what extent has income source diversification contributed to improved financial performance of the SACCO?
Not at all ☐ Low extent ☐ Moderate extent ☐ Great extent ☐ Very great extent ☐

THANK YOU AND GOD BLESS YOU