# PORTFOLIO DIVERSIFICATION, MANAGEMENT FEE, FUND SIZE AND EFFICIENCY OF MONEY MARKET UNIT TRUST FUNDS IN KENYA

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**CHUKA UNIVERSITY**

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## DECLARATION AND RECOMMENDATION

**Declaration**

This thesis is my original work and has not been submitted for the award of diploma or conferment of degree in this or any other University.

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**Recommendation**

This thesis has been examined, passed and submitted with our approval as University supervisors.

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# DEDICATION

I dedicate this research work to my husband Henry Mukaria and loving daughter, Jasmine Kendi. I am forever grateful and thankful for your love, encouragement, support and for being the driving force behind my academic journey.

I am thankful to my dad, Alex Akenga and mum, Edith Oyiengo your love, encouragement and endless support have been the foundation for my success and academic achievements. You are my rock.

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## ABSTRACT

Money Market Funds (MMF) play a significant role of mobilizing savings from investors and investing the funds in a portfolio of securities to provide returns to investors at low risk levels. Rise in market volatility, economic uncertainty, regulatory demands and geopolitical tensions have magnified risks. Therefore, fund managers need to adopt successful investments strategies and efficient operations so as to manage risks and protect investors interest. Funds that allocate their resources efficiently to form optimal portfolios can realize high returns for investors at low risk levels and low costs. On the flip side, less-than-optimal portfolios may lead to inefficient funds. Management fee prompted by portfolio diversification activities is a reward to managers but a cost to the fund and can either magnify or reduce total fund income. Fund size influences resource availability and costs, which would affect a fund's ability to create optimal portfolios and eventually a fund's efficiency. The main objective of this study was to investigate the interrelationships between portfolio diversification, management fee, fund size and efficiency of MMFs in Kenya. Specifically, this study sought to determine the effect of portfolio diversification on fund efficiency, the mediating role of management fee and the moderating role of fund size on the relationship between portfolio diversification and fund efficiency, to find out if there are significant differences in the mean efficiency of funds due to size, and to examine the joint effect of portfolio diversification, management fee and fund size on efficiency of MMFs in Kenya. The study was anchored on modern portfolio theory, capital asset pricing theory, agency theory and economic efficiency theory. The study adopted descriptive, causal and longitudinal research designs. Secondary data was collected from 25 MMFs over the period 2018 to 2024 yielding 122 fund year observations. Data analysis was done on STATA version 18. Descriptive statistics provided simple summaries of the population. Inferential statistics and panel data regressions were utilized for testing of statistical hypotheses. A two-stage analysis was adopted whereby in the first stage, efficiency scores were computed using Data Envelopment Analysis and in the second stage, Generalized Method of Moment model was used to determine the relationship among study variables. The findings revealed that, over the study period, the mean efficiency of MMFs was 46.8%, implying that funds were not 100% efficient. Further, portfolio diversification had a significant positive effect on fund efficiency ($\beta=0.520$, p-value$<0.05$). Management fee had no statistically significant mediating effect on the relationship between portfolio diversification and fund efficiency. The findings suggested that there were significant differences in the mean efficiency of MMFs due to size ($F=20.446$, p-value$<0.05$). Fund size had a statistically significant moderating effect on the relationship between portfolio diversification and efficiency ($\beta=0.522$, p-value$<0.05$). Portfolio diversification and fund size jointly influenced the efficiency of MMFs ($\beta=0.543$, p-value$<0.05$) and ($\beta= -0.06$, pvalue$<0.05$) respectively. The study recommends that fund managers should create well-diversified portfolios so as to maximize fund efficiency. Funds should operate an optimal size of assets under management in order to achieve efficiency in scale of operations. Policy makers should create policies that ensure the continuous

monitoring of MMFs and facilitate growth and development of the money market. Fund's trustees should regularly review and monitor the funds' investment strategy and size of assets under management to ensure they promote efficiency.