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# Factors Influencing Growth Strategies Of Fund Management Firms In Kenya

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***Abstract:***
*Kenya's Fund Management industry is relatively old having started off in the 20th century. Compared to more developed FM markets the Kenyan Fund Management Industry is much smaller. The size of the industry and slow growth is an indication that firms are experiencing challenges implementing their growth strategies. The study covered 20 members of the Association of Fund Managers. Data was collected using questionnaires which was administered using drop and pick method. Data was analyzed using descriptive statistics, which involved mean scores and was used to show the average effect of the factors under investigation, the standard deviation was used to check the variability from the mean and the mode to evaluate the most popular responses.*
*The findings indicated that fees charge, education level, product diversification, investment market influenced growth strategies of fund management firms in Kenya.*

***Key words:*** *Asset management, Capital Markets Authority, Fund Management, Growth strategies*

## 1.Introduction

Fund Management commonly referred to as Asset management (AS) have been one of the most significant developments in the capital markets during the past decades. Fund management are financial institutions which advise investors on the best investment vehicle to invest in at a particular time. The assets in which investors can invest in include fixed deposit, shares, bonds, off shore and property and are aimed at generating high returns. Consequently, FM has been instrumental in raising the fund performances for the fund holders. The investments are done in consultations with the owners/trustees. Fund Management firms in the world control the global investment industry. The owner/trustees normally have periodical meetings to review the investment strategy as discuss the future ones, Blake et al (2002).
The investment products offered are in form of shares, bonds, fixed deposits, property and mutual funds. The type of products chosen by the investor to commit his capital depends largely on his financial goals, time frame, and amount of capital available. Fund managers have grown substantially and big funds like pension funds, unit trust and other individual investors have come to accept their services. The funds are invested in a wide investment diversification without the need of prohibitive sums of money. As a market becomes sophisticated and more volatile, the fund managers re restructure their investment plans in order for the funds gain or have a minimal loss in the market place, Gruber (2003).
Related studies related in fund performance include that of Jensen (1968) finds that using net returns and gross returns, respectively, that, during 1945-1964, US funds perform 1.1% and 0.4% per year less than the market and only 39 funds have positive alphas. Similarly, Grinblatt and Titman (2004), Ippolito (2006), Cumby and Glen (2004) and Malkiel (2005) use Jensen's performance measure to investigate US mutual funds and draw the same conclusion: that mutual fund performance is indistinguishable from zero. Outside the US, Cai et al. (2003) have investigated mutual fund performance in Japan from 1981 to 1992 and find severe underperformance. In the UK, Blake and Timmermann (2002) have investigated unit trusts for the period 1972 to 1995 and find inferior performance of 1.8% per annum.

## 2.Statement Of The Problem

The more firms grow, the more resources they can access, thus firm growth is considered as a path dependent process, Getmansky and Makarov (2004). It's important for companies to have a framework for distinguishing good from bad growth in generating revenue growth. Good growth not only increases revenues but improves profits, is sustainable over time, and does not use unacceptable levels of capital, Sawicki (2000). It is also primarily organic (internally generated) and based on differentiated products and services that fill new or unmet needs while creating value for customers Charan (2004). Shareholders, managers and employees are increasing striving

for sustainable profitable growth often without success. Sustaining company growth requires a strategy for increasing revenue without sacrificing earnings or customer satisfaction. Putting the strategy into real implementation is a whole different matter and is widely considered to be the toughest challenge. Many top executives and their companies fail to plan the implementation of strategy due to poor prioritization or ill created strategies: Mascarenhas, Kumaraswamy, Day and Bareja (2002).
The industry has experienced growth in funds under management leading to increase in fees. However of late about five years ago the industry has degenerated in term of profits leading many firms making losses or little profit. Funds under management have stagnated with few firms having very little growth. This has affected the growth of the industry with escalating expenses being meet by stagnant income. New industry statistics show payments from individuals' schemes more than doubled to $15.7 million for the six months ending June 30, 2011, from $7.8 million paid in the same period in the previous year, as more savers withdrew part of their retirement benefits, Kamau (2012). This followed 2010's amendments to the RBA regulations allowing scheme members to access 50 per cent of employers' contributions. Return on invested funds was expected to remain flat or fall in 2012, Kamau (2012). All asset categories exhibited a positive growth, except quoted equities, fixed income and cash, which declined by 5.5 per cent, 7.6 per cent and 26 per cent respectively over the first six months to June 2011, CMA (2012). Government securities constituted 34 per cent of industry assets, the largest share with $1.9 billion, followed by quoted equities with $1.5 billion (26 per cent), immovable property with $1 billion (18 per cent) and guaranteed fund investments at $481 million (8.5 per cent) respectively, CMA (2012).
Locally, few studies have been carried out on the related research on the investments. Some of these include, Musyoka (2011) who did a study on capital markets in emerging economies and challenges to the growth of capital markets in underdeveloped economies, Kamau (2012). The study sought to fill the existing gap by determining the factors influencing growth strategies of fund management firms in Kenya.

## 3.Research Objectives

### *3.1.General Objective*
The objective of this study was to determine the factors influencing growth strategies of fund management firms in Kenya.

## 4.Literature Review

### *4.1.Agency Theory*
This was put forward by Jensen (1968). They proposed that when a firm issues outside equity, it creates agency costs of equity that reduce the value corporate assets. Jensen's free cash flow theory alleges that if management is not closely monitored they will invest in capital projects and acquisitions that do not provide sufficient expected returns.
According to Penrose (1959), an agency relationship occurs when one party acts on behalf of another. It is curious that a concept that could not be more profoundly sociological does not have a place in the sociological literature. This essay begins with the economics paradigm of agency theory, which casts a very long shadow over the social sciences, and then traces how these ideas diffuse to and are transformed in the scholarship produced in business schools, political science, law, and sociology. Johnson and Scholes (2009), says a strategy is the direction and scope of an organization over the long term which achieves advantage to the organization through its configuration of resources within the changing environment and to fulfill stakeholder's expectations. The aim is to develop a strategic fit by identifying opportunities in the environment and adapting its resources and competencies to exploit the opportunities. Chaffee (1985) concurs that strategy is the matching of resources and activities of an organization to the environment in which it operates. It acts as a link between management of the organisations internal resources and external relationships with customers, suppliers, competitors, economic and social environment in which it operates. Fund management firms require highly skilled portfolio managers who take time to qualify due to time taken in training and experience. This means that when they come to the market they are expected to be paid more. With the kind fees it may be a challenge.

### *4.2.The Learning Theory*
Thompson (1989) says a strategy consists of a pattern of moves and approaches defined by management to produce successful organization performance in simpler terms its terms it's the managerial game plan. Superior strategy enables the firm to gain competitive advantage and hence become successful. According to Markides (1999), superior strategy is all about finding and exploiting a unique strategic position in the company business while at the same searching for new strategic positions on a continuous basis. In every day industry there are several viable positions that a company can occupy. A strategic position is about finding answers to the following 3 questions, who should I target as customer? What products or services should I offer them and how should I do this? Markides (1999).
Despite the obvious importance of a superior strategy to the success of an organization and despite the decades academic research on the subject has been done, there is little agreement among academics as to what strategy really is, Markides (1999). An organization's strategy consists of a pattern of moves and approaches defined by management to produce successful organization performance; in simper terms it's the managerial game plan, Thompson (1989). According to Markides (1999), superior strategy is all about finding and exploiting a unique strategic position in the company's business while at the same time searching for new appropriateness of a firm's activities that can contribute to its performance such as innovations, cohesive culture or good implementation.

*4.3.Schumpeterian Theory On Innovations*

Schumpeter's (1934) theory of innovative profits emphasized the role of survival strategy and the seeking out of opportunities for novel value and generating activities which would expand (and transform) the circular flow of income through risk taking, pro activity by the organizational leadership and innovation which aims at fostering identification of opportunities. Schumpeterian growth theory goes beyond economist theory by distinguishing explicitly between organizational performance and innovation. It supposes that technological progress comes from innovations carried out by firms motivated by the pursuit of profit, and that it involves what Schumpeter called "creative destruction". That is, each innovation is aimed at creating some new process or product that gives its creator a competitive advantage over its business rivals; it does so by rendering obsolete some previous innovation; and it is in turn destined to be rendered obsolete by future innovations, Schumpeter (1934).

Endogenous growth theory challenges this neoclassical view by proposing channels through which the rate of technological progress, and hence the long-run rate of economic growth, can be influenced by economic factors. It starts from the observation that technological progress takes place through innovations, in the form of new products, processes and markets, many of which are the result of economic activities. For example, because many innovations result from R&D expenditures undertaken by profit-seeking firms, competition, education, taxes and organizational performance can influence the rate of innovation by affecting the private costs and benefits of doing R&D, Thompson (1989).

Schumpeter, as cited by Swedberg (2000), pointed out economic behavior is somewhat automatic in nature and more likely to be standardized, while organizational performance consists of doing new things in a new manner, innovation being an essential value. As economics focused on the external influences over organizations, he believed that change could occur from the inside, and then go through a form of business cycle to really generate economic change. For Schumpeter, the organizational performance is motivated by the will to succeed and the satisfaction of getting things done, Swedberg (2000). He conceptualized 'creative destruction' as a process of transformation that accompanies innovation where there is an incessant destruction of old ways of doing things substituted by creative new ways, which lead to constant innovation, Aghion and Howitt (1992).

The organization's crucial significance to the dynamics of the capitalist system flows from the fact that it is the organization's innovations that disrupt the economy and move forward from one equilibrium to the other. Rather than adapting to external pressures, the organization destroys the static equilibrium from within the system by inventing new products, processes or behaviors that contrast the routine systems and activities. The Schumpeterian Theory is important in guiding the entrepreneur in such a case. The above theory instigates the first research questions.

## 5.Empirical Review

Various researchers have ventured into the field of Asset management specifically on mutual funds. The aim among academics is to provide an assessment of expected dynamics in emergence of the firms in the industry. The industry is big but the firms which do fund management have not been researched before.

A number of scholars done related studies in the industry. Some of these include Musyoka (2011), Growth Strategies applied by the institute of advanced technology, Kamau (2012), Growth challenges faced by local seed companies in Uganda.

Meldrum (1998) argues that incentives for growth include the need for survival. A firm that does not attempt to grow will not merely stand still but also stagnate and eventually die. On the other hand well planned expansion is not stimulating but also present to the executive a challenge similar to the one of difficult climbs in mountaineering. In addition to the managerial stimulus, growth confers tangible financial benefits to the firm. In the short run the productivity of the firm is likely to rise as rate of output increases. As the size of the firm increases, it's likely to reap economies of scale at both production and managerial level. According to Johnson and Scholes (2004), apart from fitting the organization into the changing business environment, organizations pursue growth in order to stretch and exploit the existing competencies and resources as well as meet the expectations created by regulatory and governance frameworks as well as powerful stakeholders. Growth may also be driven by the need to respond to the environment by fitting the business into the environment. Business growth however is not without challenges and constraints.

In her analysis of the growth of the firm, Penrose (1959) contends that while the size of the firm is not determinate, the rate of growth is dependent upon the capability of the existing management team and rate at which this capacity could be expanded. She argues that if a firm deliberately or inadvertently expands its organization more rapidly than the individuals in the organization can obtain the experience, the efficiency and effectiveness of the firm might suffer. Other constraints include scarcity of financial resources and non-managerial inputs in raw materials.

## 6.Critical Review

According to Johnson and Scholes (2004), apart from fitting the organization into the changing business environment, organizations pursue growth in order to stretch and exploit the existing competencies and resources as well as meet the expectations created by regulatory and governance frameworks as well as powerful stakeholders. Growth may also be driven by the need to respond to the environment by fitting the business into the environment. Business growth however is not without challenges and constraints.

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**7.Research Gaps**

According to Chafee (1985) challenges encountered while implementing strategies are due to failure to understand the customers, inadequate or incorrect marketing research and inability to predict environment reactions. Another challenge is on overestimation of resources competence i.e. can the staff, equipment and processes handle the new strategy. The other challenge is when one fails to develop new employees and manage skills, while also failing to adequately coordinate reporting and control relationships. Inflexible organization structures will also dissuade the implementation process. It is also quite challenging to get the senior management commitment which leads to lack of sufficient company resources to accomplish tasks. Employee’s commitment and use of incentives to embrace the new strategy is also quite essential if strategy implementation process is to succeed, time is also a critical factor and should never be under estimated, Charan (2004).

**8.Methodology**

The study adopted a cross sectional survey research design. Tull and Hawkins (2002) define survey research as a systematic gathering of information from respondents with the purpose of understanding and or predicting some behavioural aspect in a given population.The study population constituted 120 management employees working in all 20 firms in the Fund Management Industry in Kenya. The primary research data was collected from the employees using a questionnaire. A pilot study was undertaken on to test the reliability and validity of the questionnaire. Data analysis was done with the help of software programme SPSS version 21 which is the most current version in the market and microsoft excel to generate quantitative reports.

**9.Results And Findings**

The study found out that majority of the respondents agreed that the products offered by the organization covered the entire universe of potential investments products in Kenya and that banks were competitors to the Fund Management industry.

The respondents indicated that minimum capital required to set up a Fund Management Firm and Industry Attractiveness Potential (Margins) on products impacted growth in the number of market players and the number of new funds to a very great extent, the respondents indicated that scarcity of skilled human personnel products impacted growth in the number of market players and the number of new funds to a great extent, finally, the respondents indicated that FM trading licensed requirements, availability of Securities, Past Performance and Performance Persistence impacted growth in the number of market players and the number of new funds to a great extent. These findings relate with the literature review where according to Thompson (1989), within the corporate sector, where enterprises are complex to consist of several distinct business units, companies seem to have developed by following a fairly standard strategic path. Majority begin as small single business serving a local or utmost regional market.

The study further found out that the respondents indicated that tax benefits and regular income were very important, the respondents indicated that liquidity was relatively important, the respondents indicated that safety and regular savings were very important, the respondents indicated that expertise and high returns were very important. These findings relate with the literature review where, Carhart (2000) contends that many firms focus on improving results by downsizing, restructuring, redeploying assets and reducing costs. There is however a limit as to how much you can improve performance using efficiency programs.

The study also found out that the current minimum amount required to open a Fund Management products and services account in the organization was affordable to all potential investors who liked to invest in FM.

Moreover, the study found out that the respondents indicated that uncertainty around withholding tax issues impacted the uptake of Fund Management products and services by Kenyans to a very great extent, the respondents indicated that impact of economic conditions on disposable income impacted the uptake of Fund Management products and services by Kenyans to a very great extent, the respondents indicated that investment returns on Funds impacted the uptake of Fund Management products and services by Kenyans to a great extent, the respondents indicated that complexity of products and services and processes , availability of information and investor knowledge on products and services and convenience in accessing products and services impacted the uptake of Fund Management products and services by Kenyans to a great extent, the respondents indicated that minimum Investment amount required to open a Fund account, fees charged on products and services investments and distribution channels employed by products and services providers impacted the uptake of Fund Management products and services by Kenyans to a great extent, the respondents indicated that lack of tax Benefits on funds impacted the uptake of Fund Management products and services by Kenyans to a great extent. These findings collate with the literature review where according to Gharghori et al (2007) the key challenge of contemporary executives is maintaining the momentum that has been built up over the years.

Additionally, the study found out that the fund management fee charged by the organization to provide the services to their clients was sufficient to cover the necessary operating expenses of your company and that the current Fund Management regulations were adequate enough to guarantee investor protection.

Finally, the study found out that the requirements for the approval of funds, fund management companies, trustees and other service providers are adequate to ensure that investors were protected and that the public was confident that the fund management regulatory framework ensured their protection.

*9.1.Regression Analysis*

**Model**

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate |
|---|---|---|---|---|
| 1 | . 837[a] | .768 | .677 | .534 |

*Table 1*
*Source: Research, 2013*

a. Predictors: (Constant), fees charge, educational level, product diversification, investment market.
b. Dependent Variable: Growth strategies
Coefficient of determination explains the extent to which changes in the dependent variable can be explained by the change in the independent variables or the percentage of variation in the dependent variable (Growth strategies) that is explained by all the 4 independent variables (fees charge, educational level, product diversification, investment market).
The four independent variables that were studied, explain 73.1% of variance in growth strategies as represented by the $R^2$. This therefore means that other factors not studied in this research contribute 26.9% of variance in the dependent variable. Therefore, further research should be conducted to determine the Factors Influencing growth strategies of fund management firms in Kenya.

| Model | | Sum of Squares | df | Mean Square | F | Sig. |
|---|---|---|---|---|---|---|
| 1 | Regression | 34.453 | 8 | .376 | 15.9 | .000[a] |
| | Residual | 15.654 | 40 | .222 | | |
| | Total | 50.107 | 48 | | | |

*Table 2: ANOVA (Analysis Of Variance)*
*Source: Research, 2013*

a. Predictors: (Constant), fees charge, educational level, product diversification, investment market.
b. Dependent Variable: Growth strategies
The F critical at 5% level of significance was 2.44. Since F calculated is greater than the F critical (value = 15.9.9), this shows that the overall model was significant. The significance is less than 0.05, thus indicating that the predictor variables, (fees charge, educational level, product diversification, investment market) explain the variation in the dependent variable which is Growth strategies. Subsequently, we reject the hypothesis that all the population values for the regression coefficients are 0. Conversely, if the significance value of F was larger than 0.05 then the independent variables would not explain the variation in the dependent variable.

| Model | | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. |
|---|---|---|---|---|---|---|
| | | B | Std. Error | Beta | | |
| 1 | (Constant) | 3.234 | .47 | | 6.654 | 0.003 |
| | fees charge | 1.761 | 0.174 | 0.212 | 0.234 | 0.002 |
| | educational level | 1.983 | 0.287 | 0.476 | 0.344 | 0.005 |
| | product diversification | 2.236 | 0.532 | 0.376 | 0.178 | 0.001 |
| | investment market | 0.973 | 0.275 | 0.299 | 0.245 | 0.004 |

*Table 3: Multiple Regression Analysis*
*Source: Research, (2013)*

From the regression findings, the substitution of the equation
(**$Y = \beta 0 + \beta 1X1 + \beta 2X2 + \beta 3X3 + \beta 4X4$**) becomes:
**$Y = 3.234 + 2.761X_1 + 1.983X_2 + 1.236X_3 + 0.973X_4$.**

Where Y is the dependent variable (Growth strategies), $X_1$ is the fees charge variable, $X_2$ is the educational level variable, $X_3$ is product diversification variable and $X_4$ is the investment market variable.
According to the equation, taking all factors (fees charge, educational level, product diversification, investment market) constant at zero, Growth strategies will be 3.234. The data findings also show that a unit increase in fees charge will lead to a 1.761 increase in growth strategies; a unit increase in educational level will lead to a 1.983 increase in growth strategies; a unit increase in product diversification will lead to a 2.236 increase in growth strategies; and a unit increase in investment market will lead to a 0.973 in growth strategies.
At 5% level of significance and 95% level of confidence, fees charge had a 0.002 level of significance; educational level had a 0.005, product diversification had a 0.001 level of significance while investment market had 0.004 level of significance implying that the most significant factor is product diversification followed by fees charge.

## 10.Conclusion

The study concludes that the products offered by the organization covered the entire universe of potential investments products in Kenya and that minimum capital required to set up a Fund Management Firm and Industry Attractiveness Potential (Margins) on products impacted growth in the number of market players and the number of new funds to a very great extent. The study also concludes that tax benefits and regular income were very important and that the company’s current products met the company’s objectives .Moreover, the study concludes that uncertainty around withholding tax issues impacted the uptake of Fund Management products and services by Kenyans to a very great extent and that impact of economic conditions on disposable income impacted the uptake of Fund Management products and services by Kenyans to a very great extent. Additionally, the study concludes that the fund management fee charged by the organization to provide the services to their clients was sufficient to cover the necessary operating expenses of your company and that the current Fund Management regulations were adequate enough to guarantee investor protection. Finally, the study concludes that the requirements for the approval of funds, fund management companies, trustees and other service providers are adequate to ensure that investors were protected and that the public was confident that the fund management regulatory framework ensured their protection.

## 11.Recommendations

The study also recommends that that many firms focus on innovating and diversifying on products and services in order to open up more sources of income as a growth strategy. The study also recommends that firms should increase their fees to be able to survive in the high inflationary economy. Finally, the study recommends that firms should focus on improving market segmentation in order to give good concentration in the market.

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