A MARKET SEGMENTATION APPROACH TO OPTIMIZING MUTUAL FUND RETURNS: EVIDENCE FROM THE NIGERIAN CAPITAL MARKET

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ABSTRACT

Mutual funds, as a form of alternative investment has witnessed remarkable growth over the past decade. More specifically, the recent global financial crisis that resulted in huge losses for equity investors, has made the investing public to search for alternative routes to investing in the capital market. Fund managers have therefore turn towards more creative ways to satisfy this need by adopting a market segmentation approach to attracting investors. In the last five years, a number of new funds targeting specific gender, ethical or religious sentiment have come on board and are competing faovourbly with the much older, equity based, "balanced funds" on all indices.

This study investigates the performance of mutual funds in Nigeria through a comparative analysis of a sample of open-ended, equity-based, balanced funds, and a sample of gender specific, ethical and faith based funds. The data set used controls for age, sixe, liquidity and investment policy of the funds.

We find that mutual funds as a whole slightly out performs the all-share index (NSEASI) but no group of funds significantly out performs the other. Size and age have explanatory powers in funds performance but this is specific to investment policy. Funds targeting specific segments recorded greater net cash flows through this makes no immediate impact on fund performance since fund managers are unable to allocate their portfolio immediately due to restricted investment policy.

The funding suggest that for economies with the benefit of huge population and diversity like Nigeria, further segmentation will deepen the market as investors can hope to get competitive returns whilst still holding on to those sentiments or values they cherish.

INTRODUCTION

Investment in unit trust scheme became part of Nigeria's investment climate since the early 1990's. However, the banking consolidation exercise of 2004 made investing in the Nigerian capital market so rewarding that it attracted all manners of investors, risk averse and non risk averse. With the global financial meltdown which began to manifest form 2008, majority of investors and participants in the Nigerian stock market went bankrupt. Marginal investors, majority of whom lacked the skill, knowledge and competence to effectively diversify their portfolio risks were particularly worse-off. Those who care to come back after a while began to be more careful and selective in their choice of investment options and financial advisors. This scenario therefore contributed in no small way to the emergence of more unit trust and the segmentation of the investment market.

The control and regulation of mutual fund investment in Nigeria is in the Investment and Securities Act of 2007 which repealed the Act of 1999. The act provides for a new set of market infrastructures and a wide ranging system of regulation of investment and securities business in Nigeria.

The purpose in this paper is to examine the performance of mutual funds in the post financial melt down era especially in the context of efforts at segmenting the market.

NEED FOR SEGMENTING FINANCIAL MARKETS.

The concept and practice of market segmentation is well entrenched in the literature. This crucial marketing strategy aims to identify and delineate market segments or groups of buyers who share certain common characteristics that influence buying behavior. These characteristics are thus relevant in explaining and predicting the response of consumers in a given market segment to particular marketing stimuli. A key objective in market segmentation is to identify gaps in the market which offer new product opportunities. This new product opportunity could be an entirely new product or a modification of an existing product.

The use of this technique has been found relevant in consumer, industrial and the services markets, in fact Harley (1968) consider that the idea that all markets can be profitably segmented has received almost as widespread acceptance as the marketing concept itself.

The challenge for marketing practitioners however is to determine the appropriate basis for segmenting the market and to test for the viability of particular segments.

Markets can be subdivided by geographic, demographic, psychological, psychographic or behavioral variables. Each of these bases has its uses and limitations. More importantly, the marketer has to evaluate the desirability of potential market segments. A desirable market segment is to be understood to mean of sufficient size that enables the marketer to earn adequate profit by catering to the specific needs of the segment members.

Kothler (1984) has identified the criteria for evaluating market segments as measurability, accessibility, substantiality and actionability. Thomas (1980) also added "stability" i.e whether you can predict the behavior of the segment in future.

What particular variables should be used in segmenting financial services market is still subject to debate. This is because at the general level, the segmentation, base chosen to subdivide a market will depend on "the type of product, the nature of demand, the method of distribution, the media available for market communication and the motivation of buyers" Chismal, 1985.

Segmentation bases are rarely used alone but rather, a combination of two or more of them is employed.

However, a cursory look at attempt by fund managers in Nigeria to segment the mutual funds market suggest that they are inclined to use the psychographic basis wherein attitude to risk, lifestyle, interest, opinion, values and the like are used as the market delineators. The only exception to this is the women investment fund where the emphasis is on gender i.e demographic.

METHODOLOGY

The study adopted a survey research method that pooled a sample of funds from the 46 funds that are so far registered in the Nigerian stock exchange. The 46 funds are classified as equity based funds (20), money market funds (3), bond funds (9), real state funds (2), ethical funds (4), balanced funds (7), and specialized fund(1).

However, for the purpose of this study, only 10 i.e 5 equity based funds and 5 which are ethical/gender based are selected. The rationale here is to see the discriminating effect on performance (if any) between the two categories of funds.

The study used secondary data sourced from the Nigerian stock exchange records and those available from the websites of affected fund managers. The data were analyzed with the use of measures of central tendencies and analysis of variance (ANOVA).

Finding and discussion:-

(A) Mutual funds operation in Nigeria:-

Mutual fund operations emerged as part of the financial market innovations that followed the policy of deregulation of the 1990's. Banks were mainly the fund managers and so it was not surprising that most of the earlier funds went down with their banks that were hit by financial distress. Mutual funds began to re-emerge from the early 2000's but has remained relatively insignificant with limited impact on the capital market.

(B) Profile of mutual funds studied:

1. Equity based funds:

Legacy Fund:- this is an open-ended unit trust scheme launched in 2005. Its net asset value by Dec 2012 was N0.68 billion. The fund manager is first city asset management Ltd, a member of first city group. The primary objective of the fund is to provide investors with income and capital appreciation in the medium to long term by investing at least 60% in equities of blue chip companies, up to 10% in alternative instruments and maximum of 40% in fixed income securities.

(ii) FBN heritage fund:- this is an open ended unit trust scheme launched in 2007. Net asset value as at Dec 2012 was N4.45 billion. The fund manger is FBN capital, a wholly owned subsidiary of first bank of Nigeria plc. The primary objective of the fund is to achieve long term capital appreciation of its assets by investing at least 50% in equities, up to 5% in real estate and maximum of 35% in money market instruments.

(iii) Coral growth fund:- this is an open ended unit trust scheme launched in 2001. Net asset value as at Dec 2012 was N3.60 billion. The fund manager is FSDH Asset Mgt Ltd. The primary objective of the fund is to achieve long term capital appreciation by investing at least 65% in large, capitalized equities and maximum of 35% in fixed in come securities.

(iv) Zenith equity fund: this is an open ended unit trust scheme launched in 2008. Net asset value as at Dec 2012 was N3.77 billion. The fund manger is Zenith funds ltd, a subsidiary of Zenith Bank plc. The primary objective of the fund is to seek aggressive growth through diversification. It invests up to 80% on equities and up to 20% on fixed income securities.

(v) Anchor fund: this is an open ended unit trust scheme lunched in 2008. Net asset value as at Dec 2012 was N0.0038 billion. The fund manger is Cash Craft Assets Mgt Ltd. The fund is a balanced fund with investment portfolio built around equities, mortgage instruments and real estate.

2. Ethical/gender based funds:-

These are funds with restricted investment policies. Ethical funds are expected to invest in what are regarded as socially responsible investments. In particular, investment in the following areas are forbidden.

- Gaming and gambling
- Alcohol and tobacco
- Arms and ammunitions
- Adult entertainment

(i) ARM ethical fund: this is an open ended unit trust scheme launched in 2006. The net asset value as at Dec 2012 was N0.226 billion. The fund manger is Asset and Resource Management Ltd. The primary

objective of the fund is to achieve a good return for investor in the long term by investing 100% in equities of socially responsible companies.

(ii) Lotus Halal Investment Fund:-

This is an open ended, unit trust scheme launched July 2008. Its net asset value by Dec 2012 was N1.90 billion. The fund manager is lotus capital ltd. the funds primary objective is to achieve long term capital appreciation by inviting 30% compliant companies, up to 60% on asset backed investment and between 5 and 30% in real estate. The fund has 15 screened equities for its investments.

(iii) Women investment fund:-

This is an open ended units trust scheme launched in 2008. It is the only gender specific unit trust scheme in Nigeria. Its net asset value by Dec 2012 was N0.125 billion. the fund manager is Chapel Hill Denham management ltd. The fund's key objective is to encourage investment culture among women and to support women owned businesses.

The fund has continued to promote the agenda of investment for and by women. The fund invest 60% on quoted securities and up to 40% on fixed income securities.

(iv) Zenith ethical fund: This is an open ended unit trust scheme launched in 2008. The net asset at as Dec 2012 was N0.80 billion. The fund manger is Zenith funds ltd. The fund's primary objective is to seek aggressive growth through diversification and within social responsibility constraints.

(v) Stanbic IBTC Ethical fund:- this is an open ended unit trust scheme launched in 2006. Its net asset value at Dec 2012 was N3.16 billion. The fund managers is Stanbic IBTC asset mgt ltd. The objectives is to help in visitors achieve long term growth though responsible investing. It invests up to 75% on equities and maximum of 25% fixed income.

C. Performance analysis of different funds.

Table 1: 5 Years Annual Yield Rankings (2008-2012)

S/N	MUTUAL FUND	5 YR AVERAGE ANNUAL YIELD (%)
1	Legacy fund	3.86
2.	FBN heritage	4.77
3	Coral growth fund	(13.50)
45	Zenith equity	4.34
5	Anchor fund	(2.26)
6	ARM ethical	1.08
7	Lotus halal	10.16

8	Women investment	(5.33)
9	Zenith ethical	4.10
10	Stanbic ethical	(12.36)
11	NSE all share index	(12.67)

Source: computed form SEC records.

The above table shows mixed results on the performance of mutual funds. While some of the funds performed better than the ASI, the overall results do not appear impressive. In particular those funds in existence before 2008 did particularly poorer because they were caught by the general crash of 2008 which led to about 46% loss on investment in the capital market. Since the exposure of these funds to equities in about 60%, it is not surprising that the result of 2008 weighed down the overall performance.

The apparently fair performance of the lotus fund is due partly to the fact that it became operational only in the 2nd half of 2008 and also because it does not invest in equities of banks that were the most affected by the meltdown.

TABLE II: Extent of acceptance of mutual funds:

S/N	Name of fund	Level of subscription on offer (%)	No of unit holders
1	Legacy fund	111.84	3,998
2	FBN heritage	110.00	6,098
3	Coral growth	119.24	980
4	Zenith equity	161.50	9,097
5	Anchor fund	29.00	1,007
6	ARM ethical	100.42	161
7	Lotus halal	278.01	17,054
8	Women investment	25.20	826
9	Zenith ethical	157.6	2,193
10	Stanbic ethical	106.3	11,566

Source: SEC Records.

The above table shows the level of awareness and adoption of mutual funds. Even though most were oversubscribed on offer, only a small segment of the population is doing the investing. This fact is corroborated by the Director general of the Nigerian stock exchange at the "commemoration of 50 years of capital market regulation in Nigeria" where she said "only 5 million Nigerians out of 150 million

invest in the capital market. Out of this 5 million, only 230,000 invest in collective investment schemes "Oteh, A (2011).

Table III: Liquidity position

S/N	Name of Fund	Cash As A % Of Total Investment
1	Legacy	0.35
2	FBN heritage	1.06
3	Coral growth	1.39
4	Zenith equity	7.29
5	Anchor fund	1.1
6	ARM ethical	0.0
7	Lotus halal	0.31
8	Women investment	15.97
9	Zenith ethical	13.08
10	Stanbic Ethical	3.86

Source: SEC records.

The above table shows that impact of investment policy on the liquidity position of the funds. Ethical funds generally have greater liquidity because of their restricted investment policy. ARM invest 100% on equity.

SUMMARY AND CONCLUSION:

The foregoing analysis shows that mutual funds cannot consistently earn above market average returns. There is however the expectation that with improvement in financial analysis skills, securities selection expertise and strategies as well as increasing availability of tradable instruments, the returns prospects for mutual funds will improve.

Even through mutual funds have not established a track record of superior returns on a consistent basis, their average annual returns have beaten average market return in the long run.

In order to reap greater benefits from the effort at segmenting the market, mutual fund operation in Nigeria need to be supported in terms of aggressive creation of further awareness of its benefits.

New types of funds are also needed to achieve greater diversification outside the main focus on equity investments. Since most of the mutual fund focused mainly on the equity market, it can be expected that their returns will fluctuate with the rise and fall of equity market. So incoming funds will need to provide a hedge against adverse market trends by exploring new financial instruments such as derivatives which is still lowly developed in Nigeria.

Newer funds will have to create new market segments and change their investment focus away from those of existing funds.

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